# KATY

KATY INDUSTRIES INCORPORATED

*1999 Annual Report*

# Profile

Katy Industries, Inc. is a diversified manufacturing company with operations in two primary industry segments: Electrical/Electronics and Maintenance Products. Headquartered in Englewood, Colorado, Katy encompasses a group of leading businesses that serve the needs of original equipment manufacturers (OEMs), commercial organizations and consumer retail outlets. Katy's businesses meet the requirements of this varied group through a commitment to producing excellent products at low cost and delivering them quickly, efficiently and on time.

Katy strives to maintain stockholder value through a consistent strategy of quality growth. This strategy dictates that the Company continually evaluate the acquisitions of select businesses that can complement or fortify its existing operations. At the same time, Katy fosters internal growth through a focus on low-cost production, and through aggressive marketing and product development programs. These measures have yielded success for Katy, allowing the Company to expand its market share in its target segments to accelerate the Company's progress toward its goal.

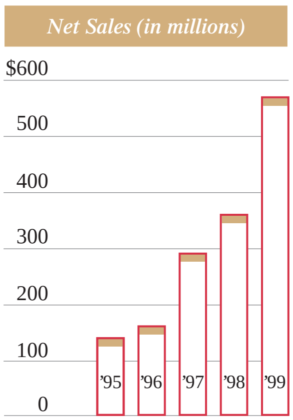
Katy operates facilities in twelve states and in three foreign countries. Katy Industries, Inc. is traded on the New York Stock Exchange under the symbol KT.

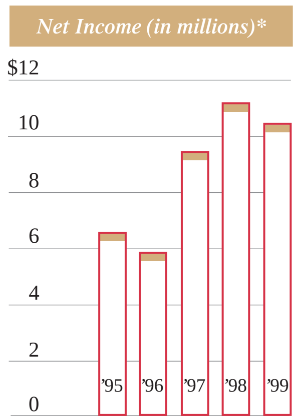
| Years ended December 31, *(Thousands of dollars, except per share data and ratios)* | **1999** | 1998 | 1997 | 1996 | 1995 |
|---|---|---|---|---|---|
| Net sales | **$565,941** | $342,315 | $286,023 | $156,024 | $136,093 |
| Income from continuing segments [a] | **$ 10,441** | $ 11,007 | $ 9,435 | $ 5,803 | $ 6,046 |
| Earnings per share from continuing segments — Basic [a] | **$ 1.25** | $ 1.33 | $ 1.14 | $ .70 | $ .67 |
| Earnings per share from continuing segments — Diluted [a] | **$ 1.21** | $ 1.30 | $ 1.12 | $ .70 | $ .67 |
| Income from continuing operations [b] | **$ 12,155** | $ 13,082 | $ 9,643 | $ 12,763 | $ 26,427 |
| Earnings per share from continuing operations — Basic [b] | **$ 1.45** | $ 1.58 | $ 1.16 | $ 1.53 | $ 2.94 |
| Earnings per share from continuing operations — Diluted [b] | **$ 1.38** | $ 1.55 | $ 1.15 | $ 1.53 | $ 2.94 |
| Total assets [c] | **$491,836** | $293,175 | $237,160 | $235,377 | $225,412 |
| Total liabilities and preferred interest | **331,525** | 143,859 | 97,989 | 105,331 | 95,082 |
| Stockholders' equity | **160,311** | 149,316 | 139,171 | 130,046 | 130,330 |
| Long-term debt, excluding current portion [c] | **150,835** | 39,908 | 9,948 | 8,582 | 9,346 |
| Ratio of debt to capitalization | **48.5%** | 21.1% | 7.1% | 6.6% | 15.8% |
| Stockholders' equity per share | **$ 19.05** | $ 17.91 | $ 16.81 | $ 15.78 | $ 14.94 |
| Return on average stockholders' equity | **7.9%** | 9.1% | 8.6% | 10.5% | 23.7% |
| Cash dividends declared per common share | **$ .30** | $ .30 | $ .30 | $ .30 | $ .25 |

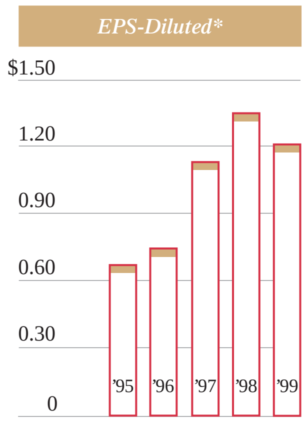
*[a] Excludes operations to be disposed of, discontinued operations and unusual items.*

*[b] Excludes discontinued operations; includes operations to be disposed of and unusual items.*

*[c] Total assets include $16,635 of net assets from discontinued operations and operations to be disposed of for 1999, $31,962 of net assets from discontinued operations and operations to be disposed of for 1998, and $42,095 of net assets from discontinued operations and operations to be disposed of for 1997. Long-term debt includes $9,948 from operations to be disposed of for 1997.*




**Continuing segments*

While no President likes to begin a report to his shareholders with a negative, there's no other way to put it—1999 was not a good year and was a personal disappointment to me. Two things occurred during the year which caused me to have regrets for the first time during the six years that I have been CEO. The *first* was a decline in earnings from continuing segments from $1.30 to $1.21 per share and the *second* was a decline in our stock price from $17.50 to $8.00 per share. Up to now, I have neither experienced an earnings decline for the year nor encountered such volatility in our stock price. Let me summarize for you our performance in 1999.

Two numbers best characterize our performance during the year. Earnings for the first half were $.32 per share and for the second half were $.87 per share. In the first half, we did three things poorly. First, we did not downsize Woods soon enough to the correct levels after the loss of a major customer. Second, we started a complicated systems change and the consolidation of GC Electronics and Waldom thereby disrupting their businesses. Third, we had a substantial shortfall of orders at Wilen/Disco.

As a result, by April, we took additional corrective measures at Woods, we completed the consolidation of GC and Waldom in September and through increased marketing and sales efforts at Wilen orders picked up substantially by mid-year. We still have work to do to improve Disco's sales, we must substantially improve the throughput at GC/Waldom and Wilen and we must improve and complete GC/Waldom's systems change over.

As the numbers indicate, the second half of the year proved much more satisfactory. Woods, both in the US and particularly in Canada, performed well. Woods' second half performance is a tribute to their management because, as we had announced, we were reviewing whether it was in Katy's best interest to sell our Electrical/Electronics businesses. I am pleased that our ultimate decision was to keep these businesses and Woods' performance in the second half of the year, even with the pressure of the unknown, was admirable and confirmed that our decision to keep this business was the right one. The second half performance for our maintenance companies was very good. With the exception of Wilen and Disco, all of the maintenance companies posted significant year-to-year improvements and our first year with Contico was right on budget.

