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KATY INDUSTRIES INC
Form 10-Q/A
March 26, 2004

United States
Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-Q/A

(AMENDMENT NO.1)

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

For Quarterly period ended: September 30, 2003

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 1-5558

Katy Industries, Inc.
(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

75-1277589
(I.R.S. Employer Identification No.)

765 Straits Turnpike, Suite 2000, Middlebury, Connecticut 06762
(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: (203)598-0397

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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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

Class	Outstanding at November 4, 2003
Common Stock, \$1 Par Value	7,961,077

EXPLANATORY NOTE

Katy Industries, Inc. ("Katy" or the "Company") is filing this Amendment No. 1 to its Quarterly Report on Form 10-Q for the quarter ended September 30, 2003, originally filed November 7, 2003 (the "Form 10-Q"), for the reasons

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explained below. Katy has determined that the amount of the gain on sale of discontinued businesses and the income from operations of discontinued businesses, previously reported in the third quarter of fiscal 2003 should be restated to reflect reductions of \$3.8 million and \$0.3 million, respectively, for a tax provision allocable to each of those amounts. This revision reduced the previously reported loss from continuing operations through a reduction of the provision for income taxes related to continuing operations by \$4.1 million.

These revisions have no effect on the Company's previously reported balance sheet, cash flow from operations, net sales, operating income, or net loss attributable to common shareholders (and related per share amounts). This Form 10-Q/A does not reflect events occurring after the filing of the Form 10-Q, or modify or update those disclosures in any way, except as required to reflect the effects of these restatements.

This Amendment No. 1 contains changes to the following disclosures:

- o Part I - Item 1. Financial Statements
- o Part I - Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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KATY INDUSTRIES, INC.
FORM 10-Q/A
September 30, 2003

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Thousands of Dollars)
(Unaudited)

ASSETS

	September 30, 2003 ----	December 31, 2002 ----
CURRENT ASSETS:		
Cash and cash equivalents	\$ 5,398	\$ 4,842
Accounts receivable, net	70,474	58,463
Inventories	59,525	56,806
Other current assets	2,289	1,775
Current assets of discontinued operations	2,089	7,748
	-----	-----
Total current assets	139,775	129,634
	-----	-----
OTHER ASSETS:		
Goodwill	10,543	10,543
Intangibles	24,988	25,536
Equity method investment	1,617	7,306
Other	10,477	12,295
Non-current assets of discontinued operations	--	4,069
	-----	-----
Total other assets	47,625	59,749
	-----	-----
PROPERTY AND EQUIPMENT		
Land and improvements	3,208	3,180
Buildings and improvements	16,063	14,707
Machinery and equipment	131,606	141,013
	-----	-----
	150,877	158,900
Less - Accumulated depreciation	(78,890)	(72,306)

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	-----	-----
Net property and equipment	71,987	86,594
	-----	-----
Total assets	\$ 259,387	\$ 275,977
	=====	=====

See Notes to Condensed Consolidated Financial Statements.

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KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Thousands of Dollars, Except Share Data)
(Unaudited)

LIABILITIES AND STOCKHOLDERS' EQUITY

	September 30, 2003

CURRENT LIABILITIES:	
Accounts payable	\$ 39,377
Accrued compensation	5,077
Accrued expenses	45,400
Current maturities of long-term debt	14,740
Revolving credit agreement	35,080
Current liabilities of discontinued operations	76

Total current liabilities	140,440
LONG-TERM DEBT, less current maturities	1,640
OTHER LIABILITIES	14,290
NON-CURRENT LIABILITIES OF DISCONTINUED OPERATIONS	5

Total liabilities	156,420

COMMITMENTS AND CONTINGENCIES (Notes 13 and 16)	-

PREFERRED INTEREST OF SUBSIDIARY	-

STOCKHOLDERS' EQUITY	
15% Convertible Preferred Stock, \$100 par value, authorized 1,200,000 shares, issued and outstanding 925,750 shares and 805,000 shares, respectively, liquidation value \$94,972 and \$85,595, respectively	90,040
Common stock, \$1 par value authorized 35,000,000 shares, issued 9,822,204 shares	9,820

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Additional paid-in capital	43,902
Accumulated other comprehensive income (loss)	2
Accumulated deficit	(19,230)
Treasury stock, at cost, 1,747,627 and 1,460,027 shares, respectively	(21,590)

Total stockholders' equity	102,982

Total liabilities and stockholders' equity	\$ 259,380
	=====

See Notes to Condensed Consolidated Financial Statements.

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KATY INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002
(Thousands of Dollars, Except Share and Per Share Data)
(Unaudited)

	Three Months Ended September 30,	
	2003	2002
	-----	-----
	Restated (Note 2)	
Net sales	\$ 125,901	\$ 134,401
Cost of goods sold	(105,675)	(112,794)
	-----	-----
Gross profit	20,226	21,607
Selling, general and administrative expenses	(15,613)	(16,059)
Severance, restructuring and related charges	(3,871)	(9,486)
Impairments of long-lived assets	(5,255)	(10,986)
Loss on SESCO transaction	--	--
	-----	-----
Operating loss	(4,513)	(14,924)
Equity in (loss) income of equity method investment (net of impairment charge of \$5.5 million in 2003)	(5,478)	(40,000)
Interest, net	(1,138)	(1,758)
Other, net	(601)	(107)
	-----	-----
Loss from continuing operations before provision for income taxes	(11,730)	(16,829)
Benefit (provision) for income taxes	3,196	(430)
	-----	-----
Loss from continuing operations before distributions on preferred interest of subsidiary	(8,534)	(17,259)
Distributions on preferred interest of subsidiary (net of tax)	--	(328)
	-----	-----

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Loss from continuing operations	(8,534)	(17,587)
Income from operations of discontinued businesses (net of tax)	478	1,028
Gain on sale of discontinued businesses (net of tax)	7,638	--
	-----	-----
Loss before cumulative effect of a change in accounting principle	(418)	(16,559)
Cumulative effect of a change in accounting principle (net of tax)	--	(4,190)
	-----	-----
Net loss	(418)	(20,749)
Gain on early redemption of preferred interest of subsidiary	--	--
Payment in kind dividends on convertible preferred stock	(3,324)	(2,615)
	-----	-----
Net loss attributable to common stockholders	\$ (3,742)	\$ (23,364)
	=====	=====
Income (loss) per share of common stock - Basic and diluted		
Loss from continuing operations attributable to common stockholders	\$ (1.44)	\$ (2.41)
Discontinued operations	0.99	0.12
Cumulative effect of a change in accounting principle	--	(0.50)
	-----	-----
Net loss attributable to common stockholders	\$ (0.45)	\$ (2.79)
	=====	=====
Weighted average common shares outstanding (thousands):		
Basic and diluted	8,237	8,362
	=====	=====

See Notes to Condensed Consolidated Financial Statements.

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KATY INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
NINE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002
(Thousands of Dollars)
(Unaudited)

	2003

	Restated
	(Note 2)
Cash flows from operating activities:	
Net loss	\$ (7,464)
Income from operations of discontinued businesses	(9,523)

Loss from continuing operations	(16,987)
Cumulative effect of a change in accounting principle	--
Depreciation and amortization	16,531
Impairments of long-lived assets	7,055
Write-off and amortization of debt issuance costs	2,057

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(Gain) loss on sale of assets	(573)
Loss on SESCO transaction	--
Equity in loss (income) of equity method investment (net of impairment charge of \$5.5 million in 2003)	5,689

	13,772

Changes in operating assets and liabilities:	
Accounts receivable	(9,969)
Inventories	(1,095)
Accounts payable	1,894
Accrued expenses	(5,166)
Other, net	(4,777)

	(19,113)

Net cash (used in) provided by continuing operations	(5,341)
Net cash (used in) provided by discontinued operations	(4,736)

Net cash (used in) provided by operating activities	(10,077)

Cash flows from investing activities:	
Capital expenditures of continuing operations	(7,026)
Capital expenditures of discontinued operations	(111)
Acquisition of subsidiary, net of cash acquired	(1,161)
Collections of notes receivable from sales of subsidiaries	1,139
Proceeds from sale of subsidiaries, net	21,948
Proceeds from sale of assets	2,389

Net cash provided by (used in) investing activities	17,178

Cash flows from financing activities:	
Net borrowings on revolving loans, prior to refinancing	7,965
Repayment of term loans prior to refinancing	--
Repayment of borrowings under revolving loans at refinancing	(52,716)
Proceeds on initial borrowings at refinancing -- term loans	20,000
Proceeds on initial borrowings at refinancing -- revolving loans	43,743
Net repayments on revolving loans following refinancing	(8,655)
Repayments of term loans following refinancing	(3,619)
Direct costs associated with debt facilities	(1,464)
Redemption of preferred interest of subsidiary	(9,840)
Repayment of real estate and chattel mortgages	(700)
Repurchases of common stock	(1,391)

Net cash used in financing activities	(6,677)

Effect of exchange rate changes on cash and cash equivalents	132

Net increase (decrease) in cash and cash equivalents	556
Cash and cash equivalents, beginning of period	4,842

Cash and cash equivalents, end of period	\$ 5,398
	=====

See Notes to Condensed Consolidated Financial Statements

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KATY INDUSTRIES, INC. NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2003

(1) Significant Accounting Policies

Consolidation Policy and Basis of Presentation

The condensed consolidated financial statements include the accounts of Katy Industries, Inc. and subsidiaries in which it has a greater than 50% interest, collectively "Katy" or "the Company". All significant intercompany accounts, profits and transactions have been eliminated in consolidation. Investments in affiliates that are not majority owned and where the Company exercises significant influence are reported using the equity method. The condensed consolidated financial statements at September 30, 2003 and December 31, 2002 and for the three and nine month periods ended September 30, 2003 and 2002 are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair statement of the financial condition and results of operations of the Company. Interim results may not be indicative of results to be realized for the entire year. The condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto, together with management's discussion and analysis of financial condition and results of operations, contained in the Company's Annual Report on Form 10-K.

Use of Estimates

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

Inventories

The components of inventories are as follows:

	September 30, 2003	December 31, 2002
	----	----
	(Thousands of dollars)	
Raw materials	\$ 19,878	\$ 18,733
Work in process	1,614	1,539
Finished goods	43,805	42,264
Inventory reserves	(5,772)	(5,730)
	-----	-----
	\$ 59,525	\$ 56,806
	=====	=====

At September 30, 2003 and December 31, 2002, approximately 29% and 35%, respectively, of Katy's inventories were accounted for using the last-in, first-out ("LIFO") method of costing, while the remaining inventories were accounted for using the first-in, first-out ("FIFO") method. Current cost, as determined using the FIFO method, exceeded LIFO cost by \$1.6 million and \$1.3 million at September 30, 2003 and December 31, 2002, respectively.

Property, Plant and Equipment

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As of January 1, 2003, the Company revised its estimate of the useful life of certain manufacturing assets, specifically molds and tooling equipment used in the manufacture of plastic products, from seven to five years. This change in estimate was made following significant impairments to these types of assets recorded during 2002. This change in estimate resulted in approximately \$1.3 million and \$4.0 million of incremental depreciation during the three and nine month periods ended September 30, 2003, respectively, versus the amount that would have been recorded had the useful life not been changed.

Refer to Note 6 for a discussion on impairments of long-lived assets shown on the Condensed Consolidated Statements of Operations.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 143, Accounting for Asset

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Retirement Obligations, the Company has recorded an asset and related liability for retirement obligations associated with returning certain leased properties to the respective lessors upon the termination of the lease agreements.

Stock Options and Other Stock Awards

The Company follows the provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, regarding accounting for stock options and other stock awards. APB Opinion No. 25 dictates a measurement date concept in the determination of compensation expense related to stock awards including stock options, restricted stock, and stock appreciation rights. Katy's outstanding stock options all have established measurement dates and therefore, fixed plan accounting is applied, generally resulting in no compensation expense for stock option awards. However, the Company has issued stock appreciation rights and restricted stock awards which are accounted for as variable stock compensation awards and compensation expense has been recorded for these awards. Compensation expense recorded relative to stock awards was \$6.5 thousand and zero for the three months ended September 30, 2003 and 2002, respectively. Compensation expense recorded relative to stock awards was \$6.5 thousand and \$8.0 thousand for the nine months ended September 30, 2003 and 2002, respectively. Compensation expense recorded associated with the vesting of stock appreciation rights was \$0.2 million and zero for the three months ended September 30, 2003 and 2002, respectively. Compensation expense recorded associated with the vesting of stock appreciation rights was \$0.6 million and zero for the nine months ended September 30, 2003 and 2002, respectively. Compensation expense for stock awards and stock appreciation rights is recorded in selling, general and administrative expenses in the Condensed Consolidated Statements of Operations.

SFAS No. 123, Accounting for Stock-Based Compensation, was issued and, if fully adopted by the Company, would change the method for recognition of expense related to option grants to employees. Under SFAS No. 123, compensation cost would be recorded based upon the fair value of each option at the date of grant using an option-pricing model that takes into account as of the grant date the exercise price and expected life of the option, the current price of the underlying stock and its expected volatility, expected dividends on the stock and the risk-free interest rate for the expected term of the option. Options granted during the three months ended September 30, 2003 and 2002 were 36,000, and 275,000, respectively. Options granted during the nine months ended September 30, 2003 and 2002 were 36,000 and 281,000, respectively.

In December 2002, the Financial Accounting Standards Board (FASB) issued

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SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure. This standard provides alternative methods of transition for a voluntary change to the fair value based methods of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123, to require prominent disclosure in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The disclosure provisions of SFAS No. 148 were adopted by the Company at December 31, 2002. Katy will continue to comply with the provisions under APB Opinion No. 25 for accounting for stock-based employee compensation.

The fair value of each option grant is estimated on the date of grant using a Black-Scholes option-pricing model with an expected life of five to ten years for all grants. Had compensation cost been determined based on the fair value method of SFAS No. 123, the Company's net loss and loss per share would have been increased to the pro forma amounts indicated below (thousands of dollars, except per share data).

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	Three Months ended September 30,		Ni Ended
	2003	2002	2003
	----	----	----
Net loss attributable to common stockholders, as reported	\$ (3,742)	\$ (23,364)	\$ (10,25
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(103)	(92)	(29
	-----	-----	-----
Pro forma net loss	\$ (3,845)	\$ (23,456)	\$ (10,54
	=====	=====	=====
Loss per share			
Basic and diluted - as reported	\$ (0.45)	\$ (2.79)	\$ (1.2
Basic and diluted - pro forma	\$ (0.47)	\$ (2.81)	\$ (1.2

(2) Restatement

Katy has restated its unaudited consolidated financial statements to correct the intraperiod tax allocation between loss from continuing operations, income from discontinued businesses and gain on sale of discontinued businesses.

This restatement has no effect on the Company's previously reported balance sheet, cash flow from operations, net sales, operating income, or net loss attributable to common shareholders (and related per share amounts). The table below summarizes the effect of the restatement.

(Thousands of dollars)	
Three Months ended September 30, 2003	
As Reported	As Restated

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	-----	-----
Loss from continuing operations before income taxes	\$ (11,730)	\$ (11,730)
(Provision) benefit for income taxes	(905)	3,196
	-----	-----
Loss from continuing operations	\$ (12,635)	\$ (8,534)
	=====	=====
Discontinued operations		
Income from operations of discontinued businesses	\$ 736	\$ 478
Gain on sale of discontinued businesses	11,481	7,638
	-----	-----
Income from discontinued operations	\$ 12,217	\$ 8,116
	=====	=====
Income (loss) per share of common stock - Basic and diluted		
Loss from continuing operations attributable to common stockholders	\$ (1.93)	\$ (1.44)
Discontinued operations	1.48	0.99
	-----	-----
	\$ (0.45)	\$ (0.45)
	=====	=====

(3) New Accounting Pronouncements

In April 2002, the FASB released SFAS No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections. SFAS No. 145 rescinds and makes technical corrections regarding various topics, including early extinguishments of debt and sale-leaseback transactions. The statement is effective for fiscal years beginning after May 15, 2002. The Company adopted SFAS No. 145 on January 1, 2003. SFAS No. 145 requires that certain costs and losses associated with early extinguishments of debt be reported as interest

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expense as a component of income from continuing operations, whereas the prior accounting guidance provided for classification of these costs and losses as extraordinary items, reported separately on a tax-effected basis after income from continuing operations. As a result of the refinancing of our borrowing facility in February 2003, the Company wrote off approximately \$1.2 million (pre-tax) of unamortized debt costs, during the first quarter of 2003. These costs have been reported as interest expense, a component of income from continuing operations.

In July 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. The standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by the standard include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. Previous accounting guidance was provided by EITF Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring). SFAS No. 146 replaces EITF Issue No. 94-3. The new standard is effective for exit or restructuring activities initiated after December 31, 2002. Katy has initiated since January 1, 2003 and is further considering a number of restructuring and exit activities, including plant closings and consolidation of facilities. Since

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these activities have been or will be initiated after December 31, 2002, this statement could have a significant impact on the timing of the recognition of these costs in the statements of operations, tending to spread the costs out as opposed to recognition of a large portion of the costs at the time Katy commits to and communicates such restructuring and exit plans. Katy's operating plans call for additional restructuring and facility consolidation activity during the remainder of 2003 and 2004, concerned mainly with further consolidation of St. Louis, Missouri plastics manufacturing facilities, and restructuring and consolidation of certain abrasives manufacturing facilities. Katy has adopted the provisions of SFAS No. 146 for all restructuring activities initiated after December 31, 2002.

In January 2003, the FASB released FASB Interpretation No. (FIN) 46, Consolidation of Variable Interest Entities - an Interpretation of ARB No. 51. FIN 46 clarifies issues regarding the consolidation of entities which may have features that make it unclear whether consolidation or equity method accounting is appropriate. The effective date of FIN 46 has been delayed until the fourth quarter of 2003 for variable interest entities created prior to February 1, 2003. Katy is currently evaluating FIN 46 to determine any potential impact on its financial reporting.

In April 2003, the FASB released SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. Katy does not currently use derivative instruments or participate in hedging activities and therefore, does not expect SFAS No. 149 to impact its financial reporting. If Katy were to utilize derivative instruments or participate in hedging activities, it would follow the provisions of SFAS No. 149.

In May 2003, the FASB released SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Liabilities and Equity. SFAS No. 150 establishes standards for how certain financial instruments with characteristics of both liabilities and equity are to be classified and measured. It requires that certain financial instruments within its scope be classified as a liability (or an asset in some circumstances), while many of those instruments were previously classified as equity. SFAS No. 150 is effective for the third quarter of 2003. Katy has determined that SFAS No. 150 does not impact its financial reporting.

(4) Goodwill and Intangible Assets

During 2002, Katy completed the transition to SFAS No. 142, Goodwill and Other Intangible Assets. As a result, amortization of goodwill ceased as of January 1, 2002. There have been no changes to goodwill during the nine months ended September 30, 2003.

Following is detailed information regarding Katy's intangible assets (in thousands):

	September 30, 2003	December 31, 2002
	----	----
Tradenames	\$ 9,168	\$ 9,022
Customer lists	21,887	21,447
Patents	4,793	4,305
Non-compete agreements	1,000	1,000
	-----	-----
Subtotal	36,848	35,774

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Accumulated amortization	(11,860)	(10,238)
	-----	-----
Intangible assets, net	\$ 24,988	\$ 25,536
	=====	=====

The increase in gross intangibles from December 31, 2002 to September 30, 2003 can be primarily attributed to tradenames (\$0.1 million) and customer lists (\$0.4 million) acquired in connection with the purchase of Spraychem (see Note 8), patents purchased (\$0.1 million), as well as the impact of exchange rates on patents (\$0.4 million).

Katy recorded the following amounts of amortization expense on intangible assets: \$0.5 million and \$0.9 million in the three-month periods ending September 30, 2003 and 2002, respectively, and \$1.6 million and \$1.9 million for the nine-month periods ending September 30, 2003 and 2002, respectively.

Estimated aggregate amortization expense related to intangible assets is (in thousands):

2003	\$2,160
2004	1,794
2005	1,794
2006	1,791
2007	1,786

Intangible assets are reviewed for impairment if events or circumstances indicate the carrying amount of these assets may not be recoverable through future undiscounted cash flows. If this review indicates that the carrying value of these assets will not be recoverable, based on future undiscounted net cash flows from the use of these assets, the carrying value is reduced to the fair value. The carrying value of goodwill and intangible assets is reviewed by the Company annually in the fourth quarter in accordance with SFAS No. 142.

(5) Discontinued Operations

Three of Katy's operations have been classified as discontinued operations as of September 30, 2003, and for all periods shown, in accordance with SFAS No. 144, Accounting for the Impairments or Disposal of Long Lived Assets. The Company adopted SFAS No. 144 on January 1, 2002.

Duckback Products, Inc. (Duckback) was sold on September 16, 2003, with Katy collecting net proceeds of \$15.8 million (including \$1.4 million of net proceeds received subsequent to September 30, 2003). The proceeds were used to pay down a portion of the Company's term loans and revolving credit loans. A gain (net of tax) of \$7.6 million was recognized in the third quarter of 2003 as a result of the Duckback sale (restated - see Note 2).

GC/Waldom Electronics, Inc. (GC/Waldom) was held for sale at December 31, 2002 and was sold on April 2, 2003, with Katy collecting net proceeds of \$7.5 million. The proceeds were used to pay down a portion of the Company's term loans (\$2.2 million), as well as the Company's revolving credit loans. A loss (net of tax) of \$0.2 million was recognized in the second quarter of 2003 as a result of the GC/Waldom sale.

Hamilton Precision Metals, L.P. (Hamilton) was sold on October 31, 2002, with Katy collecting net proceeds of \$12.4 million. These proceeds were used primarily to pay off the remaining balance of the Company's then outstanding term debt. The Company may receive additional payments dependent upon the occurrence of certain events associated with Hamilton's financial performance in 2003 and 2004. These contingent amounts have not been recorded as

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receivables on the Condensed Consolidated Balance Sheets. A gain (net of tax) of \$3.3 million was recognized in the fourth quarter of 2002 as a result of the Hamilton sale.

Duckback has historically been presented as part of the Maintenance Products Group for segment reporting purposes, while both Hamilton and GC/Waldom have historically been presented as part of the Electrical Products Group. Management and the board of Katy determined that these businesses were not core to the Company's long-range strategic goals.

The historical operating results have been segregated as discontinued operations on the Condensed Consolidated Statements of Operations and the related assets and liabilities have been separately identified on the Condensed Consolidated Balance Sheets.

Following is a summary of the major asset and liability categories for the discontinued operations (in thousands):

	September 30, 2003	December 31, 2002
	-----	-----
Current assets		
Trade accounts receivable, net	\$ --	\$ 2,188
Inventories	--	5,325
Other current assets	2,089	235
	-----	-----
	\$ 2,089	\$ 7,748
	=====	=====
Non-current assets		
Goodwill	\$ --	\$ 668
Intangibles, net	--	2
Net property and equipment	--	3,399
	-----	-----
	\$ --	\$ 4,069
	=====	=====
Current liabilities		
Accounts payable	\$ 12	\$ 1,708
Accrued expenses	749	1,255
	-----	-----
	\$ 761	\$ 2,963
	=====	=====
Non-current liabilities	\$ 52	\$ --
	=====	=====

Selected financial data for the discontinued operations is summarized as follows (restated - see Note 2) (in thousands):

	Three Months Ended September 30, 2003	September 30, 2002	Nine Months 2003
	-----	-----	-----

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Net sales	\$ 3,578	\$ 12,006	\$ 18,896
	=====	=====	=====
Net income, including gain or loss on sale	\$ 8,116	\$ 1,028	\$ 9,523
	=====	=====	=====

Katy anticipates that SFAS No. 144 will likely continue to have a future impact on its financial reporting as 1) Katy is considering further divestitures of certain businesses and exiting of certain facilities and operational activities, 2) the statement broadens the presentation of discontinued operations, and 3) the Company anticipates that impairments of long-lived assets may be necessitated as a result of the above contemplated actions. If certain divestitures occur, they may qualify as discontinued operations under SFAS No. 144, whereas they would have not met the requirements of discontinued operations treatment under APB Opinion No. 30. However, the Company does not believe that it is probable that these divestitures will occur within one year, and notes that significant changes to plans or intentions may occur. Therefore, these operations have not presently been classified as discontinued operations.

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(6) Impairments of Long-Lived Assets

During the third quarter of 2003, Katy recorded a \$3.7 million impairment charge related to certain assets at its Contico business unit. This charge included \$2.0 million and \$1.6 million for idled manufacturing assets at the Hazelwood, Missouri operation (Hazelwood) and Bridgeton, Missouri facility (Bridgeton), respectively. In addition, a charge of \$0.1 million was recorded at Contico's now closed Santa Fe Springs, California (Santa Fe Springs) metals facility. In addition, Katy recorded a \$1.2 million impairment related to the closure of its abrasives facilities in Pineville, North Carolina and Lawrence, Massachusetts, as well as certain idled assets at its Wrens, Georgia facility. Also, certain obsolete molds and tooling totaling \$0.3 million were written off at Contico's plastics operation in the United Kingdom.

During the second quarter of 2003, certain manufacturing assets at the Contico business unit were evaluated and determined to be impaired, resulting in charges of \$1.8 million. These impairments were the result of management's conclusion that the carrying values of the assets would not be recovered by future cash flows. The assets are primarily injection molding machines at Hazelwood.

During the third quarter of 2002, Katy recorded impairments of long-lived assets of \$11.0 million which included impairment charges for certain molds and tooling at Contico of \$7.0 million, a customer list intangible at Contico for \$2.6 million, certain machinery and equipment at the Wilen business unit for \$1.2 million and \$0.2 million for equipment at Earth City.

During the second quarter of 2002, the Company recorded an impairment charge of \$2.4 million for machinery and equipment at the Warson Road facility.

(7) Impairment of Equity Method Investment

During the third quarter of 2003, Katy reduced the carrying value of its 43% equity investment in Sahlman Holding Company, Inc. (Sahlman), resulting in a charge to operations of \$5.5 million.

Sahlman is in the business of harvesting shrimp off the coast of South America, and farming shrimp in Nicaragua. Sahlman's customers are primarily in the United States. Sahlman experienced poor results of operations in 2002,

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primarily as a result of producers receiving very low prices for shrimp. Increased foreign competition, especially from Asia, has had a significant downward impact on shrimp prices in the United States. Upon review of Sahlman's results for 2002 (and year to date in 2003), and after initial study of the status of the shrimp industry and markets in the United States, Katy evaluated the business further to determine if there had been a loss in the value of the investment that was other than temporary. Per ABP No. 18, The Equity Method for of Accounting for Investments in Common Stock, losses in the value of equity investments that are other than temporary should be recognized.

Based upon the results of a third party appraisal, Katy estimated the fair value of the Sahlman business through a liquidation value analysis whereby all of Sahlman's assets would be sold and all of its obligations would be settled. Also based on the aforementioned appraisal, Katy evaluated the business by using various discounted cash flow analyses, estimating future free cash flows of the business with different assumptions regarding growth, and reducing the value of the business arrived at through this analysis by its outstanding debt. All values were then multiplied by 43%, Katy's investment percentage. The answers derived by each of the three assumption models were then probability weighted. As a result, Katy concluded that \$1.6 million was a reasonable estimate of the value of its investment in Sahlman, and therefore a charge of \$5.5 million was recorded to reduce the carrying value of the investment.

(8) Acquisitions

During the second quarter of 2003, Katy's Contico Manufacturing Limited subsidiary acquired Spraychem, Limited (Spraychem), a United Kingdom distributor of spray bottles and related products. The purchase price for Spraychem was approximately \$1.2 million, net of cash acquired of \$0.3 million. Spraychem's annual revenues were approximately \$2.6 million. In connection with the acquisition, Katy allocated the purchase price to the acquired net

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tangible assets, customer lists and tradenames at their estimated fair values. Refer to Note 4 for further discussion of intangible assets acquired in connection with the Spraychem acquisition. The Spraychem acquisition is not material for presentation of pro forma information.