***Overall Financial Results*** Our financial results other than earnings and stock price were quite good. Revenues increased $224,000,000 from $342,000,000 to $566,000,000. Net income was down $2,600,000 from $13,100,000 to $10,500,000. My favorite measure, income from all operations increased $10,890,000 from $16,500,000 in 1998 to $27,390,000 in 1999. Obviously our interest cost exceeded this increase. However, our management of cash was excellent reducing our debt load from $172,000,000 after the Contico acquisition in early 1999 to $151,000,000 at year-end. This reduction occurred even though we spent $21,000,000 on capital expenditures as an investment in our future. $7,600,000 of the above cash came from the divestitures of Airtronics, Diehl and Peters. We still are looking at ways to divest Savannah and we have had discussions concerning the divestiture of our interest in Bee Gee. We are striving to dispose of both of these operations during 2000.

***The Future and Other Positives*** We have had a number of positive developments in 1999 that have not yet been translated into earnings. Our branding program at Woods with ACDelco™ and IBM® has started out well. Our new products at Contico, both retail and sanitary maintenance, have had outstanding acceptance. One of our new products at the retail level was sold out completely for the year to the first customer who saw it. Our new bucket & wringers, hospitality cart, coolers and trash receptacles were the talk of the

**John R. Prann, Jr.**
*President, Chief Executive Officer*

International Sanitary Supply Association's convention. We also hired six former Rubbermaid rep companies as the changes at Newell Rubbermaid included going with direct company sales people in the marketplace rather than reps. We, on the other hand, have a long-standing commitment to using independent representatives to sell our products. As an example, our Glit/Microtron representatives are responsible for growing our business from a small $1,000,000 manufacturer of floor pads to the leader in a $125,000,000 marketplace beating the former 80% market share leader 3M. We have the broadest line of Jan/San products of any of our competitors and I am very confident that with our team of management and reps that we will be the dominant player within the next three years. We intend to accomplish this the old fashioned way—low cost and great service.

On the retail side for both electrical and plastics I am equally confident that our product lines are already or will be major players. In a recent Consumer Reports article, Woods' IBM® surge suppressor received the highest rating of any surge suppressor tested under $35, and our Yellow Jacket line of contractor cords are selling very well. Our team at Contico has developed an array of new products to defend our strong position in shelving, storage and automotive. Furthermore, as I've discussed in the past, retailers are brutal on price points, but have shown an enthusiasm for innovation of products and marketing to the point that I believe there is developing a true partnership with their major vendors.

Obviously Katy's future performance will depend on how we implement these opportunities. During 2000, we will take advantage of the above opportunities and intend to outperform 1999. That being said, as we indicated last fall, the first quarter of 2000 will be weak as a result of plastic resin prices increasing from $.23/lb to $.40/lb last year. We are encouraged that the prices of polyethylene and polypropylene appear to have plateaued, and have even decreased slightly. If resin prices continue to fall or if we get product price increases, 2000 will be a very good year.

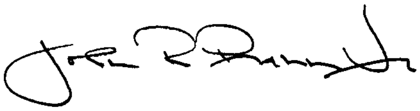
***Goals*** We achieved all of last year's goals with the exception of the earnings goal. The other four goals will always be works in process, but I am pleased with our progress.

This year's goals are:

- Improve earnings
- Improve our stock price

Katy is a public company and as such must create value for all of its shareholders. Every executive, manager and employee of Katy knows the importance I place on creating that value. 2000 is the year to prove it.

**Sincerely,**



**John R. Prann, Jr.**
*President, Chief Executive Officer*

*Continental Manufacturing's buckets, wringers, and other plastic tools (far left) and Glit/Microtron's abrasive floor pads (near left) are prime examples of Katy products serving the Janitorial/Sanitation market.*

*Wilen's mops, brooms and brushes (middle) fit naturally into Katy's maintenance products offerings, while Glit/Disco offers an array of products (bottom) to the food service industry.*

The businesses of Katy's Maintenance Products group include Continental Manufacturing and Contico Consumer Manufacturing, both divisions of Contico International, Duckback Products, Glit/Disco, Glit/Gemtex, Glit/Microtron, Loren Products, and Wilen Products. Collectively, these businesses manufacture and distribute sanitary maintenance supplies, consumer storage, home and automotive products, professional cleaning products, abrasives and coating products. Because these products lend themselves to recurring need, the maintenance product market maintains a steady pattern of growth, regardless of fluctuations in the economy and other outside influences.

Katy's Maintenance Products group serves industrial markets, including the sanitary maintenance, automotive, construction, food service, and professional paint segments, as well as the retail markets, including the do-it-yourself hardware and household consumer markets. The United Kingdom operation services the European retail and commercial markets while the Canadian operation services the industrial and commercial markets in Canada.

These businesses are recognized as leaders in the markets they serve and the Glit, Microtron, Contico, Continental, Wilen, Gemtex, Disco, and Duckback brands are well known and respected for quality, service, and price. They have attained their market leadership positions while competing directly with brands such as 3M, Newell Rubbermaid and Norton.

The strength of the Katy Maintenance Products group is focused on creative brand and private label marketing and promotion, flexible manufacturing, and customer service driven personality. The Katy Maintenance Products group strives to be the low cost producers in the major markets served.

These businesses will continue to fulfill the needs of their customers and grow their collective business through:

- Broader product offerings of mops, buckets, floor pads and brushes to the industrial markets.
- The most innovative, user-friendly designs for the retail markets.
- Ordering and delivery programs to lower customer transaction costs dramatically.
- Unique marketing flexibility to offer customers both recognized brand names as well as private-label.
- Shared marketing programs combined with experienced market representatives to create more dynamic growth nationally in all business segments.
- Developing business to business e-commerce strategies to facilitate and expedite knowledge-information exchange/ordering efficiencies and solutions.
- Continued commitment and expansion of the companies' national rep organizations to expand their competitive advantage with a more responsive, knowledgeable, and local-market intelligent sales force than the competitors.

Through these shared visions and strategies, the Katy Maintenance group will be more responsive and innovative, and customers will benefit from these shared economic benefits to create and cement a deeper, more integrated relationship. The Katy Maintenance group remains committed to its distributors and national rep organizations, and having been an aggressive and far-reaching consolidator in the maintenance industry, will continue to respond to every opportunity today, and the evolving needs of the markets tomorrow.