(9) Sale of Assets

During the first quarter of 2003, Katy's Woods Industries, Inc. (Woods U.S.) subsidiary sold its wire fabrication facility in Mooreseville, Indiana (Mooreseville). The assets sold consisted of land, building and equipment. The sale of the Mooreseville facility followed the shut down by Woods U.S. in December 2002 of all manufacturing facilities in the U.S. Gross proceeds from the sale were \$1.9 million. Proceeds were used to pay off a \$0.7 million mortgage debt payable on the Mooreseville property, with the remainder reducing Katy's outstanding debt obligations. Katy recognized a gain on the sale of \$0.8 million.

During the third quarter of 2003, Katy's Woods Industries (Canada), Inc. subsidiary (Woods Canada) sold real estate for proceeds of \$0.1 million. Proceeds were used to further reduce outstanding debt obligations. Katy recognized a loss on the sale of \$0.2 million.

(10) SESCO Partnership

On April 29, 2002, Katy and SESCO, an indirect wholly owned subsidiary, entered into a partnership agreement with Montenay Power Corporation and its

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affiliates (Montenay) that turned over the operation of SESCO's waste-to-energy facility to the partnership. The Company entered into this agreement as a result of evaluations of SESCO's business. First, Katy determined that SESCO was not a core component of the Company's long-term business strategy. Moreover, Katy did not feel it had the management expertise to deal with certain risks and uncertainties presented by the operation of SESCO's business, given that SESCO was the Company's only waste-to-energy facility. Katy had explored options for divesting SESCO for a number of years, and management felt that this transaction offered a reasonable strategy to exit this business.

The partnership, with Montenay's leadership, assumed SESCO's position in various contracts relating to the facility's operation. Under the partnership agreement, SESCO contributed its assets and liabilities (except for its liability under the loan agreement with the Resource Recovery Development Authority (the Authority) of the City of Savannah and the related receivable under the service agreement with the Authority) to the partnership. While SESCO will maintain a 99% interest as a limited partner, Montenay will have most of the day to day responsibility for administration, operations, financing and other matters of the partnership, and accordingly, the partnership will not be consolidated. Katy agreed to pay Montenay \$6.6 million over the span of seven years under a note payable as part of the partnership and related agreements. Certain amounts may be due to SESCO upon expiration of the service agreement in 2008; also, Montenay may purchase SESCO's interest in the partnership at that time. Katy has not recorded any amounts receivable or other assets relating to amounts that may be received at the time the service agreement expires, given their uncertainty.

The Company made payments of \$1.0 million and \$0.8 million in July 2003 and 2002, respectively, on the \$6.6 million note. The table below schedules the remaining payments as of September 30, 2003 which are reflected in accrued expenses and other liabilities in the Condensed Consolidated Balance Sheet (in thousands):

2004	\$ 1,000
2005	1,050
2006	1,100
2007	1,100
2008	550

	\$ 4,800
	=====

In the first quarter of 2002, the Company recognized a charge of \$6.0 million, consisting of 1) the discounted value of the \$6.6 million note, 2) the carrying value of certain assets contributed to the partnership, consisting primarily of machinery spare parts, and 3) costs to close the transaction. It should be noted that all of SESCO's long-lived assets

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were reduced to a zero value at March 31, 2002, so no additional impairment was required. On a going forward basis, Katy would expect that income statement activity associated with its involvement in the partnership will not be material, and Katy's consolidated balance sheet will carry the liability mentioned above.

In 1984, the Authority issued \$55.0 million of Industrial Revenue Bonds and lent the proceeds to SESCO under the loan agreement for the acquisition and construction of the waste-to-energy facility that has now been transferred to the partnership. The funds required to repay the loan agreement come from the

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monthly disposal fee paid by the Authority under the service agreement for certain waste disposal services, a component of which is for debt service. To induce the required parties to consent to the SESCO partnership transaction, SESCO retained its liability under the loan agreement. In connection with that liability, SESCO also retained its right to receive the debt service component of the monthly disposal fee.

Based on an opinion from outside legal counsel, SESCO has a legally enforceable right to offset amounts it owes to the Authority under the loan agreement against amounts that are owed from the Authority under the service agreement. At September 30, 2003, this amount was \$35.8 million. Accordingly, the amounts owed to and due from SESCO have been netted for financial reporting purposes and are not shown on the Condensed Consolidated Balance Sheet.

In addition to SESCO retaining its liabilities under the loan agreement, to induce the required parties to consent to the partnership transaction, Katy also continues to guarantee the obligations of the partnership under the service agreement. The partnership is liable for liquidated damages under the service agreement if it fails to accept the minimum amount of waste or to meet other performance standards under the service agreement. The liquidated damages, an off balance sheet risk for Katy, are equal to the amount of the Industrial Revenue Bonds outstanding, less \$4.0 million maintained in a debt service reserve trust. Management does not expect non-performance by the other parties. Additionally, Montenay has agreed to indemnify Katy for any breach of the service agreement by the partnership.

Following are scheduled principal repayments on the loan agreement (and the Industrial Revenue Bonds) as of September 30, 2003 (in thousands):

2003	\$ 5,385
2004	6,765
2005	8,370
2006	15,300

Total	\$ 35,820
	=====

(11) Indebtedness

On February 3, 2003, the Company refinanced its indebtedness (the Refinancing) and entered into a new credit facility agented by Fleet Capital Corporation (the Fleet Credit Agreement). The new \$110 million facility, which is comprised of a \$20 million term loan (Term Loan) and \$90 million of revolving credit (Revolving Credit Facility), involves a syndicate of banks, all of whom had participated in the credit facility that was refinanced (the Deutsche Bank Credit Agreement). The Fleet Credit Agreement is an asset-based lending agreement, and is generally on similar terms to those found in the Deutsche Bank Credit Agreement.

Below is a summary of the sources and uses associated with the funding of the Fleet Credit Agreement (in thousands):

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Sources:

Term borrowings under the Fleet Credit Agreement
 Revolving borrowings under the Fleet Credit Agreement

\$ 20
 43

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Uses:

Payment of principal and interest under the Deutsche Bank Credit Agreement	\$ 52
Purchase of the remaining preferred interest of subsidiary at a discount	9
Payment of accrued distributions on one-half of preferred interest of subsidiary	
Certain costs associated with the Fleet Credit Agreement	
	\$ 63

Under the Fleet Credit Agreement, the Term Loan originally had a final maturity date of February 3, 2008 and quarterly repayments of \$0.7 million, two of which have been made to date. However, the net proceeds received from the GC/Waldom and Duckback sales were used to prepay the Term Loan, which is now scheduled to be repaid in its entirety by 2005. The Term Loan is collateralized by the Company's property, plant and equipment. The Revolving Credit Facility has an expiration date of February 3, 2008. The borrowing base of the Revolving Credit Facility is determined by eligible inventory and accounts receivable.

Unused borrowing availability on the Revolving Credit Facility of \$37.3 million at September 30, 2003 was temporarily higher due to the application of proceeds from the Duckback sale (see below). In accordance with the Fleet Credit Agreement, the net proceeds from an asset sale are first used to pay down the Term Loan to the extent of Term Loan collateral (real estate and equipment) sold, then proceeds are applied to the Revolving Credit Facility to the extent of Revolving Credit collateral (accounts receivable and inventory) sold, and subsequently to pay down the Term Loan (to the extent of the outstanding Term Loan) and finally to the Revolving Credit Facility until all proceeds are applied. In connection with the Duckback sale, all of the net proceeds were initially used to pay down the Revolving Credit Facility as there was uncertainty (pending finalization of a balance sheet as of the date of the sale) as to the amount of underlying Revolving Credit collateral sold. Subsequent to September 30, 2003, based on the process for applying proceeds, the Term Loan was reduced by \$11.9 million by funding received from the Revolving Credit Facility. Had the net proceeds been applied to the Term Loan on or before September 30, 2003, unused borrowing availability would have been \$25.4 million at September 30, 2003.

All extensions of credit under the Fleet Credit Agreement are collateralized by a first priority perfected security interest in and lien upon the capital stock of each material domestic subsidiary (65% of the capital stock of each material foreign subsidiary), and all present and future assets and properties of Katy. Customary financial covenants and restrictions apply under the Fleet Credit Agreement, with which the Company was in compliance at September 30, 2003. Until June 30, 2003, interest accrued on Revolving Credit Facility borrowings at 225 basis points over applicable LIBOR rates and at 250 basis points over LIBOR for Term Loan borrowings. Subsequent to June 30, 2003, and in accordance with the terms of the Fleet Credit Agreement, margins dropped an additional 25 basis points for both revolving and term loans based on the achievement of a financial covenant target. Interest accrues at higher margins on prime rates for swing loans, the amounts of which were nominal as of September 30, 2003.

As a result of the Refinancing, Katy's borrowing capacity was reduced from \$140 million under the Deutsche Bank Credit Agreement to \$110 million under the Fleet Credit Agreement, a reduction of 21%. Therefore, proportionate shares of previously capitalized debt costs, amounting to approximately \$1.2 million, were written off to interest expense during the first quarter of 2003. The remainder of the previously capitalized costs, along with the newly capitalized costs from the Fleet Credit Agreement of \$1.5 million, is being amortized over the life of

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the Fleet Credit Agreement through January 2008.

Long-term debt consists of the following:

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	September 30, 2003
(Thousands of)	
Term loan payable under Fleet Credit Agreement, interest based on LIBOR and Prime Rates (3.38% - 5.00%), due through 2008	\$ 16,381
Revolving loans payable under Fleet Credit Agreement, interest based on LIBOR and Prime Rates (3.13 - 5.00%)	35,088
Revolving loans payable under Deutsche Bank Credit Agreement, interest based on Eurodollar and Prime Rates (3.75 - 5.50%)	--
Real estate and chattel mortgages, with interest at fixed rates (7.14%), due through 2003	--

Total debt	51,469
Less revolving loans, classified as current (see below)	(35,088)
Less current maturities	(14,741)

Long-term debt	\$ 1,640
	=====

Aggregate remaining scheduled maturities of the Term Loan as of September 30, 2003 (see discussion of borrowing availability above) are as follows (in thousands):

2003	\$12,598
2004	2,857
2005	926

The Revolving Credit Facility under the Fleet Credit Agreement requires lockbox agreements which provide for all receipts to be swept daily to reduce borrowings outstanding. These agreements, combined with the existence of a material adverse effect (MAE) clause in the Fleet Credit Agreement, cause the Revolving Credit Facility to be classified as a current liability, per guidance in the Emerging Issues Task Force (EITF) Issue No. 95-22, Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements that Include Both a Subjective Acceleration Clause and a Lock-Box Arrangement. However, the Company does not expect to repay, or be required to repay, within one year, the balance of the Revolving Credit Facility classified as a current liability. The MAE clause, which is a fairly typical requirement in commercial credit agreements, allows the lender to require the loan to become due if it determines there has been a material adverse effect on its operations, business, properties, assets, liabilities, condition or prospects. The classification of the Revolving Credit Facility as a current liability is a result only of the combination of the two aforementioned factors: the lockbox agreements and the MAE clause. The Revolving Credit Facility does not expire or have a maturity date within one year, but rather has a final expiration date of January 31, 2008. Also, the Company was in compliance with the applicable financial covenants at September 30, 2003. The lender had not notified Katy of any indication of a MAE at September 30, 2003, and to management's knowledge, the Company was not in violation of any provision of the Fleet Credit Agreement at

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September 30, 2003.

(12) Preferred Interest in Subsidiary

Coincident with the refinancing of Katy's debt obligations discussed in Note 11, the Company redeemed early, at a discount, the remaining preferred interest in Contico, plus accrued distributions thereon, which had a stated value of \$16.4 million. Katy utilized approximately \$10.0 million of the proceeds from the Fleet Credit Agreement for this purpose, with \$9.8 million applied toward the preferred interest and the remainder applied toward accrued distributions through the date of the redemption. The difference between the amount paid on redemption and the stated value of preferred interest redeemed (\$6.6 million pre-tax) was recognized as an increase to stockholders' equity on the Condensed Consolidated Balance Sheets, and is an addition to earnings available to common stockholders in the calculation of basic earnings per share during 2003.

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(13) Income Taxes

As of December 31, 2002, the Company had deferred tax assets, net of deferred tax liabilities, of \$42.8 million. Domestic net operating loss (NOL) carry forwards comprised \$22.8 million of the deferred tax assets. Katy's history of operating losses provides significant negative evidence with respect to the Company's ability to generate future taxable income, a requirement in order to recognize deferred tax assets on the Condensed Consolidated Balance Sheets. For this reason, the Company was unable at September 30, 2003 and December 31, 2002 to conclude that NOLs and other deferred tax assets would be utilized in the future. As a result, valuation allowances were recorded as of such dates for the full amount of deferred tax assets, net of the amount of deferred tax liabilities.

The provision for income taxes reflected on the Condensed Consolidated Statements of Operations for the three months and nine months ended September 30, 2003 and 2002 represents current tax expense associated with state and foreign taxes.

(14) Commitments and Contingencies

As set forth more fully in the Company's 2002 Annual Report on Form 10-K, the Company and certain of its current and former direct and indirect corporate predecessors, subsidiaries and divisions are involved in remedial activities at certain present and former locations and have been identified by the United States Environmental Protection Agency (EPA), state environmental agencies and private parties as potentially responsible parties (PRPs) at a number of hazardous waste disposal sites under the Comprehensive Environmental Response, Compensation and Liability Act (Superfund) or equivalent state laws and, as such, may be liable for the cost of cleanup and other remedial activities at these sites. Responsibility for cleanup and other remedial activities at a Superfund site is typically shared among PRPs based on an allocation formula. Under the federal Superfund statute, parties could be held jointly and severally liable, thus subjecting them to potential individual liability for the entire cost of cleanup at the site. Based on its estimate of allocation of liability among PRPs, the probability that other PRPs, many of whom are large, solvent, public companies, will fully pay the costs apportioned to them, currently available information concerning the scope of contamination, estimated remediation costs, estimated legal fees and other factors, the Company has recorded and accrued for indicated environmental liabilities amounts that it deems reasonable and believes that any liability with respect to these matters

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in excess of the accruals will not be material. The ultimate costs will depend on a number of factors and the amount currently accrued represents management's best current estimate of the total costs to be incurred. The Company expects this amount to be substantially paid over the next one to four years.

The most significant environmental matter in which the Company is currently involved relates to the W.J. Smith site. In 1993, the EPA initiated a Unilateral Administrative Order Proceeding under Section 7003 of the Resource Conservation and Recovery Act (RCRA) against W.J. Smith and Katy. The proceeding requires certain actions at the W.J. Smith site and certain off-site areas, as well as development and implementation of additional cleanup activities to mitigate off-site releases. In December 1995, W.J. Smith, Katy and the EPA agreed to resolve the proceeding through an Administrative Order on Consent under Section 7003 of RCRA. Pursuant to the Order, W.J. Smith is currently implementing a cleanup to mitigate off-site releases.

In December 1996, Banco del Atlantico, a bank located in Mexico, filed a lawsuit against Woods, a subsidiary of Katy, and against certain past and then-present officers and directors and former owners of Woods, alleging that the defendants participated in a violation of the Racketeer Influenced and Corrupt Organizations (RICO) Act involving allegedly fraudulently obtained loans from Mexican banks, including the plaintiff, and "money laundering" of the proceeds of the illegal enterprise. All of the foregoing is alleged to have occurred prior to Katy's purchase of Woods. The plaintiff also alleged that it made loans to an entity controlled by certain past officers and directors of Woods based upon fraudulent representations. The plaintiff seeks to hold Woods liable for its alleged damages directly, and under principles of respondeat superior and successor liability. The plaintiff is claiming damages in excess of \$24.0 million and is requesting treble damages under RICO. Because certain threshold procedural and jurisdictional issues have not yet been fully adjudicated in this litigation, it is not possible at this time for the Company to reasonably determine an outcome or accurately estimate the range of potential exposure. Katy may have recourse against the former owner of Woods and others for, among other things, violations of covenants, representations and warranties under the purchase agreement through which Katy acquired Woods, and under state, federal and common law. In addition, the purchase

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price under the purchase agreement may be subject to adjustment as a result of the claims made by Banco del Atlantico or other issues relating to the litigation. The extent or limit of any such adjustment cannot be predicted at this time. An adverse judgment in this matter could have a material impact on Katy's liquidity and financial position if the Company were not able to exercise recourse against the former owner of Woods.

Katy also has a number of product liability and workers' compensation claims pending against it and its subsidiaries. Many of these claims are proceeding through the litigation process and the final outcome will not be known until a settlement is reached with the claimant or the case is adjudicated. The Company estimates that it can take up to 10 years from the date of the injury to reach a final outcome on certain claims. With respect to the product liability and workers' compensation claims, Katy has provided for its share of expected losses beyond the applicable insurance coverage, including those incurred but not reported to the Company or its insurance providers, which are developed using actuarial techniques. Such accruals are developed using currently available claim information, and represent management's best estimates. The ultimate cost of any individual claim can vary based upon, among other factors, the nature of the injury, the duration of the disability period, the length of the claim period, the jurisdiction of the claim and the nature of

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the final outcome.

Since 1998, Woods Canada has used the NOMA trademark in Canada under the terms of a license with Gentek Inc. (Gentek). In October 2002, Gentek filed a petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code. In July 2003, as part of the bankruptcy proceedings, Gentek filed a motion to reject the trademark license agreement. On November 5, 2003, Gentek's motion was granted by the U.S. Bankruptcy Court. As a result, the trademark license agreement is no longer in effect. Woods Canada is in discussions with Gentek to enter into a new trademark license agreement. However, there is no guarantee that a new license agreement with Gentek will be reached, in which case Woods Canada would lose the right to brand certain of its product with the NOMA trademark. Approximately 45% of Woods Canada's sales are of NOMA - branded products. Should it lose the right to use the NOMA trademark, Woods Canada would seek to replace those sales with sales of other products. However, there is no guarantee that Woods Canada will be able to replace the lost sales of NOMA - branded products.

Although management believes that these actions individually and in the aggregate are not likely to have a material adverse effect on the Company's financial position, results of operations or cash flows, further costs could be significant and will be recorded as a charge to operations when such costs become probable and reasonably estimable.

(15) Stock Repurchase Program

On April 20, 2003, the Company announced a plan to spend up to \$5.0 million to repurchase shares of its common stock. As of September 30, 2003, the Company had spent \$1.4 million in acquiring 289,100 shares in accordance with the plan.

(16) Industry Segment Information

The Company is a manufacturer and distributor of a variety of industrial and consumer products, including sanitary maintenance supplies, coated abrasives, and electrical components. Principal markets are the United States, Canada and Europe, and include the sanitary maintenance, restaurant supply, retail, electronic and automotive markets. These activities are grouped into two industry segments: Electrical Products and Maintenance Products.

The following table sets forth information by segment:

	Three months ended September 30,	
	2003	2002
	----	----
	(Thousands of dollars)	
Maintenance Products Group		
Net external sales	\$ 72,403	\$ 72,403
Operating loss	(5,984)	(1,000)
Operating deficit	(8.3%)	(1.4%)
Severance, restructuring and related charges	2,676	2,676
Impairments of long-lived assets	5,255	1,000
Depreciation and amortization	5,245	5,245
Capital expenditures	2,212	2,212

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Electrical Products Group			
Net external sales		\$ 53,498	\$ 5
Operating income		4,939	
Operating margin		9.2%	
Severance, restructuring and related charges		1,179	
Depreciation and amortization		331	
Capital expenditures		155	
Total			
Net external sales	- Operating segments	\$ 125,901	\$ 13
	- Other [a]	--	
	Total	\$ 125,901	\$ 13
		=====	=====
Operating income (loss)	- Operating segments	\$ (1,045)	\$ (1)
	- Other [a]	--	
	- Unallocated corporate	(3,468)	(
	Total	\$ (4,513)	\$ (1)
		=====	=====
Severance, restructuring and related charges	- Operating segments	\$ 3,855	\$
	- Unallocated corporate	16	
	Total	\$ 3,871	\$
		=====	=====
Impairments of long-lived assets	- Operating segments	\$ 5,255	\$ 1
	Total	\$ 5,255	\$ 1
		=====	=====
Depreciation and amortization	- Operating segments	\$ 5,576	\$
	- Unallocated corporate	(200)	
	Total	\$ 5,376	\$
		=====	=====
Capital expenditures	- Operating segments	\$ 2,367	\$
	- Unallocated corporate	--	
	- Discontinued operations	28	
	Total	\$ 2,395	\$
		=====	=====
		September 30,	Decemb
		2003	20
		-----	-----
Total assets	- Maintenance Products Group	\$ 180,616	\$ 19
	- Electrical Products Group	62,952	4
	- Other [a]	1,624	
	- Unallocated corporate	12,106	1
	- Discontinued operations	2,089	1
	Total	\$ 259,387	\$ 27
		=====	=====

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[a] Amounts shown as "Other" represent items associated with the SESCO partnership and an equity investment in a shrimp harvesting and farming operation.

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(17) Severance, Restructuring and Related Charges

During the third quarter of 2003, the Company recorded \$3.9 million for severance, restructuring and related charges. Such charges include \$2.0 million related to the establishment of and adjustments to non-cancelable lease liabilities for abandoned facilities, primarily as a result of the consolidation of the facilities at the Contico business unit. Katy also recorded severance costs of \$1.1 million related to the announced closure of the Woods Canada manufacturing facility in Toronto. Manufacturing operations will cease in the fourth quarter of 2003, as Katy will implement a third-party sourcing plan similar to that implemented at the Woods U.S. operation in the fourth quarter of 2002. As a result of the shut down, approximately 100 employees will be terminated. In addition, Katy incurred costs of \$0.7 million associated with the consolidation efforts at Contico, including severance and moving inventory and equipment. Katy also recorded charges of \$0.1 million associated with the restructuring of its abrasives business.

During the first and second quarters of 2003, the Company recorded \$0.2 million and \$1.7 million, respectively, for severance, restructuring and related charges. These costs related to equipment moves, adjustments to non-cancelable lease liabilities for abandoned facilities, severance, and related charges associated with consolidation of facilities and administrative functions. Included in these costs were severance charges related to five administrative and fifteen operations employees at Contico's Santa Fe Springs facility. Costs were also incurred related to plastics manufacturing facilities at Warson Road, and the abrasives manufacturing facility in Wrens, Georgia (Wrens).

During the fourth quarter of 2002, the Company recorded \$2.4 million of severance and other exit costs associated with the shut down of the Woods manufacturing facilities in Indiana. Manufacturing operations were ceased in order to implement a more cost-effective procurement of finished goods inventory through sourcing with third party suppliers. As a result of this shut down, 361 employees were terminated. Woods incurred \$1.5 million in severance, pension, and other employee-related costs associated with the employee terminations. Woods also incurred a charge for the creation of a liability for non-cancelable lease costs at abandoned production facilities of \$0.8 million. An additional \$0.1 million of other exit costs were incurred related to facility repairs and other minor expenses. Woods also incurred \$0.9 million of inventory write-offs related to raw and packaging materials that will not be utilized efficiently with the change-over to a fully sourced inventory strategy. Contico incurred restructuring costs of \$0.6 million in the fourth quarter of 2002 associated with costs of revaluing their non-cancelable lease liability at the Warson Road and Earth City, Missouri (Earth City) facilities, and \$0.3 million of costs in moving inventory and equipment from the Warson Road facility to the Bridgeton facility, as discussed below. Each of these facilities is in the St. Louis, Missouri area.

During the third quarter of 2002, the Company recorded \$9.5 million of severance, restructuring and related charges. During the third quarter, the Company committed to a plan to abandon the Earth City facility and to consolidate its operations into the Bridgeton facility. As a result, a \$7.1 million charge was recorded to accrue a liability for non-cancelable lease payments associated with the Earth City facility. Also during the third quarter, the Contico business recorded a \$1.4 million charge related to rent and other

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facility costs associated with its Warson Road facility, whose operations are also being consolidated into the Bridgeton facility. A charge of \$1.8 million was recorded in the second quarter of 2002 for the Warson Road facility, and the additional amount of \$1.4 million was recorded after consideration of the market for sub-leasing and to accrue costs to refurbish the facility. The Contico business recorded related charges of \$0.2 million incurred in moving inventory and equipment from the Warson Road facility to the Bridgeton facility, and \$0.2 million in severance costs. The Corporate group recorded a \$0.1 million charge for non-cancelable lease payments related to the former corporate headquarters. Also in the third quarter of 2002, a charge of \$0.5 million was recorded for payments for consultants working with the Company on sourcing and other manufacturing and production efficiency initiatives.

During the second quarter of 2002, the Company recorded \$3.8 million of severance, restructuring and related charges. Approximately \$1.6 million of the charges related to accruals for payments for consultants working with the Company on sourcing and other manufacturing and production efficiency initiatives. Additionally, net non-cancelable rental payments of \$1.8 million associated with the shut down of Contico's Warson Road facility were charged to operations, as well as involuntary termination benefits of \$0.1 million. The Warson Road facility shutdown involved a reduction in workforce of nineteen employees. The remaining \$0.3 million (for involuntary termination benefits) related to SESCO and for various integration costs in the consolidation of administrative functions into St. Louis, Missouri, from various operating divisions in the Maintenance Products group.

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During the first quarter of 2002, the Company recorded \$2.3 million of severance, restructuring and related charges. Approximately \$1.9 million of the charges related to accruals for payments for consultants working with the Company on sourcing and other manufacturing and production efficiency initiatives. Approximately \$0.3 million related to involuntary termination benefits for two management employees whose positions were eliminated, and \$0.1 million were costs associated with the consolidation of administrative and operational functions.

Certain assumptions have been made regarding potential future sub-lease revenue at rented facilities that have been, or will be, abandoned as a result of restructuring and consolidation activities. If the Company is unable to achieve its estimated sub-lease revenue estimates, charges could be recognized in future periods to update the estimated liability and cost to Katy for these facilities.

The table below details activity in restructuring reserves since December 31, 2002 (in thousands).

	Total	One-time Termination Benefits [a]
Restructuring liabilities at December 31, 2002	\$ 14,499	\$ 2,085
Additions to restructuring liabilities	5,812	2,230
Payments on restructuring liabilities	(12,010)	(2,818)
	-----	-----
Restructuring liabilities at September 30, 2003	\$ 8,301	\$ 1,497
	=====	=====

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The table below summarizes the remaining future obligations for severance and restructuring charges detailed above as of September 30, 2003 (in thousands):

2003	\$	2,054
2004		3,350
2005		1,469
2006		668
2007		380
Thereafter		380

Total Payments	\$	8,301
		=====

[a] Includes severance, benefits, and other employee-related costs associated with the employee terminations.

[b] Includes charges related to non-cancelable lease liabilities for abandoned facilities, net of potential sub-lease revenue.

[c] Includes charges associated with moving inventory, machinery and equipment, consolidation of administrative and operational functions, and consultants working on sourcing and other manufacturing and production efficiency initiatives

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

Three Months Ended September 30, 2003 versus Three Months Ended September 30, 2002

The table below and the narrative that follows summarize the key factors in the year-to-year changes in operating results.

	Three months ended September 30,	
	2003	2002
	----	----
	(Thousands of dollars)	
Maintenance Products Group [a]		
Net external sales	\$ 72,403	\$ 78,641
Operating loss	(5,984)	(16,499)
Operating deficit	(8.3%)	(21.0%)
Severance, restructuring and related charges	2,676	9,134
Impairments of long-lived assets	5,255	10,986
Depreciation and amortization	5,245	4,784
Capital expenditures	2,212	1,303
Electrical Products Group [b]		
Net external sales	\$ 53,498	\$ 55,784
Operating income	4,939	4,495
Operating margin	9.2%	8.1%

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Severance, restructuring and related charges	1,179	278
Depreciation and amortization	331	404
Capital expenditures	155	319
Total Company [c]		
Net external sales [d]	\$ 125,901	\$ 134,401
Operating loss [d]	(4,513)	(14,924)
Operating deficit [d]	(3.6%)	(11.1%)
Severance, restructuring and related charges	3,871	9,486
Impairments of long-lived assets [d]	5,255	10,986
Depreciation and amortization [d]	5,376	5,221
Capital expenditures [e]	2,395	1,737
	September 30,	December 31,
	2003	2002
	----	----
Total assets		
Maintenance Products Group	\$ 180,616	\$ 195,121
Electrical Products Group	62,952	48,228
Corporate, other and discontinued operations	15,819	32,628
	-----	-----
	\$ 259,387	\$ 275,977
	=====	=====

[a] Includes Contico, Continental Manufacturing, Contico U.K., Disco, Gemtex, Glit/Microtron, Loren Products, and Wilen Products.