*One of the new product offerings from Contico's consumer division are clear plastic storage containers with ergonomic handles (top). Duckback Products offers a full line of premium quality coatings and restoration products for wood and concrete, sold through leading home centers, paint and decorating retailers and lumberyards (middle).*



*Glit/Gemtex produces abrasive products (far right) used in the industrial, automotive and OEM markets, while Loren manufactures and distributes Brillo™ (near right) and Boraxo™ soap pads and roofing products in commercial markets.*


*Woods Canada's NOMA® consumer electronic products (far left) have allowed Katy to gain market strength in Canada, while the Woods Yellow Jacket® (near left) is recognized as the toughest brand of contractor grade extension cords.*


*ACDelco™ retractable cord reels and lights (middle) and the IBM® line of computer accessories (bottom) are prime examples of successful licensed branding efforts by Woods Industries.*

The businesses of Katy's Electrical/Electronics group include Woods North America, GC/Waldom, and Hamilton Precision Metals.

Woods North America is a leading manufacturer and distributor of electrical and electronic consumer products and non-powered hand tools for the do-it-yourself and professional markets. Woods North America is comprised of Woods Industries and Thorsen Tool, based in Carmel, Indiana, and Woods Canada, located in Toronto. Woods North America contributed 28% of Katy's total sales in 1999, and is a key component to the future growth of Katy.

The strength of Woods North America arises from four distinct competitive factors:

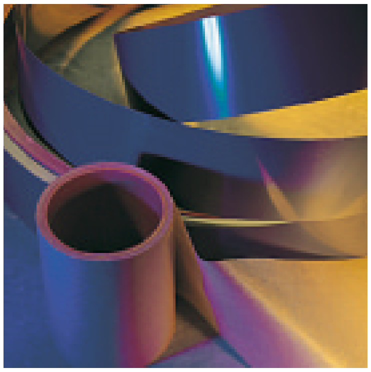
- A corporate brand strategy that brings proprietary & licensed brands to the North American markets. In addition to the Woods brand in the United States and NOMA®, the leading electrical brand in Canada, Woods North America serves their customers with ACDelco™, IBM®, Ameritech®, & Zenith product offerings.
- State of the art manufacturing and distribution methods position Woods North America as the low cost provider to its targeted channels of distribution.
- Continued commitment to product innovation complements the companies' corporate brand strategy.
- Superior customer service that earns and maintains customer loyalty.

The breadth and uniqueness of Woods' product offerings, merchandised under the most prominent consumer brands in the world, provides the company with the opportunity to develop long term relationships with its retail partners. Supporting these relationships are state-of-the-art information systems, and dedicated customer account teams that allow for vendor-assisted management activities which translate into higher performance at the point of purchase, benefiting both the customer and Woods.

In late 1998, Katy Industries made the strategic decision to consolidate the operations of GC Electronics and Waldom Electronics to take advantage of cross-selling and cost reduction opportunities. This was driven by substantial overlap in customer base and the strong market presence of GC and Waldom within the electrical and electronics distribution industry. The resulting GC/Waldom Electronics, Inc. is a wholesaler/distributor servicing the electronics and electrical component marketplace. Its products are sourced domestically and abroad and sold as both private label and branded products. GC/Waldom has a unique market position as a "master" distributor giving the company a significant competitive advantage. GC/Waldom has over 70 years of experience as a specialist in the sourcing, packaging and distribution of electrical and electronic components and accessories. GC/Waldom is an authorized master distributor for industry leading manufacturers such as AMP, Molex, Littlefuse and Cherry Electrical Products. Katy expects to reap the benefit of the consolidation of these two operations in 2000 and future years.

Hamilton Precision Metals is a leader in the specialized niche market of alloy re-rolling for highly specialized strip and foil. At its 100,000 square foot plant in Lancaster, Pennsylvania, Hamilton employs state-of-the-art technology and sophisticated equipment to re-roll almost every alloy made. The majority of Hamilton's product output is generated for sale to the electronics and medical industries.

*Thorsen Tools (top) are high quality, lifetime guaranteed non-powered hand tools. Hamilton Precision Metals (middle) maintains a unique niche as a re-roller of alloys for the electronics, communications and medical equipment markets.*



*GC/Waldom Electronics is a recent combination of GC Electronics, which packages and distributes electronic parts and accessories (far right), and Waldom Electronics, a master distributor of electrical components, accessories and loudspeakers (near right).*

## Maintenance Products

| Date Acquired | Address | Business | Markets Served |
|---|---|---|---|
| 1999 | Contico Manufacturing<br>305 Rock Industrial Park Drive<br>Bridgeton, MO 63044<br>(800) 831-7077 | Manufacturer and distributor of consumer and OEM plastic products | Home Improvement, Retail, Automotive, Food Service and OEM |
| 1999 | Continental Manufacturing<br>13330 Lakefront Drive<br>Earth City, MO 63045<br>(800) 325-1051 | Manufacturer and distributor of plastic tools and containers as well as other cleaning maintenance essentials | Sanitary Maintenance markets, including Institutional, Food Service and OEM |
| 1998 | Wilen Products, Inc.<br>3760 Southside Industrial Pkwy<br>Atlanta, GA 30354<br>(404) 366-2111 | Manufacturer of professional cleaning products, including mops, brooms, brushes and plastic tools | Sanitary Maintenance markets including Institutional and Food Service. Consumer markets including Retail and Home Improvement |
| 1998 | Glit/Disco, Inc.<br>1895 Brannan Road<br>McDonough, GA 30253<br>(770) 474-7575 | Manufacturer and distributor of cleaning and specialty food service products | Food Service markets |
| 1997 | Loren Products<br>250 Canal Street<br>Lawrence, MA 07840<br>(978) 685-0911 | Manufacturer and distributor of both abrasive (Brillo™ and Boraxo™ brands) and roof ventilation products | Sanitary Maintenance markets including Institutional and Food Service, as well as Residential/ Commercial Building industry |
| 1995 | Glit/Gemtex, Ltd.<br>60 Belfield Road<br>Etobicoke, Ontario<br>Canada M9W 1G1<br>(416) 245-5605 | Manufacturer and distributor of coated abrasives and standard abrasive products | Automotive, OEM, and Consumer Markets, as well as Institutional and Food Service Sanitary Maintenance markets |
| 1991 | Duckback Products, Inc.<br>2644 Hegan Lane<br>PO Box 980<br>Chico, CA 95927<br>(530) 343-3261 | Manufacturer and distributor of exterior transparent stains (Superdeck brand), coatings, and water repellant sealants | Retail, Home Improvement, Hardware, and OEM Construction industries |
| 1981 | Glit/Microtron Abrasives, Inc.<br>809 Broad Street<br>PO Box 709<br>Wrens, GA 30833<br>(706) 547-6555 | Manufacturer of abrasive hand pads, floor pads, sponges, and sanding items | Sanitary Maintenance markets including Institutional and Food Service. Consumer Markets including Automotive, Home Improvement and Hardware |

## Electrical / Electronics

| Date Acquired | Address | Business | Markets Served |
|---|---|---|---|
| 1998<br>Canada | Woods Industries (Canada), Inc.<br>375 Kennedy Road<br>Scarborough, Ontario<br>Canada M1K 2A3<br>(416) 267-4614 | Manufacturer and distributor of consumer electric corded products, including garden lighting and timers | Professional, OEM and Consumer markets, including Home Improvement and Automotive |
| 1996 | Woods Industries, Inc.<br>510 Third Avenue SW<br>Carmel, IN 46032<br>(416) 267-4614 | Manufacturer and distributor of consumer electric corded products | Professional, OEM and Consumer markets, including Home Improvement and Automotive |
| 1995 | Thorsen Tools, Inc.<br>510 Third Avenue SW<br>Carmel, IN 46032<br>(416) 267-4614 | Distributor of non-powered hand tools | Automotive and Home Improvement |
| 1995/1975 | GC/Waldom Electronics, Inc.<br>1801 Morgan Street<br>PO Box 1209<br>Rockford, IL 61102<br>(815) 968-9661 | Distributor and packager of electrical and electronic parts, accessories, components and loudspeakers | Cable, Home Entertainment, Hardware, Home Improvement, Technical Services Contractors, Communications, Automotive |
| 1975 | Hamilton Precision Metals, Inc.<br>1780 Rohrerstown Road<br>Lancaster, PA 17601<br>(717) 569-7061 | Re-roller of a wide range of precision strip and foil for various industries | Electronics, Communications, Medical Equipment |

| Years ended December 31, (Thousands of dollars, except per share data and ratios) | **1999** | 1998 | 1997 | 1996 | 1995 |
|---|---|---|---|---|---|
| Net sales | **$ 565,941** | $ 342,315 | $ 286,023 | $ 156,024 | $ 136,093 |
| Net income | | | | | |
| Continuing segments— | | | | | |
| businesses to be retained | **$ 10,441** | $ 11,007 | $ 9,435 | $ 5,803 | $ 6,046 |
| Unusual Items [a] | **1,848** | — | 387 | 6,685 | 22,520 |
| Operations to be disposed of | **(134)** | 2,075 | (179) | 275 | (2,139) |
| Continuing operations | **12,155** | 13,082 | 9,643 | 12,763 | 26,427 |
| Discontinued operations [b] | **(1,700)** | — | 1,959 | 953 | 2,144 |
| Net income | **$ 10,455** | $ 13,082 | $ 11,602 | $ 13,716 | $ 28,571 |
| Earnings per share—Basic | | | | | |
| Continuing segments | **$ 1.25** | $ 1.33 | $ 1.14 | $ .70 | $ .67 |
| Unusual Items [a] | **.22** | — | .05 | .80 | 2.51 |
| Operations to be disposed of | **(.02)** | .25 | (.03) | .03 | (.24) |
| Continuing operations | **1.45** | 1.58 | 1.16 | 1.53 | 2.94 |
| Discontinued operations [b] | **(.20)** | — | .24 | .11 | .24 |
| Earnings per common share | **$ 1.25** | $ 1.58 | $ 1.40 | $ 1.64 | $ 3.18 |
| Earnings per share—Diluted | | | | | |
| Continuing segments | **$ 1.21** | $ 1.30 | $ 1.12 | $ .70 | $ .67 |
| Unusual Items [a] | **.18** | — | .05 | .80 | 2.51 |
| Operations to be disposed of | **(.01)** | .25 | (.02) | .03 | (.24) |
| Continuing operations | **1.38** | 1.55 | 1.15 | 1.53 | 2.94 |
| Discontinued operations [b] | **(.17)** | — | .23 | .11 | .24 |
| Earnings per common share | **$ 1.21** | $ 1.55 | $ 1.38 | $ 1.64 | $ 3.18 |
| Total assets [c] | **$ 491,836** | $ 293,175 | $ 237,160 | $ 235,377 | $ 225,412 |
| Total liabilities and preferred interest | **331,525** | 143,859 | 97,989 | 105,331 | 95,082 |
| Stockholders' equity | **160,311** | 149,316 | 139,171 | 130,046 | 130,330 |
| Long-term debt, excluding current portion [c] | **150,835** | 39,908 | 9,948 | 8,582 | 9,346 |
| Depreciation and amortization [c] | **20,172** | 7,162 | 4,568 | 5,505 | 5,949 |
| Capital expenditures | **21,066** | 15,921 | 10,699 | 5,319 | 9,163 |
| Working capital [c] | **120,893** | 100,971 | 103,252 | 107,571 | 96,425 |
| Ratio of debt to capitalization | **48.5%** | 21.1% | 7.1% | 6.6% | 15.8% |
| Stockholders' equity per share | **$ 19.05** | $ 17.91 | $ 16.81 | $ 15.78 | $ 14.94 |
| Return on average stockholders' equity | **7.9%** | 9.1% | 8.6% | 10.5% | 23.7% |
| Weighted average common shares outstanding—Basic | **8,366,178** | 8,289,915 | 8,272,836 | 8,339,189 | 8,984,513 |
| Stockholders of record | **2,230** | 2,170 | 2,220 | 2,670 | 2,730 |
| Number of employees | **3,834** | 2,472 | 1,907 | 2,049 | 1,109 |
| Cash dividends declared per common share | **$ .30** | $ .30 | $ .30 | $ .30 | $ .25 |

*[a] Includes the following after-tax items for 1999: collections on previously reserved notes of $520,000, increase to LIFO inventory reserve of ($669,000), costs related to potential sale of Electrical/Electronics and other restructuring of ($753,000) and a reversal of income tax liabilities of $2,750,000; 1997: gain on sale of property of $387,000; 1996: gain on sale of investments of $6,685,000; 1995: gain on sale of investments of $20,095,000, and gain on insurance proceeds of $2,425,000.*

*[b] Loss from operations for Discontinued Operations has been recorded in the line item "Income (loss) from operations of discontinued businesses (net of tax)" on the 1999 Consolidated Statement of Operations. See Note 3 to Consolidated Financial Statements.*