[b] Includes Woods U.S. and Woods Canada.

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[c] Included in "Total Company" are certain amounts in addition to those shown for the Maintenance Products and Electrical Products segments, including amounts associated with 1) unallocated corporate expenses, 2) our equity investment in a shrimp harvesting and farming operation, and 3) our waste-to-energy facility (SESCO). See Note 16 to the Condensed Consolidated Financial Statements for detailed reconciliations of segment information to the Consolidated Financial Statements.

[d] Excludes 2002 transitional goodwill impairment charges of \$2.6 million in the Maintenance Products group and \$1.6 million in the Electrical Products group.

[e] Includes discontinued operations.

Sales in the Maintenance Products group decreased from \$78.6 million to \$72.4 million, a decrease of \$6.2 million or 7.9%. The most significant sales shortfalls to prior year were realized at Contico's metal truck box and consumer plastic businesses, principally due to the loss of certain business at a major retail customer. Sales were also lower at Contico's janitorial/sanitation plastics (Jan/San) business, as we believe that this business continues to be impacted by the slow economy and reduced demand for cleaning products, due to commercial real estate vacancy rates and reduced demand in the travel and hospitality industries. In addition, sales were lower at the Gemtex business unit, which sells abrasive products mainly to industrial customers, primarily due to increased foreign competition.

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The Maintenance Products group's operating results improved from an operating loss of (\$16.5) million in the third quarter of 2002 to an operating loss of (\$6.0) million in the third quarter of 2003, a difference of 63.7%. Operating loss was impacted in both years by severance, restructuring and related charges, as well as by impairments of long-lived assets. Excluding these items, operating income decreased by \$1.7 million, or 46.5%. Results were negatively impacted by the reduction in volumes at Contico's metal truck box, consumer plastics and Jan/San businesses, as well as rising resin costs and isolated manufacturing inefficiencies. In addition, operating results were negatively impacted by \$1.3 million of incremental depreciation related to the revision of the estimated useful lives of certain manufacturing assets related to plastic products. Results were positively impacted at both the consumer and Jan/San businesses of Contico in the U.S. from the implementation of cost reduction strategies.

The Maintenance Products group recorded severance, restructuring and related charges of \$2.7 million during the third quarter of 2003 and \$9.1 million during the third quarter of 2002. The costs in the third quarter of 2003 were related primarily to the establishment of and adjustments to non-cancelable lease liabilities for abandoned facilities (\$1.9 million), costs associated with the consolidation efforts at Contico, including severance and moving inventory and equipment (\$0.7 million), and charges associated with the restructuring of its abrasives business (\$0.1 million). The 2002 costs consisted primarily of net non-cancelable lease rentals and severance related to the Warson Road facility, as well as consultant fees associated with the company-wide sourcing project, and integration costs associated with consolidation of administrative functions. During the third quarter of 2003, the group also recorded impairments of long-lived assets of \$5.3 million, and included \$3.7 million of idle and obsolete equipment and leasehold improvements at Warson Road, Hazelwood and Bridgeton, \$1.2 million related to the closure of abrasives facilities in Lawrence, Massachusetts and Pineville, North Carolina and the subsequent consolidation into the Wrens facility, and \$0.3 million of obsolete molds and tooling at Contico's plastics operation in the United Kingdom. The group recorded impairments of long-lived assets of \$11.0 million during the third quarter of 2002, which included impairment charges of \$7.0 million for certain molds and tooling at Contico, a customer list intangible at Contico for \$2.6 million, certain machinery and equipment at the Wilen Products business unit for \$1.2 million and \$0.2 million for equipment at Earth City.

Sales in the Electrical Products group decreased from \$55.8 million to \$53.5 million, a decline of 4.1%. The decrease was primarily attributable to lower sales at Woods U.S. as a result of an usually strong third quarter in 2002. The 2002 sales benefited from a significant restocking of inventory at a major retail outlet consumer.

The Electrical Products group's operating income improved from \$4.5 million in the third quarter of 2002 to \$4.9 million in the third quarter of 2003, an increase of 9.9%. Operating income was impacted in both years by severance, restructuring and related charges. Excluding these items, operating income increased by \$1.3 million, or 28.2%. Operating income was higher at both Woods U.S. and Woods Canada. Cost reduction strategies implemented, which have focused on increased sourcing of product from third party manufacturers, have reduced the cost structures of both businesses, thereby improving margins and profitability.

The Electrical Products group recorded severance, restructuring and related charges of \$1.2 million in the third

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quarter of 2003 and \$0.3 million in the third quarter of 2002. The 2003 costs relate primarily to severance for Woods Canada in connection with the announced shutdown of their manufacturing facility in the fourth quarter of 2003. For 2002, these charges consisted of consulting fees incurred by both Woods U.S. and Woods Canada related to the third party manufacturer sourcing project that has been largely completed.

Equity in income of equity method investment was lower by \$5.4 million almost entirely due to the write down of the Sahlman joint venture. See further discussion relating to the financial results of Sahlman in Note 7 to the Condensed Consolidated Financial Statements.

Interest expense decreased from \$1.8 million in the third quarter of 2002 to \$1.1 million in the third quarter of 2003. The decrease is due mainly to lower average borrowings and to a lesser extent, lower interest rates. Other, net was unfavorable primarily as a result of expenses associated with the attempt to sell the Woods businesses and a loss on the sale of real estate at an idle facility in Canada in the current year quarter.

Total Company assets between December 31, 2002 and September 30, 2003 were impacted primarily by reductions in assets of discontinued operations, which were reduced from \$11.8 million to \$2.1 million. The reduction in discontinued operations assets is due to the assets of GC/Waldom and Duckback being included in assets of discontinued operations at December 31, 2002, but excluded at September 30, 2003 due to the sale of those businesses in 2003 (see Note 5 to the Condensed Consolidated Financial Statements). In addition, assets are lower at September 30, 2003, primarily due to impairments of property and equipment of \$7.1 million and the write down of the investment of Sahlman of \$5.5 million.

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Nine Months Ended September 30, 2003 versus Nine Months Ended September 30, 2002

The table below and the narrative that follows summarize the key factors in the year-to-year changes in operating results.

	Nine months ended September 30, 2003	2002
	----	----
	(Thousands of dollars)	
Maintenance Products Group [a]		
Net external sales	\$ 213,509	\$ 227,655
Operating loss	(6,286)	(17,287)
Operating deficit	(2.9%)	(7.6%)
Severance, restructuring and related charges	4,013	12,275
Impairments of long-lived assets	7,055	13,380
Depreciation and amortization	15,111	14,211
Capital expenditures	6,580	7,132
Electrical Products Group [b]		
Net external sales	\$ 104,305	\$ 106,289
Operating income	6,409	2,492
Operating margin	6.1%	2.3%
Severance, restructuring and related charges	1,404	2,707
Depreciation and amortization	893	1,074
Capital expenditures	432	541

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Total Company [c]		
Net external sales [d]	\$ 317,814	\$ 335,121
Operating loss [d]	(10,001)	(28,826)
Operating deficit [d]	(3.1%)	(8.6%)
Severance, restructuring and related charges	5,812	15,567
Impairments of long-lived assets [d]	7,055	13,380
Depreciation and amortization [d]	16,531	15,396
Capital expenditures [e]	7,137	8,233

[a] Includes Contico, Continental Manufacturing, Contico U.K., Disco, Gemtex, Glit/Microtron, Loren Products, and Wilen Products.

[b] Includes Woods U.S. and Woods Canada.

[c] Included in "Total Company" are certain amounts in addition to those shown for the Maintenance Products and Electrical Products segments, including amounts associated with 1) unallocated corporate expenses, 2) our equity investment in a shrimp harvesting and farming operation, and 3) our waste-to-energy facility (SESCO). See Note 16 to Condensed Consolidated Financial Statements for detailed reconciliations of segment information to the Consolidated Financial Statements.

[d] Excludes 2002 transitional goodwill impairment charges of \$2.6 million in the Maintenance Products group and \$1.6 million in the Electrical Products group.

[e] Includes discontinued operations.

Sales in the Maintenance Products group decreased from \$227.7 million to \$213.5 million, a decrease of \$14.2 million or 6.2%. The most significant sales shortfalls to the prior year were realized in the businesses that sell to commercial customers, including Contico's Jan/San business. We believe that this business continues to be impacted by the slow economy and reduced demand for cleaning products, due to commercial real estate vacancy rates and reduced demand in the travel and hospitality industries. Sales were lower at Contico's metal truck box and consumer plastics businesses due to the loss of certain business at a major outlet customer. Sales were also lower at the Loren Products

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division, primarily because a major customer increased their supplier base in 2003. Sales were also lower at Gemtex, primarily due increased foreign competition.

The Maintenance Products group's operating results improved from a loss of \$17.3 million for the nine months ended September 30, 2002 to a loss of \$6.3 million for the nine months ended September 30, 2003, a change of 63.6%. Operating results were impacted in each year by severance, restructuring and related charges, as well as the impairment of long-lived assets. Excluding these items, operating loss decreased by \$3.6 million, or 42.9%. Profitability was lower at Contico's metal truck box business, Loren and Gemtex due to volume-related issues, while the Contico consumer plastic business in the U.S. and in the U.K. was negatively impacted by top-line pricing pressures, an unfavorable mix of lower margin products and rising resin costs. These shortfalls were partially offset by improved results at the Contico Jan/San business which benefited from the implementation of cost reduction strategies. In addition, operating results were negatively impacted by \$4.0 million of incremental depreciation related to the revision of the estimated useful lives of certain manufacturing assets related to plastic products.

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The Maintenance Products group recorded severance, restructuring and related charges of \$4.0 million during the nine months ended September 30, 2003, and \$12.3 million during the nine months ended September 30, 2002. The 2003 costs related primarily to the establishment of and adjustments to non-cancelable lease liabilities for abandoned facilities (\$2.4 million), costs associated with the consolidation efforts at Contico, including severance and moving inventory and equipment (\$1.1 million) and charges associated with the restructuring of the abrasives business (\$0.5 million). The 2002 severance, restructuring and related charges were comprised of non-cancelable rental payments on the Earth City and Warson Road facilities of \$10.3 million, severance costs of \$0.8 million, consulting costs related to sourcing and other manufacturing and production efficiencies initiatives of \$0.8 million, costs associated with moving inventory and equipment of \$0.2 million, and various integration costs for the consolidation of administrative functions of \$0.2 million. The group recorded impairments of long-lived assets of \$7.1 million during the nine months ended September 30, 2003 and \$13.4 million during the same period of 2002. Charges in 2003 included \$5.5 million related to idle and obsolete equipment and leasehold improvements at Warson Road, Hazelwood and Bridgeton, \$1.2 million related to the closure of abrasives facilities in Lawrence, Massachusetts and Pineville, North Carolina and the subsequent consolidation into the Wrens facility, and \$0.3 million of obsolete molds and tooling at Contico's plastics operation in the United Kingdom. Impairment charges in 2002 included \$7.0 million for certain molds and tooling at Contico, a customer list intangible at Contico for \$2.6 million, certain machinery and equipment at Warson Road for \$2.4 million, certain machinery and equipment at the Wilen Products business unit for \$1.2 million and \$0.2 million for equipment at Earth City.

Sales in the Electrical Products group decreased from \$106.3 million to \$104.3 million, a decline of 1.9%. The decrease was primarily attributable to lower sales at Woods U.S. as a result of certain promotions at a major retail customer in 2002 that did not repeat in 2003, as well as a strong third quarter of 2002 resulting from significant restocking of inventory for a certain customer. This decrease was offset by higher sales at Woods Canada, principally due to the impact of currency translation.

The Electrical Products group's operating income improved from \$2.5 million to \$6.4 million, an increase of 157.2%. Operating income was impacted in both years by severance, restructuring and related charges. Excluding these items, operating income increased by \$2.6 million, or 50.3%. Operating income was higher at both Woods U.S and Woods Canada, driven primarily by higher sales volumes and cost reductions at Woods Canada and by cost reductions at Woods U.S.

The Electrical Products group recorded severance, restructuring and related charges of \$1.4 million in the nine month period ending September 30, 2003, compared to \$2.7 million recorded during the same period of 2002. The costs in 2003 are mostly related to severance for Woods Canada in connection with the announced shutdown of their manufacturing facility in the fourth quarter of 2003 and to a lesser degree, consulting fees for resourcing projects. The 2002 costs all related to consulting fees for resourcing projects. The resourcing initiative has had a significant positive impact on the operations of both Woods U.S. and Woods Canada.

Equity in income of equity method investment was lower by \$6.3 million almost entirely due to the write down of the Sahlman joint venture in 2003, offset by equity income from Sahlman in 2002. See further discussion relating to the financial results of Sahlman in Note 7 to the Condensed Consolidated Financial Statements.

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Interest, net was essentially the same for the first nine months of 2003 as compared to the first nine months of 2002. During the first quarter of 2003, we wrote off \$1.2 million of unamortized debt issuance costs due to the reduction in our borrowing capacity as a result of the refinancing of our debt obligations in February 2003. The amount of this write-off is included in interest expense. Excluding the write-off, interest, net decreased by \$1.1 million, or 23.4%, due mainly to lower average borrowings and to a lesser extent, lower interest rates.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity was negatively impacted in the first nine months of 2003 by lower operating cash flow during the first quarter. We used \$10.1 million of operating cash flow during the first nine months of 2003 compared to operating cash flow generated during the first nine months of 2002 of \$12.4 million. Debt obligations increased from December 31, 2002 by \$6.0 million. However, \$9.8 million of the increase in debt obligations related to the early redemption of higher-interest preferred units of a subsidiary, which were redeemed at a discount coincident with the refinancing of our debt obligations in February 2003 (see discussion below). Excluding the impact of this factor on debt obligations, debt decreased by \$3.8 million during the first nine months of 2003. Net proceeds from the sales of the GC/Waldom and Duckback businesses were used to reduce debt by \$21.9 million, and were offset by working capital changes, primarily higher accounts receivable due largely to seasonality at the Woods' businesses and payments on previously recorded restructuring liabilities.