*[c] Total assets include $16,635 of net assets from Discontinued Operations and Operations to be Disposed Of for 1999, $31,962 of net assets from Discontinued Operations and Operations to be Disposed Of for 1998, and $42,095 of net assets from Discontinued Operations and Operations to be Disposed Of for 1997. Long-term debt includes $9,948 from Operations to be Disposed Of for 1997. Depreciation and amortization includes $459, $1,640 and $2,230 from Discontinued Operations and Operations to be Disposed Of for 1999, 1998 and 1997 respectively. Working capital includes $737, $12,162 and $12,593 of net current assets from Discontinued Operations and Operations to be Disposed Of for 1999, 1998 and 1997 respectively. See Note 3 to Consolidated Financial Statements.*

### Results of Operations

For purposes of this discussion and analysis section, reference is made to the table below and the Company's Consolidated Financial Statements. Katy has two principal operating groups: Electrical/Electronics and Maintenance Products. Under the Divestiture and Reorganization Plan announced during 1997, the Company has disposed of its entire previously reported Machinery Manufacturing Group and, accordingly that group has been reported as "Discontinued Operations" in the Consolidated Financial Statements. The other businesses being disposed of comprise only a portion of Katy's previously reported Distribution and Service Group and one of Katy's equity investments. The operations of these businesses have been reported as "Equity in income (loss) of operations to be disposed of" in the Consolidated Statement of Operations. For purposes of discussion and analysis, information for the Discontinued Operations and the Operations to be Disposed Of is presented below.

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

| Years ended December 31, *(Thousands of dollars)* | **1999** | 1998 | 1997 |
|---|---|---|---|
| ***Electrical/Electronics Group*** | | | |
| Net external sales | **$204,180** | $230,927 | $218,237 |
| Net intercompany sales | **59,992** | 32,103 | 175 |
| Income from operations [a] | **8,303** | 14,839 | 13,191 |
| Operating margin | **4.1%** | 6.4% | 6.0% |
| Identifiable assets | **133,890** | 126,362 | 112,156 |
| Depreciation and amortization | **2,557** | 1,652 | 398 |
| Capital expenditures | **3,434** | 7,348 | 5,138 |
| ***Maintenance Products Group*** | | | |
| Net external sales | **$361,761** | $111,388 | $ 67,786 |
| Net intercompany sales | **11,141** | 6,389 | 4,306 |
| Income from operations [a] | **29,458** | 8,401 | 6,328 |
| Operating margin | **8.1%** | 7.5% | 9.3% |
| Identifiable assets | **318,906** | 110,317 | 46,333 |
| Depreciation and amortization | **17,065** | 3,779 | 1,854 |
| Capital expenditures | **16,936** | 2,725 | 1,234 |
| ***Operations to be Disposed Of*** | | | |
| Net external sales | **$ 3,900** | $ 6,297 | $ 9,568 |
| Net intercompany sales | **—** | — | — |
| Income (loss) from operations | **(190)** | (3,262) | 122 |
| Operating margin (deficit) | **(4.9)%** | (7.3)% | 1.3% |
| Identifiable assets | **17,903** | 17,680 | 31,599 |
| Equity Investments | **6,988** | 7,034 | 6,500 |
| Depreciation and amortization | **5** | 1,009 | 1,549 |
| Capital expenditures | **429** | 5,126 | 3,034 |
| ***Discontinued Operations*** | | | |
| Net external sales | **$ 10,025** | $ 23,349 | $ 31,537 |
| Net intercompany sales | **—** | 146 | — |
| Income (loss) from operations | **(191)** | 1,663 | 3,046 |
| Operating margin (deficit) | **(1.9)%** | 7.1% | 9.7% |
| Identifiable assets | **—** | 16,975 | 18,486 |
| Depreciation and amortization | **454** | 631 | 681 |
| Capital expenditures | **80** | 547 | 1,252 |

| Years ended December 31, (Thousands of dollars) | 1999 | 1998 | 1997 |
|---|---|---|---|
| ***Corporate*** | | | |
| Corporate expenses [a] | **$ 9,990** | $ 7,965 | $ 6,496 |
| Identifiable assets | **22,405** | 24,535 | 43,818 |
| Depreciation and amortization | **91** | 91 | 86 |
| Capital expenditures | **187** | 175 | 41 |
| ***Company*** | | | |
| Net external sales [b] | **$579,866** | $371,961 | $327,128 |
| Net intercompany sales | **71,133** | 38,638 | 4,481 |
| Income from operations [b] | **27,390** | 13,676 | 16,191 |
| Operating margin [b] | **4.7%** | 4.4% | 4.9% |
| Identifiable assets [b] | **493,104** | 295,869 | 252,392 |
| Depreciation and amortization [b] | **20,172** | 7,162 | 4,568 |
| Capital expenditures | **21,066** | 15,921 | 10,699 |

*[a] Salaries and related costs for certain executive officers were included in Maintenance Products and Electrical/Electronics in 1998 and 1997, but have been included in Corporate Expense in 1999. These amounts were approximately $1,500,000 in 1999, $1,400,000 in 1998 and $900,000 in 1997.*

*[b] Company balances include amounts from both "Discontinued Operations" and "Operations to be Disposed Of" in the Consolidated Financial Statements for 1999, 1998 and 1997. The "Income (loss) from operations" for "Discontinued Operations" has been recorded in the line item "Income (loss) from operations of discontinued businesses (net of tax)" on the 1999 Consolidated Statement of Operations. See Note 3 to Consolidated Financial Statements.*

### *1999 Compared to 1998*

The Electrical/Electronics Group's sales decreased $26,747,000 or 12% primarily due to decreased volumes in the consumer electric corded products and electrical and electronic parts and accessories businesses, offset by increased volumes associated with the Company's Woods Canada acquisition in May of 1998. Excluding this acquisition, the Group's sales decreased $39,291,000. These lower volumes were primarily a result of the loss of consumer electric corded products business announced on November 4, 1998. As of that date, Katy's largest single customer withdrew its commitment to purchase electric corded products from Woods, resulting in a loss of sales of approximately $31,000,000. Another significant customer, Hechinger Company, filed for Chapter 11 bankruptcy in mid-1999. Sales to this customer were lower by $7,600,000 in 1999 compared to 1998.

The Group's operating income decreased $6,536,000 or 44% mainly as a result of decreased volumes and higher selling, general and administrative costs as a percentage of sales, offset slightly by the increased operating income associated with the Woods Canada acquisition in May of 1998. Excluding the acquisition, operating income decreased $8,278,000. A pre-tax restructuring charge of $600,000 relating primarily to severance costs for the elimination of 22 positions in the Electrical/Electronics businesses, and competitive market pressures in the electrical and electronic components business contributed to the decrease. Results are also negatively impacted by costs and operational considerations related to the consolidation of GC Electronics and Waldom Electronics during the later half of the year.

Identifiable assets for the Group increased slightly during the year mainly as a result of higher working capital levels at Woods and Woods Canada.

Sales from the Maintenance Products Group increased $250,373,000 or 225% primarily as a result of the Contico acquisition in January of 1999, the Disco acquisition in May of 1998 and the Wilen acquisition in August of 1998. Excluding these acquisitions, the Group's sales increased $5,663,000 or 7% primarily due to increased volumes in the Group's coated abrasive and stain businesses.

The Group's operating income increased $21,057,000 or 251%. Excluding the acquisitions mentioned above, operating income increased $2,645,000. The increase was primarily a result of the increased volumes and the slightly higher margins in the stain and coated abrasives businesses. The higher margins resulted from the introduction of new products and a favorable product mix.

Identifiable assets for the Group increased during the year mainly as a result of the previously announced acquisition of Contico in January of 1999.

Sales from Operations to be Disposed Of decreased $2,397,000 or 38%, mainly as a result of decreased volumes associated with the disposal of the refrigeration and cold storage facilities business in June of 1998. Excluding the disposition, sales remained relatively stable compared to the prior year.

The Group's operating income increased $3,072,000 or 94% primarily as a result of an impairment recorded at the waste-to-energy facility during the fourth quarter of 1998.

Identifiable assets for the Group remained relatively stable from the prior year.

Sales from Discontinued Operations decreased $13,324,000 or 57% primarily as a result of the disposition of Bach Simpson, Ltd., in January of 1999, Diehl Machines, Inc., in May of 1999, and Peters Machinery, Inc., in September of 1999. All of the companies included in Discontinued Operations had been disposed of as of December 31, 1999. See Note 3 to the Consolidated Financial Statements.

The Group's operating loss decreased $1,854,000 or 112% primarily as a result of the dispositions described above.

Corporate expenses increased $2,025,000 or 25%. This increase was primarily a result of allocating certain employees salaries and related costs to the corporate segment for the year ended December 31, 1999. Corporate expenses also included $303,000 of costs associated with the potential sale of the Electrical/Electronics segment.

Identifiable assets at Corporate decreased primarily as a result of lower cash levels at year end.

Although the results of these operating groups can be significantly affected by the strength of the general economy, the Company believes that it has positioned itself well in segments that can be expanded both externally through acquisitions and internally through new products, operational improvements and increased market penetrations.

Following is a discussion concerning other factors that affected the Company's net income.

Gross profit from continuing operations increased $75,995,000 or 77% as gross margin percentages increased to 31% from 29% in 1998. The increase in gross profit is primarily a result of the Contico acquisition in January of 1999. Gross margins in 1999 were negatively impacted by $1,029,000 as a result of the adoption of LIFO inventory accounting for its Contico subsidiary acquired in January of 1999. The LIFO method is not used by any other subsidiary and was not used by Katy in 1998 or 1997. The increased expense due to LIFO accounting resulted from price increases for the thermoplastic resins, a significant raw material in the Contico production process. Selling, general and administrative expenses increased $63,499,000 or 76% in 1999 compared to the prior year. Selling, general and administrative expenses increased as a percentage of sales to 26% in 1999 from 24% for the same period in 1998. The increase was primarily a result of the increased amortization of goodwill and other intangibles associated with the acquisitions during 1998 and the first part of 1999 combined with the restructuring charge, costs related to the potential sale of the Electrical/Electronics Group and costs to restructure Contico's outside sales force.

Interest expense increased substantially for 1999 compared to 1998, as a result of increased interest expense associated with bank borrowings to fund the Company's acquisitions. Interest income decreased slightly due to the Company maintaining lower average cash and cash equivalent balances during 1999 compared to 1998. Other, net in 1999 was income of $1,620,000 versus income of $1,523,000 in 1998. The amounts in both years resulted from the Company receiving past due balances on previously written-off notes and investments.

Income before provision for income taxes decreased to $17,050,000 in 1999 from $19,821,000 in 1998. In addition to the factors mentioned previously, other items affecting income in 1998 were the gain on sale of the Company's cold storage facility of $6,122,000, which was partially offset by the impairment loss resulting from the reduction in the fair value of the waste-to-energy facility of $2,800,000 being recorded in "Equity in income (loss) of operations to be disposed of" on the Consolidated Statement of Operations. Excluding these items, the income from continuing operations before income taxes increased $551,000, primarily as a result of increased operating income from the Maintenance Products Group, offset partially by decreased operating income in the Electrical/Electronics Group.

Provision for income taxes in 1999 was $3,217,000 or an effective tax rate of 19% and $6,739,000 or an effective tax rate of 34% in 1998. The decrease in the 1999 effective tax rate resulted from the reversal of income tax reserves as a result of the expiration of the relevant statute of limitations with respect to certain income tax returns, or the resolution of specific income tax matters with the relevant tax authorities.

### *1998 Compared to 1997*

The Electrical/Electronics Group external sales increased $12,690,000 or 6%. The increased sales were primarily a result of the Woods Canada acquisition in May of 1998. Excluding the Woods Canada acquisition, sales decreased $10,223,000 or 5% due to lower volumes in the electric corded products and the distribution of electronic and electrical components, parts and accessories. These decreases were a result of unfavorable line reviews from major customers pertaining to our electric corded products business and additional program pricing pressures in the Electrical/Electronics segment.

Operating income for the Group increased $1,648,000 or 12%. Excluding the increased volumes associated with the Woods Canada acquisition, operating income increased 5%. This increase was attributable to increased margins in the specialty metal business resulting from favorable product mix. These increases were partially offset by lower volumes associated with the line reviews discussed above and higher selling, general and administrative costs as a percentage of sales in the electric corded products and electrical components, parts and accessories businesses. Consolidation and intense pricing pressures by national distributors had a negative impact on both revenues and margins in the electrical components, parts and accessories businesses.

Identifiable assets for the Group increased during the year mainly as a result of the Woods Canada acquisition in May of 1998.

Sales for the Maintenance Products Group increased $43,602,000 or 64%. The increase in sales was primarily due to the Disco acquisition in May of 1998, the Wilen acquisition in August of 1998, and a full year of sales from Loren, acquired in August of 1997. Excluding these acquisitions, sales increased approximately $3,600,000 due to general volume increases in the previously owned sanitary maintenance and stain businesses.