In February 2003, we funded a new credit agreement, agented by Fleet Capital Corporation (Fleet Credit Agreement), which replaced the credit agreement entered into at the time of the recapitalization in June of 2001 (Deutsche Bank Credit Agreement). The new \$110 million facility, which is comprised of a \$20 million term loan (Term Loan) and \$90 million of revolving credit (Revolving Credit Facility), involves a syndicate of banks, all of whom had participated in the Deutsche Bank Credit Agreement. The Fleet Credit Agreement is an asset-based lending agreement, and is generally on similar terms to those found in the Deutsche Bank Credit Agreement.

In September 2003, we sold the Duckback business for net proceeds of \$15.8 million, of which \$1.4 million was received subsequent to September 30, 2003 as a result of a post-closing working capital adjustment. In April 2003, we sold the GC/Waldom business for net proceeds of \$7.5 million. The proceeds of these sales resulted in a positive impact to cash flows from investing activities for the nine months ended September 30, 2003, and allowed us to reduce our debt obligations. A gain (net of tax) of \$7.6 million was recorded on the sale of Duckback (see Note 2 to the Condensed Consolidated Financial Statements for effect of restatement) while a loss (net of tax) of \$0.2 million was recognized on the sale of GC/Waldom.

The Fleet Credit Agreement allows us to more efficiently leverage our entire asset base, and to create more borrowing room under our Revolving Credit Facility, which is based on the liquidation values of accounts receivable and inventories. The Term Loan is collateralized by real and personal property. Below is a summary of the sources and uses associated with the funding of the Fleet Credit Agreement (in thousands):

Sources:

Term borrowings under the Fleet Credit Agreement	
Revolving borrowings under the Fleet Credit Agreement	

\$	20
	43

\$	63

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Uses:

Payment of principal and interest under the Deutsche Bank Credit Agreement	\$ 52
Purchase of the remaining preferred interest of subsidiary at a discount	9
Payment of accrued distributions on one-half of preferred interest of subsidiary	
Certain costs associated with the Fleet Credit Agreement	

	\$ 63
	=====

As a result of the refinance with the new Fleet Credit Agreement, we were able to redeem at a 40% discount the remaining preferred interest that the former owner of Contico had held. This balance sheet liability, which had a carrying

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value of \$16.4 million immediately prior to redemption, was redeemed for \$9.8 million in February 2003. The excess of carrying value over redemption price is an addition to stockholders' equity, and favorably impacts earnings per share. This will result in a reduction of preferred cash distributions by approximately \$1.3 million annually, which had accrued at an annual rate of 8%. After giving effect to the interest cost incurred by the Company to fund the redemption, the net decrease in financing cost for the Company will be approximately \$1.0 million annually.

Under the Fleet Credit Agreement, the Term Loan originally had a final maturity date of February 3, 2008 and quarterly repayments of \$0.7 million, two of which were made on April 1 and July 1, 2003, respectively. However, the net proceeds received from the GC/Waldom and Duckback sales (see above), were used to prepay the Term Loan, which is now scheduled to be repaid in its entirety by 2005. The Revolving Credit Facility has an expiration date of February 3, 2008.

Unused borrowing availability on the Revolving Credit Facility of \$37.3 million at September 30, 2003, was temporarily higher due to the application of the proceeds of the Duckback sale (see below). In accordance with the Fleet Credit Agreement, the net proceeds from an asset sale are first used to pay down the Term Loan to the extent of Term Loan collateral (real estate and equipment) sold, then proceeds are applied to the Revolving Credit Facility to the extent of Revolving Credit collateral (accounts receivable and inventory) sold, and subsequently to pay down the Term Loan (to the extent of the outstanding Term Loan) and finally to the Revolving Credit Facility until all proceeds are applied. In connection with the Duckback sale, all of the net proceeds were initially used to pay down the Revolving Credit Facility as there was uncertainty (pending finalization of a balance sheet as of the date of the sale) as to the amount of underlying Revolving Credit collateral sold. Subsequent to September 30, 2003, based on the process for applying proceeds, the Term Loan was reduced by \$11.9 million from funding received from the Revolving Credit Facility. Had the net proceeds been applied to the Term Loan on or before September 30, 2003, unused borrowing availability would have been \$25.4 million at September 30, 2003.

Our borrowing base under the Fleet Credit Agreement is reduced by the outstanding amount of standby and commercial letters of credit. Vendors, financial institutions and other parties with whom we conduct business may require letters of credit in the future that either 1) do not exist today or 2) would be at higher amounts than those that exist today. Currently, our largest letters of credit relate to our casualty insurance programs. At September 30, 2003, total outstanding letters of credit were \$9.3 million.

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All extensions of credit under the Fleet Credit Agreement are collateralized by a first priority perfected security interest in and lien upon the capital stock of each material domestic subsidiary (65% of the capital stock of each material foreign subsidiary), and all present and future assets and properties of Katy. Customary financial covenants and restrictions apply under the Fleet Credit Agreement, and we were in compliance with these covenants as of September 30, 2003. Until June 30, 2003, interest accrued on revolving borrowings at 225 basis points over applicable LIBOR rates, and at 250 basis points over LIBOR for term borrowings. Subsequent to June 30, 2003 and in accordance with the Fleet Credit Agreement, Katy's margins dropped an additional 25 basis points from the pre-June 30 levels on both the Revolving Credit Facility and the Term Loan based on the achievement of a financial covenant target. Interest accrues at higher margins on prime rates for swing loans, the amounts of which were nominal at September 30, 2003.

Katy has incurred \$1.5 million in debt issuance costs associated with the Fleet Credit Agreement. Additionally, at the time of the inception of the Fleet Credit Agreement, Katy had approximately \$5.6 million of unamortized debt issuance costs associated with the Deutsche Bank Credit Agreement. Based on the pro rata reduction in borrowing capacity from the Deutsche Bank Credit Agreement to the Fleet Credit Agreement, Katy charged to expense \$1.2 million of the Deutsche Bank Credit Agreement unamortized debt issuance costs. The remainder of the previously capitalized costs, along with the newly capitalized costs from the Fleet Credit Agreement of \$0.9 million, is being amortized over the life of the Fleet Credit Agreement through January 2008.

The Revolving Credit Facility under the Fleet Credit Agreement requires lockbox agreements which provide for all receipts to be swept daily to reduce borrowings outstanding. These agreements, combined with the existence of a material adverse effect (MAE) clause in the Fleet Credit Agreement, causes the Revolving Credit Facility to be classified as a current liability, per guidance in the Emerging Issues Task Force (EITF) Issue No. 95-22, Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements that Include Both a Subjective Acceleration Clause and a Lock-Box Arrangement. However, the Company does not expect to repay, or be required to

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repay, within one year, the balance of the Revolving Credit Facility classified as a current liability. The MAE clause, which is a fairly typical requirement in commercial credit agreements, allows the lender to require the loan to become due if it determines there has been a material adverse effect on our operations, business, properties, assets, liabilities, condition or prospects. The classification of the Revolving Credit Facility as a current liability is a result only of the combination of the two aforementioned factors: the lockbox agreements and the MAE clause. The Revolving Credit Facility does not expire or have a maturity date within one year, but rather has a final expiration date of January 31, 2008. Also, we were in compliance with the applicable financial covenants at September 30, 2003. The lender had not notified us of any indication of a MAE at September 30, 2003, and to our knowledge, we were not in default of any provision of the Fleet Credit Agreement at September 30, 2003.

The Fleet Credit Agreement, and the additional borrowing ability on revolving credit obtained by incurring new term debt, results in three important benefits related to the long-term strategy of Katy: 1) it allowed us to redeem early at a discount a preferred interest obligation of Contico, 2) it provides borrowing power to invest in capital expenditures key to our strategic direction, and 3) it provides working capital flexibility to build inventory when necessary to accommodate lower cost outsourced finished goods inventory. We

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believe that our operations and the Fleet Credit Agreement provide sufficient liquidity for our operations going forward.

We require cash to fund working capital needs, make payments on previously recorded restructuring liabilities (see schedule of Contractual Obligations below), and fund capital expenditures. These requirements are expected to be met principally through cash flows from operations and available borrowings under the Fleet Credit Agreement. Capital expenditures for 2003 are expected to approximate the levels in 2002 and 2001, mainly for investments planned for the restructuring of the abrasives businesses and the various Contico facilities. These restructuring and consolidation activities are important steps in reducing our cost structure to a competitive level.

We are continually evaluating alternatives relating to divestitures of certain of our businesses. Divestitures present opportunities to de-leverage our financial position and free up cash for further investments in core activities. On September 16, 2003, we announced the sale of our Duckback business with total net proceeds of \$15.8 million, which were used to reduce our debt obligations. On April 2, 2003, we announced the sale of GC/Waldom with net proceeds of \$7.5 million, which were also used to reduce our debt obligations. On February 3, 2003, we announced that we sold a Woods manufacturing facility in Mooresville, Indiana. Gross proceeds were \$1.9 million, of which \$0.7 million was used to repay a mortgage loan payable on the property. The remainder of the proceeds reduced our debt obligations.

We have recorded valuation allowances of \$42.8 million on deferred tax assets as of December 31, 2002. These deferred tax assets include \$22.8 million of domestic net operating loss carry forwards. To the extent we generate taxable income in future years, these net operating loss carry forwards will be available to reduce future income tax liabilities.

On April 20, 2003, we announced a plan to repurchase up to \$5.0 million of our common stock. This repurchase is being funded through our credit facility. As of September 30, 2003, we had spent \$1.4 million to repurchase 289,100 shares of our common stock on the open market.

OFF-BALANCE SHEET ARRANGEMENTS

On April 29, 2002, Katy and SESCO, an indirect wholly owned subsidiary, entered into a partnership agreement with Montenay Power Corporation and its affiliates (Montenay) that turned over the operation of SESCO's waste-to-energy facility to the partnership. The Company entered into this agreement as a result of evaluations of SESCO's business. First, we determined that SESCO was not a core component of our long-term business strategy. Moreover, we did not feel the Company had the management expertise to deal with certain risks and uncertainties presented by the operation of SESCO's business, given that SESCO was the Company's only waste-to-energy facility. We had explored options for divesting SESCO for a number of years, and management felt that this transaction offered a reasonable strategy to exit this business.

The partnership, with Montenay's leadership, assumed SESCO's position in various contracts relating to the facility's operation. Under the partnership agreement, SESCO contributed its assets and liabilities (except for its liability under the loan agreement with the Resource Recovery Development Authority (the Authority) of the City of Savannah

and the related receivable under the service agreement) to the partnership. While SESCO will maintain a 99% partnership interest as a limited partner,

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Montenay will have most of the day to day responsibility for administration, financing and other matters of the partnership, and accordingly, the partnership will not be consolidated. Katy agreed to pay Montenay \$6.6 million over the span of seven years under a note payable as part of the partnership and related agreements. Certain amounts may be due to SESCO upon expiration of the service agreement in 2008; also, Montenay may purchase SESCO's interest in the partnership at that time. Katy has not recorded any amounts receivable or other assets relating to amounts that may be received at the time the service agreement expires, given their uncertainty. The Company recognized in the first quarter of 2002 a charge of \$6.0 million, consisting of 1) the discounted value of the \$6.6 million note, which is payable over seven years, 2) the carrying value of certain assets contributed to the partnership, consisting primarily of machinery spare parts, and 3) costs to close the transaction. All of SESCO's long-lived assets were reduced to a zero value at December 31, 2001, so no additional impairment was required. Going forward, Katy would expect that income statement activity associated with its involvement in the partnership will not be material, and Katy's balance sheet will carry the liability mentioned above.

In 1984, the Authority issued \$55.0 million of Industrial Revenue Bonds and lent the proceeds to SESCO, under the loan agreement, for the acquisition and construction of the waste-to-energy facility that has now been transferred to the partnership. The funds required to repay the loan agreement come from the monthly disposal fee paid by the Authority to SESCO under the service agreement for certain waste disposal services, a component of which is for debt service. To induce the required parties to consent to the SESCO partnership transaction, SESCO retained its liability under the loan agreement. In connection with that liability, SESCO also retained its right to receive the debt service component of the monthly disposal fee.

Based on an opinion from outside legal counsel, SESCO has a legally enforceable right to offset amounts it owes to the Authority under the loan agreement against amounts that are owed from the Authority under the service agreement. At September 30, 2003, this amount was \$35.8 million. Accordingly, the amounts owed to and due from SESCO have been netted for financial reporting purposes and are not shown on the consolidated balance sheets.

In addition to SESCO retaining its liabilities under the loan agreement, to induce the required parties to consent to the partnership transaction, Katy also continues to guarantee the obligations of the partnership under the service agreement. The partnership is liable for liquidated damages under the service agreement if it fails to accept the minimum amount of waste or to meet other performance standards under the service agreement. The liquidated damages, an off balance sheet risk for Katy, are equal to the amount of the Industrial Revenue Bonds outstanding, less \$4.0 million maintained in a debt service reserve trust. We do not expect non-performance by the other parties. Additionally, Montenay has agreed to indemnify Katy for any breach of the service agreement by the partnership.

Following are scheduled principal repayments on the loan agreement (and the Industrial Revenue Bonds) as of September 30, 2003 (in thousands):

2003	\$ 5,385
2004	6,765
2005	8,370
2006	15,300

Total	\$35,820
	=====

We also enter into operating lease agreements in the ordinary course of business, and many of our facilities are leased. Contractual obligations associated with these leases are listed in the table under the following section

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entitled "Contractual Obligations and Commercial Obligations."