Operating income for the Group increased $2,073,000 or 33%. Excluding the Maintenance Products Group acquisitions discussed above, operating income increased $911,000 or 14% primarily as a result of the above mentioned volume improvements offset partially by slightly lower margins in the stain and sanitary maintenance businesses.

Identifiable assets for the Group increased during the year mainly as a result of the previously announced acquisitions of Disco and Wilen in 1998.

Sales for Operations to be Disposed Of decreased $3,271,000 or 34%. The decrease was a result of lower volumes associated with the disposition of the cold storage facility business in June of 1998. Excluding the disposition, sales remained relatively stable in 1998 compared to 1997.

Operating income for Operations to be Disposed Of decreased $3,384,000. The decrease was primarily a result of an impairment related to the waste-to-energy business combined with the disposition of the cold storage facility in June of 1998. Excluding the impairment and disposition, operating income decreased slightly due to lower margins in the waste-to-energy business.

Identifiable assets for Operations to be Disposed Of decreased during the year mainly as a result of the previously announced disposition of the Company's cold storage facility in June of 1998.

Sales for Discontinued Operations decreased $8,188,000 or 26%. The decrease in sales was primarily a result of the disposition of Beehive effective July 1997, combined with lower volumes in the cookie sandwich machinery, wood processing machinery and gauging and control systems businesses.

Operating income for Discontinued Operations decreased $1,383,000 or 45%. The decrease in operating income was primarily a result of lower volumes combined with diminished margins in the wood processing machinery and cookie sandwich machinery businesses.

Corporate expenses increased $1,469,000 or 23%. This increase was mainly a result of banking fees, increased outside service fees and salary and compensation increases for 1998 as compared to 1997.

Identifiable assets at Corporate decreased primarily as a result of lower cash levels at year end.

Although the results of these operating groups can be significantly affected by the strength of the general economy, the Company believes that it has positioned itself well in segments that can be expanded both externally through acquisitions particularly in the electrical/electronics and maintenance products areas, and internally through new products, operational improvements and increased market penetrations.

Following is a discussion concerning other factors that affected the Company's net income.

Gross profit from continuing operations increased $19,541,000 or 25% as gross margins increased slightly to 29% from 28% in 1997 while selling, general and administrative expenses increased $17,289,000 or 26% in 1998 compared to the prior year. The increase in gross profit and selling, general and administrative expenses is attributable to both the increased volumes and the acquisition activity previously mentioned.

Interest expense increased $978,000 from 1997 primarily as a result of the borrowings associated with the acquisition of Wilen in August of 1998. Interest income decreased slightly due to the Company maintaining lower average cash and cash equivalent balances during 1998 compared to 1997.

Other, net in 1998 was income of $1,523,000 versus income of $920,000 in 1997. The increase was a result of the Company receiving past due balances on previously written-off investments.

Income before provision for income taxes increased to $19,821,000 in 1998 from $14,565,000 in 1997. The increase resulted primarily from the gain on sale of the Company's cold storage facility of $6,122,000, which was partially offset by the impairment loss resulting from the reduction in the fair value of the waste-to-energy facility of $2,800,000 being recorded in "Equity in income (loss) of operations to be disposed of" on the Consolidated Statement of Operations. Excluding these items, the income from continuing operations before income taxes increased $1,934,000 primarily as a result of increased operating income from both the Electrical/Electronics and the Maintenance Products Groups.

Provision for income taxes in 1998 was $6,739,000 or an effective tax rate of 34% and $4,922,000 or an effective tax rate of 34% in 1997.

### *Liquidity and Capital Resources*

Combined cash and cash equivalents decreased 23% to $9,988,000 on December 31, 1999, from $12,898,000 on December 31, 1998, mostly due to maintaining a lower cash balance due to better application of cash against long-term debt at year end. Excluding the current year acquisitions, cash flow from operations was substantial enough to cover liquidity and capital resource requirements. Current ratios were 2.03 to 1.00 and 2.52 to 1.00 at December 31, 1999 and 1998, respectively. Working capital increased 20% to $120,893,000 on December 31, 1999, from $100,971,000 on December 31, 1998. This increase is attributable to the Contico acquisition in January of 1999. Excluding this acquisition, working capital decreased approximately 17%.

At December 31, 1999, Katy had short and long-term indebtedness of $150,902,000, substantially all of which was outstanding under an unsecured revolving credit agreement. Total debt was 48.5% of total capitalization at December 31, 1999. The Company had $159,000,000 outstanding under this agreement as of March 17, 2000. See Note 6 to Consolidated Financial Statements for further discussion. Interest accrues at a rate equal to LIBOR plus 2% and ranged from (6.73–8.13%) in 1999. The principal outstanding under the agreement at December 31, 1999 is currently due at the current expiration date of the facility on December 11, 2001.

Katy has authorized and expects to commit approximately $24,000,000 for capital projects in 2000, exclusive of acquisitions, if any. Also, on February 26, 2000, the Company's Board of Directors authorized management to spend up to $5,000,000 over a twelve month period for the repurchase of Katy common stock in the open market. The Company expects to meet these cash requirements through the use of available cash and internally generated funds. The revolving credit agreement has certain covenants which limit the Company's borrowing capacity.

In addition to constantly striving for improved earnings results, the Company is focusing on further improving its management of working capital to ensure optimal utilization of its assets. The Company's financial plans for 2000 focus on efforts in both of these areas.

Management continuously reviews each of its businesses. As a result of these ongoing reviews, management may determine to sell certain companies and may augment its remaining businesses with acquisitions. When sales do occur, management anticipates that funds from these sales will be used for general corporate purposes or to fund acquisitions. Acquisitions may also be funded through cash balances, available lines of credit and future borrowings. See Notes 2 and 3 to Consolidated Financial Statements for further discussion.

### *Restructuring and Evaluation of Alternatives for Electrical/Electronics Segment*

In June 1999, the Company announced a restructuring plan for its Electrical/Electronics businesses as a result of weaker than expected sales performance and lower margins. The restructuring plan included (i) making substantial cost reductions in these operations, (ii) intensifying the marketing and product development efforts initiated earlier in the year; and, (iii) accelerating the consolidation of operations within the segment begun earlier in the second quarter.

The cost of this restructuring, which includes severance costs related to the elimination of 22 management employees, resulted in a pre-tax charge to earnings in the second quarter of approximately $600,000. Additionally, plant personnel levels were reduced in excess of 100 persons and 24 unfilled administrative positions were eliminated.