Contractual Obligations and Commercial Obligations

Katy's obligations as of September 30, 2003 are summarized below:
(In thousands of dollars)

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Contractual Cash Obligations	Total	Due in less than 1 year	Due in 1-3 years	4-5
Revolving credit facility [a]	\$ 35,088	\$ --	\$ --	\$
Term loans	16,381	14,741	1,640	
Operating leases [b]	43,071	11,516	16,849	
Severance and restructuring [b]	8,301	4,766	2,773	
SESCO payable to Montenay [c]	4,800	1,000	2,050	
Total Contractual Obligations	\$ 107,641	\$ 32,023	\$ 23,312	\$
Other Commercial Commitments	Total	Due in less than 1 year	Due in 1-3 years	4-5
Commercial letters of credit	\$ 892	\$ 892	\$ --	\$
Stand-by letters of credit	8,380	8,380	--	
Guarantees [d]	35,820	5,385	15,135	
Total Commercial Commitments	\$ 45,092	\$ 14,657	\$ 15,135	\$

[a] As discussed in the Liquidity and Capital Resources section above, the entire Fleet Revolving Credit Facility is classified as a current liability on the Condensed Consolidated Balance Sheets as a result of the combination in the Fleet Credit Agreement of 1) lockbox agreements on Katy's depository bank accounts and 2) a subjective Material Adverse Effect (MAE) clause. The revolving credit agreement expires in January of 2008.

[b] These "Severance and restructuring" obligations represent liabilities associated with restructuring activities, other than liabilities for non-cancelable lease rentals. Future non-cancelable lease rentals are included in the line entitled "Operating leases." Our balance sheet at September 30, 2003 includes \$6.7 million in discounted liabilities associated with non-cancelable operating lease rentals, net of estimated sub-lease revenues, related to facilities that have been abandoned as a result of restructuring and consolidation activities.

[c] Amount owed to Montenay as a result of the SESCO partnership, discussed above and in Note 10 to the Condensed Consolidated Financial Statements. \$1.0 million of this obligation is classified in the Condensed Consolidated Balance Sheets as an Accrued Expense in Current Liabilities, while the remainder is included in Other Liabilities, recorded on a discounted basis.

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[d] As discussed in the Off-Balance Sheet Arrangements section above, SESCO, an indirect wholly-owned subsidiary of Katy, is party to a partnership that operates a waste-to-energy facility, and has certain contractual obligations, for which Katy provides certain guarantees. If the partnership is not able to perform its obligations under the contracts, under certain circumstances SESCO and Katy could be subject to damages equal to the amount of Industrial Revenue Bonds outstanding (which financed construction of the facility) less amounts held by the partnership in debt service reserve funds. Katy and SESCO do not anticipate non-performance by parties to the contracts. See the Off-Balance Sheet Arrangements section above and Note 10 to Condensed Consolidated Financial Statements.

SEVERANCE, RESTRUCTURING AND RELATED CHARGES

During the third quarter of 2003, we recorded \$3.9 million for severance, restructuring and related charges pursuant to SFAS No. 146. Such charges include \$2.0 million related to the establishment of and adjustments to non-cancelable lease liabilities for abandoned facilities, primarily as a result of the consolidation of the facilities at the Contico business units. We also recorded severance costs of \$1.1 million related to the announced closure of the Woods Canada manufacturing facility in Toronto. Manufacturing operations will cease in the fourth quarter of 2003, as Katy will implement a third-party sourcing plan similar to that implemented at the Woods U.S. operation in the fourth quarter of 2002. As of result of the shut down, approximately 100 employees will be terminated. In addition Katy incurred costs of \$0.7 million associated with the consolidation efforts at Contico, including severance and moving inventory and equipment. Katy also recorded charges of \$0.1 million associated with the restructuring of its abrasives business.

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During the first and second quarters of 2003, we recorded \$0.2 million and \$1.7 million, respectively, for severance, restructuring and related charges. These costs related to equipment moves, adjustments to non-cancelable lease liabilities for abandoned facilities, severance, and related charges associated with consolidation of facilities and administrative functions. Included in these costs were severance charges related to five administrative and fifteen operations employees at Contico's Santa Fe Springs facility. Costs were also incurred related to plastics manufacturing facilities at Warson Road, and the abrasives manufacturing facility in Wrens.

During the fourth quarter of 2002, we recorded \$2.4 million of severance and other exit costs associated with the shut down of the Woods manufacturing facilities in Indiana. Manufacturing operations were ceased in order to implement a more cost-effective procurement of finished goods inventory through sourcing with third party suppliers. As a result of this shut down, 361 employees were terminated. Woods incurred \$1.5 million in severance, pension, and other employee-related costs associated with the employee terminations. Woods also incurred a charge for the creation of a liability for non-cancelable lease costs at abandoned production facilities of \$0.8 million. An additional \$0.1 million of other exit costs were incurred related to facility repairs and other minor expenses. Woods also incurred \$0.9 million of inventory write-offs related to raw and packaging materials that will not be utilized efficiently with the change-over to a fully sourced inventory strategy. Contico incurred restructuring costs of \$0.6 million in the fourth quarter of 2002 associated with costs of revaluing their non-cancelable lease liability at the Warson Road and Earth City, Missouri (Earth City) facilities, and \$0.3 million of costs in moving inventory and equipment from the Warson Road facility to the Bridgeton facility, as discussed below. Each of these facilities is in the St. Louis, Missouri area.

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During the third quarter of 2002, we recorded \$9.5 million of severance, restructuring and related charges. During the third quarter, we committed to a plan to abandon the Earth City facility and to consolidate its operations into the Bridgeton facility. As a result, a \$7.1 million charge was recorded to accrue a liability for non-cancelable lease payments associated with the Earth City facility. Also during the third quarter, the Contico business recorded a \$1.4 million charge related to rent and other facility costs associated with its Warson Road facility, whose operations are also being consolidated into the Bridgeton facility. A charge of \$1.8 million was recorded in the second quarter of 2002 for the Warson Road facility, and the additional amount of \$1.4 million was recorded after consideration of the market for sub-leasing and to accrue costs to refurbish the facility. The Contico business recorded related charges of \$0.2 million incurred in moving inventory and equipment from the Warson Road facility to the Bridgeton facility, and \$0.2 million in severance costs. The Corporate group recorded a \$0.1 million charge for non-cancelable lease payments related to the former corporate headquarters. Also in the third quarter of 2002, a charge of \$0.5 million was recorded for payments for consultants working with the Company on sourcing and other manufacturing and production efficiency initiatives.

During the second quarter of 2002, we recorded \$3.8 million of severance, restructuring and related charges. Approximately \$1.6 million of the charges related to accruals for payments for consultants working with us on sourcing and other manufacturing and production efficiency initiatives. Additionally, net non-cancelable rental payments of \$1.8 million associated with the shut down of Contico's Warson Road facility were charged to operations during the quarter, as well as involuntary termination benefits of \$0.1 million. The Warson Road facility shutdown involved a reduction in workforce of nineteen employees. The remaining \$0.3 million (for involuntary termination benefits) related to SESCO and for various integration costs in the consolidation of administrative functions into St. Louis, Missouri, from various operating divisions in the Maintenance Products group.

During the first quarter of 2002, we recorded \$2.3 million of severance, restructuring and related charges. Approximately \$1.9 million of the charges related to accruals for payments for consultants working with us on sourcing and other manufacturing and production efficiency initiatives. Approximately \$0.3 million related to involuntary termination benefits for two management employees whose positions were eliminated, and \$0.1 million were costs associated with the consolidation of administrative and operational functions.

Certain assumptions have been made regarding potential future sub-lease revenue at rented facilities that have been, or will be, abandoned as a result of restructuring and consolidation activities. If we are unable to achieve its estimated sub-lease revenue estimates, charges could be recognized in future periods to update the estimated liability and cost to Katy for these facilities.

The table below details activity in restructuring reserves since December 31, 2002 (in thousands).

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Total	One-time Termination Benefits [a]	Cont- Termin Cost
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Restructuring liabilities at December 31, 2002	\$ 14,499	\$ 2,085	\$ 10
Additions to restructuring liabilities	5,812	2,230	2
Payments on restructuring liabilities	(12,010)	(2,818)	(6)
	-----	-----	-----
Restructuring liabilities at September 30, 2003	\$ 8,301	\$ 1,497	\$ 6
	=====	=====	=====

The table below summarizes the future obligations for severance and restructuring charges detailed above as of September 30, 2003 (in thousands):

2003	\$ 2,054
2004	3,350
2005	1,469
2006	668
2007	380
Thereafter	380

Total Payments	\$ 8,301
	=====

[a] Includes severance, benefits, and other employee-related costs associated with the employee terminations.

[b] Includes charges related to non-cancelable lease liabilities for abandoned facilities, net of potential sub-lease revenue.

[c] Includes charges associated with moving inventory, machinery and equipment, consolidation of administrative and operational functions, and consultants working on sourcing and other manufacturing and production efficiency initiatives.

OUTLOOK FOR 2003

We anticipate a continuation of the difficult economic conditions and business environment in 2003, which will present challenges in maintaining net sales. In particular, we expect to see softness continue in the restaurant, travel and hotel markets to which we sell cleaning products. We have seen continued strong sales performance from the Woods U.S. and Woods Canada retail electrical corded products business, but we do not expect to see the same level of year-over-year top line growth from those businesses in 2003 as we experienced in 2002. We have a significant concentration of customers in the mass-market retail, discount and do-it-yourself market channels. Our ability to maintain and increase our sales levels depends in part on our ability to retain and improve relationships with these customers. We face the continuing challenge of recovering or offsetting cost increases for raw materials.

Gross margins have been improving and are expected to continue to improve for the remainder of 2003 as we realize the benefits of various profit-enhancing strategies begun in 2001 and 2002. These strategies include sourcing previously manufactured products, as well as locating new sources for products already sourced outside of our facilities. We have significantly reduced headcount, and continue to examine issues related to excess facilities. Cost of goods sold is subject to variability in the prices for certain raw materials, most significantly thermoplastic resins used by Contico in the manufacture of plastic products. Prices of plastic resins, such as polyethylene and polypropylene, increased during the early months of 2003, but have fallen and stabilized by the end of the third quarter. Management has observed that the prices of plastic resins are driven to an extent by prices for crude oil and natural gas, in addition to other factors specific to the supply and demand of the resins themselves. We cannot predict the direction resin prices will take during the remainder of 2003 and beyond. We are also exposed to price changes for copper (a

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primary material in many of the products sold by Woods U.S. and Woods Canada), aluminum (a primary material in production of truck boxes), corrugated packaging material and other raw materials. We have not employed an active hedging program

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related to our commodity price risk, but are employing other strategies for managing this risk, including contracting for a certain percentage of resin needs through supply agreements and supplementing these agreements with opportunistic spot purchases. In a climate of rising raw material costs, we experience difficulty in raising prices to shift these higher costs to our customers.

Depreciation expense will continue to be higher during 2003 as a result of the reduction in depreciable lives for certain assets used in Contico's manufacturing process, effective January 1, 2003. The estimated amount of incremental depreciation expense during 2003 as a result of this reduction in depreciable lives is approximately \$5.4 million. However, many of these assets will become fully depreciated during 2003 since the Contico acquisition occurred in early 1999. Therefore, depreciation expense related to these assets is expected to reduce again in 2004 and subsequent years. Our total depreciation expense in 2004 and subsequent years will depend on changes in the level of depreciable assets.

Selling, general and administrative expenses have remained stable and are expected to continue to remain stable as a percentage of sales from 2002 levels. Cost reduction efforts are ongoing throughout the Company. Our corporate office was relocated in 2001 and we expect to maintain modest headcount and rental costs for that office. We have completed the process of transferring most back-office functions of our Wilen subsidiary from Atlanta, Georgia to St. Louis, Missouri, the headquarters of Contico. We are nearly complete with the process of transferring most back-office functions of the Glit/Microtron subsidiary in Wrens, Georgia to St. Louis, Missouri. We will continue to evaluate the possibility of further consolidation of administrative processes at our subsidiaries.

We have announced or committed to several restructuring plans involving our operations. During the second and third quarters of 2002, respectively, we announced plans to consolidate the Warson Road and Earth City facilities of Contico into the Bridgeton facility. All of these facilities are located in the St. Louis, Missouri area. The move from our Warson Road facility is complete. Subsequent to September 30, 2003, the move from our Earth City facility will require approximately an additional \$0.5 million of capital expenditures. The significant charges recorded during 2002 and 2003 related to these facilities were mainly to accrue non-cancelable lease payments for these facilities (i.e., non-incremental cash). We also intend to reduce the capacity of Contico's Hazelwood facility, which currently provides injection molding of plastic products for the janitorial/sanitation and consumer plastics businesses. Hazelwood will continue to operate on a satellite basis, but with reduced capacity. Certain molding machines will be transferred to the Bridgeton facility, and excess machinery will be sold. Capital expenditures of \$1.3 million will be required at Bridgeton to accommodate the former Hazelwood capacity, and some additional severance and restructuring expenses will be incurred during the last quarter of 2003 to accommodate this move. We expect the Contico business unit to benefit from lower overhead costs in 2003 and beyond as a result of these consolidations. Further facility consolidations with respect to the Contico operations are under review.

During September 2003, we announced the planned closure of the Woods Canada manufacturing facility in Toronto, necessitated by our decision to fully

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outsource its products to lower cost sources. Prior to the plant closure, Woods Canada already sourced a portion of its finished goods from vendors. The plant closure will take place in December 2003. While outsourcing of the Woods Canada products is a cost-saving measure, Woods Canada expects to maintain higher inventory levels, especially through mid-2004, as a result of this move.

We have committed to other restructuring alternatives as well, most of which center around consolidation of operations into fewer facilities. Certain of these projects will require significant levels of incremental cash for both capital expenditures and moving and relocation costs. Capital expenditures, severance, restructuring and related costs, and potential asset impairments, related to these initiatives are expected to be in the range of \$5 to \$7 million, and will be incurred in the fourth quarter of 2003 and into the first half of 2004.

We continue to pursue a strategy within the Maintenance Products group to simplify our business transactions and improve our customer relationships. We have started operating centralized customer service functions for Continental, Glit, Wilen and Disco, allowing customers to order products from any division on one purchase order. We believe that operating these businesses as a cohesive unit will improve customer service because our customers' purchasing processes will be simplified, as will follow up on order status, billing, collection and other related functions. We expect that these steps will increase customer loyalty and help in attracting new customers and increasing top line sales in future years.

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Our integration cost reduction efforts, integration of back office functions and simplifications of our business transactions are all dependent on executing a system integration plan. This plan involves the migration of data across information technology platforms and implementation of new software and hardware. The systems integration plan was substantially completed in October 2003.

Interest expense in 2003, excluding the write-off of \$1.2 million of unamortized debt issuance costs, has been lower than the amounts reported in 2002, due primarily to lower debt balances and, to a lesser extent, lower interest rates. We expect this trend to continue for the remainder of the year. However, we cannot predict the future levels of interest rates. In addition, after June 30, 2003, interest rate margins on our Fleet Credit Agreement borrowings are determined on a pricing matrix which factors operating performance into the pricing grid. Margins drop an additional 25 basis points in the most favorable pricing grid from the pre-June 30 levels. Our operating performance has resulted in us obtaining the more favorable pricing for our borrowings.

Given our history of operating losses, along with guidance provided by the accounting literature covering accounting for income taxes, we were unable to conclude it is more likely than not that we will be able to generate future taxable income sufficient to realize the benefits of deferred tax assets carried on our books. Therefore, a full valuation allowance on the net deferred tax asset position was recorded at September 30, 2003 and December 31, 2002, and we do not expect to record the benefit of any deferred tax assets that may be generated in 2003. We will continue to record current expense associated with foreign and state income taxes.

We are continually evaluating alternatives that relate to divestitures of non-core businesses. Divestitures present opportunities to de-leverage our financial position and free up cash for further investments in core activities.

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On March 6, 2003, we announced that we were exploring the sale of the Woods and Woods Canada businesses. However, on July 31, 2003, we announced that we have decided not to pursue a sale of these businesses at this time. On April 2, 2003, we announced the sale of GC/Waldom with net proceeds of \$7.5 million, resulting in a loss of \$0.2 million (net of tax) on the sale. On September 16, 2003, we announced the sale of Duckback with net proceeds of \$15.8 million, resulting in a gain of \$7.6 million (net of tax).

Cautionary Statement Pursuant to Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995

This report and the information incorporated by reference in this report contain various "forward-looking statements" as defined in Section 27A of the Securities Act of 1933 and Section 21E of the Exchange Act of 1934, as amended. The forward-looking statements are based on the beliefs of our management, as well as assumptions made by, and information currently available to, our management. We have based these forward-looking statements on current expectations and projections about future events and trends affecting the financial condition of our business. These forward-looking statements are subject to risks and uncertainties that may lead to results that differ materially from those expressed in any forward-looking statement made by us or on our behalf, including, among other things:

- Increases in the cost of, or in some cases continuation of, the current price levels of, plastic resins, copper, paper board packaging, and other raw materials.
 - Our inability to reduce product costs, including manufacturing, sourcing, freight, and other product costs.
 - Greater reliance on third parties for our finished goods as we increase the portion of our manufacturing that is outsourced.
 - Our inability to reduce administrative costs through consolidation of functions and systems improvements.
 - Our inability to execute our systems integration plan.
 - Our inability to successfully integrate our operations as a result of the facility consolidations.
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- Our inability to sub-lease rented facilities which have been abandoned as a result of consolidation and restructuring initiatives.
 - Our inability to achieve product price increases, especially as they relate to potentially higher raw material costs.
 - The potential impact of losing lines of business at large retail outlets in the discount and do-it-yourself markets.
 - Competition from foreign competitors.
 - The potential impact of new distribution channels, such as e-commerce, negatively impacting us and our existing channels.
 - The potential impact of rising interest rates on our LIBOR-based Fleet Credit Agreement.

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- Our inability to meet covenants associated with the Fleet Credit Agreement.
- The potential impact of rising costs for insurance for properties and various forms of liabilities.
- Labor issues, including union activities that require an increase in production costs or lead to a strike, thus impairing production and decreasing sales. We are also subject to labor relations issues at entities involved in our supply chain, including both suppliers and those involved in transportation and shipping.
- Changes in significant laws and government regulations affecting environmental compliance and income taxes.
- Our inability to sell certain assets to raise cash and de-leverage our financial condition.

Words and phrases such as "expects," "estimates," "will," "intends," "plans," "believes," "anticipates" and the like are intended to identify forward-looking statements. The results referred to in forward-looking statements may differ materially from actual results because they involve estimates, assumptions and uncertainties. Forward-looking statements included herein are as of the date hereof and we undertake no obligation to revise or update such statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. All forward-looking statements should be viewed with caution.

ENVIRONMENTAL AND OTHER CONTINGENCIES

As set forth more fully in our 2002 Annual Report on Form 10-K, we and certain of our current and former direct and indirect corporate predecessors, subsidiaries and divisions are involved in remedial activities at certain present and former locations and have been identified by the United States Environmental Protection Agency (EPA), state environmental agencies and private parties as potentially responsible parties (PRPs) at a number of hazardous waste disposal sites under the Comprehensive Environmental Response, Compensation and Liability Act (Superfund) or equivalent state laws and, as such, may be liable for the cost of cleanup and other remedial activities at these sites. Responsibility for cleanup and other remedial activities at a Superfund site is typically shared among PRPs based on an allocation formula. Under the federal Superfund statute, parties could be held jointly and severally liable, thus subjecting them to potential individual liability for the entire cost of cleanup at the site. Based on its estimate of allocation of liability among PRPs, the probability that other PRPs, many of whom are large, solvent, public companies, will fully pay the costs apportioned to them, currently available information concerning the scope of contamination, estimated remediation costs, estimated legal fees and other factors, we have recorded and accrued for indicated environmental liabilities amounts that we deem reasonable and believe that any liability with respect to these matters in excess of the accrual will not be material. The ultimate costs will depend on a number of factors and the amount currently accrued represents management's best current estimate of the total cost to be incurred. We expect this amount

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to be substantially paid over the next one to four years.

The most significant environmental matter in which we are currently

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involved relates to the W.J. Smith site. In 1993, the EPA initiated a Unilateral Administrative Order Proceeding under Section 7003 of the Resource Conservation and Recovery Act (RCRA) against W.J. Smith and Katy. The proceeding requires certain actions at the W.J. Smith site and certain off-site areas, as well as development and implementation of additional cleanup activities to mitigate off-site releases. In December 1995, W.J. Smith, Katy and the EPA agreed to resolve the proceeding through an Administrative Order on Consent under Section 7003 of RCRA. Pursuant to the Order, W.J. Smith is currently implementing a cleanup to mitigate off-site releases.

In December 1996, Banco del Atlantico, a bank located in Mexico, filed a lawsuit against our Woods subsidiary and against certain past and then-present officers and directors and former owners of Woods, alleging that the defendants participated in a violation of the Racketeer Influenced and Corrupt Organizations (RICO) Act involving allegedly fraudulently obtained loans from Mexican banks, including the plaintiff, and "money laundering" of the proceeds of the illegal enterprise. All of the foregoing is alleged to have occurred prior to Katy's purchase of Woods. The plaintiff also alleged that it made loans to an entity controlled by certain past officers and directors of Woods based upon fraudulent representations. The plaintiff seeks to hold Woods liable for its alleged damages directly, and under principles of respondeat superior and successor liability. The plaintiff is claiming damages in excess of \$24.0 million and is requesting treble damages under RICO. Because certain threshold procedural and jurisdictional issues have not yet been fully adjudicated in this litigation, it is not possible at this time for the Company to reasonably determine an outcome or accurately estimate the range of potential exposure. Katy may have recourse against the former owner of Woods and others for, among other things, violations of covenants, representations and warranties under the purchase agreement through which Katy acquired Woods, and under state, federal and common law. In addition, the purchase price under the purchase agreement may be subject to adjustment as a result of the claims made by Banco del Atlantico or other issues relating to the litigation. The extent or limit of any such adjustment cannot be predicted at this time. An adverse judgment in this matter could have a material impact on Katy's liquidity and financial position if the Company were not able to exercise recourse against the former owner of Woods.

We also have a number of product liability and workers' compensation claims pending against us and our subsidiaries. Many of these claims are proceeding through the litigation process and the final outcome will not be known until a settlement is reached with the claimant or the case is adjudicated. We estimate that it can take up to 10 years from the date of the injury to reach a final outcome on certain claims. With respect to the product liability and workers' compensation claims, we have provided for our share of expected losses beyond the applicable insurance coverage, including those incurred but not reported to us or our insurance providers, which are developed using actuarial techniques. Such accruals are developed using currently available claim information, and represent our best estimates. The ultimate cost of any individual claim can vary based upon, among other factors, the nature of the injury, the duration of the disability period, the length of the claim period, the jurisdiction of the claim and the nature of the final outcome.

Since 1998, Woods Canada has used the NOMA trademark in Canada under the terms of a license with Gentek Inc. (Gentek). In October 2002, Gentek filed a petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code. In July 2003, as part of the bankruptcy proceedings, Gentek filed a motion to reject the trademark license agreement. On November 5, 2003, Gentek's motion was granted by the U.S. Bankruptcy Court. As a result, the trademark license agreement is no longer in effect. Woods Canada is in discussions with Gentek to enter into a new trademark license agreement. However, there is no guarantee that a new license agreement with Gentek will be reached, in which case Woods Canada would lose the right to brand certain of its product with the NOMA trademark. Approximately 45% of Woods Canada's sales are of NOMA - branded

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products. Should it lose the right to use the NOMA trademark, Woods Canada would seek to replace those sales with sales of other products. However, there is no guarantee that Woods Canada will be able to replace the lost sales of NOMA - branded products.

Although we believe that these actions individually and in the aggregate are not likely to have a material adverse effect on Katy's financial position, results of operations or cash flows, further costs could be significant and will be recorded as a charge to operations when such costs become probable and reasonably estimable.

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RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In April 2002, the Financial Accounting Standards Board (FASB) released Statement of Financial Accounting Standards (SFAS) No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections. SFAS No. 145 rescinds and makes technical corrections regarding various topics, including early extinguishments of debt and sale-leaseback transactions. The statement is effective for fiscal years beginning after May 15, 2002. We adopted SFAS No. 145 on January 1, 2003. SFAS No. 145 requires that certain costs and losses associated with early extinguishments of debt be reported as interest expense as a component of income from continuing operations, whereas the prior accounting guidance provided for classification of these costs and losses as extraordinary items, reported separately on a tax-effected basis after income from continuing operations. As a result of the refinancing of our borrowing facility in February 2003, we wrote off approximately \$1.2 million of debt costs, pre-tax, during the first quarter of 2003. These costs have been reported as interest expense, a component of income from continuing operations.

In July 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. The standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by the standard include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. Previous accounting guidance was provided by EITF Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring). SFAS No. 146 replaces EITF Issue No. 94-3. The new standard is effective for exit or restructuring activities initiated after December 31, 2002. We have initiated since January 1, 2003 and are further considering a number of restructuring and exit activities, including plant closings and consolidation of facilities. Since these activities have been or will be initiated after December 31, 2002, this statement could have a significant impact on the timing of the recognition of these costs in our statements of operations, tending to spread the costs out as opposed to recognition of a large portion of the costs at the time we commit to and communicate such restructuring and exit plans. Our operating plans call for additional restructuring and facility consolidation activity during the remainder of 2003 and 2004, concerned mainly with further consolidation of St. Louis, Missouri plastics manufacturing facilities, and restructuring and consolidation of certain abrasives manufacturing facilities. We have adopted the provisions of SFAS No. 146 for all restructuring activities initiated after December 31, 2002.

In January 2003, the FASB released FASB Interpretation No. (FIN) 46, Consolidation of Variable Interest Entities - an Interpretation of ARB No. 51.

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FIN 46 clarifies issues regarding the consolidation of entities which may have features that make it unclear whether consolidation or equity method accounting is appropriate. The effective date of FIN 46 has been delayed until the fourth quarter of 2003 for variable interest entities created prior to February 1, 2003. Katy is currently evaluating FIN 46 to determine any potential impact on its financial reporting.

In April 2003, the FASB released SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. Katy does not currently use derivative instruments or participate in hedging activities and therefore, does not expect SFAS No. 149 to impact its financial reporting. If Katy were to utilize derivative instruments and participate in hedging activities, it would follow the provisions of SFAS No. 149.

In May 2003, the FASB released SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Liabilities and Equity. SFAS No. 150 establishes standards for how certain financial instruments with characteristics of both liabilities and equity are to be classified and measured. It requires that certain financial instruments within its scope be classified as a liability (or an asset in some circumstances), while many of those instruments were previously classified as equity. SFAS No. 150 is effective for the third quarter of 2003. Katy has determined that SFAS No. 150 does not impact its financial reporting.

CRITICAL ACCOUNTING POLICIES

We disclosed details regarding certain of our critical accounting policies in the Management's Discussion and Analysis section of our 2002 Annual Report on Form 10-K (Part II., Item 7). There have been no changes to policies as of September 30, 2003.

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Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk associated with changes in interest rates relates primarily to our debt obligations and temporary cash investments. We currently do not use derivative financial instruments relating to either of these exposures. Our interest obligations on outstanding debt are indexed from short-term Eurodollar rates. We do not believe our exposures to interest rate risks are material to our financial position or results of operations. We have not employed an active hedging program related to our commodity price risk, but are employing other strategies for managing this risk, including contracting for a certain percentage of resin needs through supply agreements and supplementing these agreements with opportunistic spot buyers.

Item 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our SEC filings is reported within the time periods specified in the SEC's rules, and that such information is accumulated and communicated to the management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. We also have investments in certain unconsolidated entities. As we do not control or manage these entities, the disclosure controls and procedures with respect to such entities are necessarily more limited than those we maintain with respect to our consolidated subsidiaries.

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Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, Katy carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period of our report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to Katy (including its consolidated subsidiaries) required to be included in our periodic SEC filings.

(b) Change in Internal Controls

There have been no changes in Katy's internal control over financial reporting during the quarter ended September 30, 2003 that has materially affected, or is reasonable likely to materially affect Katy's internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

During the quarter for which this report is filed, there have been no material developments in previously reported legal proceedings, and no other cases or legal proceedings, other than ordinary routine litigation incidental to the Company's business and other nonmaterial proceedings, brought against the Company.

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

- 31.1 Certification of Chief Executive Officer pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

- Form 8-K filed August 6, 2003, including press release and schedules announcing results of operations for the second quarter of 2003.

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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.

KATY INDUSTRIES, INC.
Registrant

DATE: March 26, 2004

By /s/ C. Michael Jacobi

C. Michael Jacobi
President and Chief Executive Officer

By /s/ Amir Rosenthal

Amir Rosenthal
Vice President, Chief Financial Officer,
General Counsel and Secretary

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