Concurrently, the Company announced that it retained Donaldson, Lufkin & Jenrette Securities Corporation to assist in exploring strategic alternatives relating to the Electrical/Electronics businesses, including the possible sale thereof. Prior to year end, the Company announced that after reviewing various alternatives, it had decided to retain the Electrical/Electronic businesses. The Company believes that with the consolidation of GC Electronics and Waldom Electronics, and the restructuring and branding initiatives at Woods, substantially more value exists in these businesses than could be translated into a fair offer at the time alternatives were being evaluated.

### *New Accounting Pronouncements*

In September 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities". This statement requires that all derivatives be recognized as either assets or liabilities in the statement of financial position and requires that those assets and liabilities be measured at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and its resulting designation. In September

1999, the FASB issued Statement No. 137, which delays the required implementation of Statement No. 133 to years beginning after June 15, 2000. While the Company is still evaluating the potential effect of this statement, its adoption is not expected to have a significant impact on the Company's financial position or results of operations.

### *Environmental and Other Contingencies*

In December 1996, Banco del Atlantico, a bank located in Mexico, filed a lawsuit against Woods, a subsidiary of the Company, 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 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 the Company's purchase of Woods. The plaintiff also alleges that it made loans to an entity controlled by certain officers and directors based upon fraudulent representations. The plaintiff seeks to hold Woods liable for its alleged damage under principles of respondeat superior and successor liability. The plaintiff is claiming damages in excess of $24,000,000 and is requesting treble damages under the statutes. The defendants have filed a motion, which has not been ruled on, to dismiss this action on jurisdictional grounds. Because the litigation is in preliminary stages, it is not possible at this time for the Company to determine an outcome or reasonably estimate the range of potential exposure. The Company 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 the Company 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. The extent or limit of any such recourse cannot be predicted at this time.

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. It can take up to 10 years from the date of the injury to reach a final outcome for such 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, 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 the final outcome.

The Company and certain of its current and former direct and indirect corporate predecessors, subsidiaries and divisions have been identified by the United States Environmental Protection Agency, 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 in the aggregate amount of approximately $4,100,000 at December 31, 1999. The ultimate cost 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. The Company expects this amount to be substantially paid over the next one to four years.

The most significant environmental matters in which the Company is currently involved are as follows:

1. In 1993, the United States Environmental Protection Agency ("USEPA") 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 USEPA 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.

2. During 1995, the Company reached agreement with the Oregon Department of Environmental Quality ("ODEQ") as to a cleanup plan for PCB contamination at the Medford, Oregon facility of the former Standard Transformer division of American Gage. The agreement required the Company to pay $1,300,000 of the first $2,000,000 in cleanup costs. Those funds were expended in 1998. Another former occupant of the site, Balteau Standard, Inc. was responsible for the remaining $700,000 of the first $2,000,000 and the next $450,000 in cleanup costs above the $2,000,000. The parties are now sharing equally in cleanup costs. Katy believes the cleanup plan has been successful and has requested that the ODEQ inspect and approve the remediation work. Katy has received such approval with respect to a portion of the cleanup plan. Further monitoring of groundwater and testing and cleanup of adjacent property may be required before approval can be obtained with respect to the remainder of the plan. Pending such approval, the liability of Katy and its subsidiary cannot be determined at this time.

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

### *Year 2000*

The year 2000 issue was a problem that has a potentially material adverse impact on the Company as well as governments, businesses, and individuals throughout the world. The year 2000 issue related to computer programs and microchips that may not have been able to properly recognize the first two digits of a year, beginning after December 31, 1999. The problem was thought to have the potential to disrupt the operation of products and services that rely on these computer programs or microchips.

Based on assessment activities conducted by the Company beginning in 1997 regarding the year 2000 problem, the Company determined that the modification or replacement of a moderate number of computer programs and microchips was required. The changes required were necessary for a wide variety of assets which included, but were not limited to, computer hardware and software, production machinery and phone systems. The Company believes that it identified the major sources of potential internal year 2000 issues and implemented a Company-wide year 2000 remediation program (the "Y2K Program") during 1998 which included the performance of due diligence procedures for all acquisitions made by the Company. The Company had completed the Y2K Program as of December 31, 1999. The Company believes that the Y2K Program mitigated all known significant potential internal year 2000 problems. The Company will continue to investigate additional year 2000 risks as they come to the attention of the Company.

While the Company has not been informed of, nor experienced any problems with, any material risks associated with its critical suppliers, financial institutions, public utilities and other entities, there is no guarantee of the year 2000 readiness of those entities or the potential material adverse effect on the Company.

The Company has expensed approximately $850,000 of costs incurred to date related to the Y2K Program and does not expect material costs in the future.

### *Outlook for 2000*

Net sales are expected to increase in 2000 over 1999, due to the introduction of new products and core growth in the Maintenance Products Group and the resurgence of business in the Electrical/Electronics Group after 1999's results, which were significantly impacted by the loss of business announced in November of 1998.

Cost of goods sold are expected to be negatively impacted in 2000 by higher costs for polyethylene, polypropylene, and other thermoplastic resins (based on price levels in early 2000) that are used in the Company's production processes, especially at Contico. Prices for copper, a significant raw material in the Electrical/Electronics Group, may also increase in 2000. The Company anticipates mitigating these costs by creating efficiencies in and improvements to its production processes.

Selling, general and administrative costs are expected to remain stable from 1999 levels.

Interest expense is also expected to be relatively stable in 2000, with lower debt levels offset by expected higher interest rates.

The effective tax rate for 2000 is not expected to differ significantly from the federal statutory rate.

The above factors indicate that full year results from continuing segments for 2000 will be comparable to 1999. While many factors will impact the eventual results, an important component will certainly be the impact of plastic resin costs. Improved results for 2000 will depend on either softening resin prices or the Company achieving price increases on resin-based and other products.

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

This report contains "forward-looking statements" within the meaning of the federal securities laws. The forward-looking statements include, among others, statements concerning the Company's outlook for 2000, cost reduction strategies and their results, the Company's expectations for funding its 2000 capital expenditures and operations and other statements of expectations, beliefs, future plans and strategies, anticipated events or trends, and similar expressions concerning matters that are not historical facts. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ dramatically from those expressed in or implied by the statements.

To improve its financial performance, the Company must reduce its cost structure and improve its production efficiency, improve its management of working capital, and grow its existing base of retail and distribution customers. The most important factors that could influence the achievement of these goals, and cause actual results to differ materially from those expressed in the forward-looking statements, include, but are not limited to the following:

- Increases in the cost of plastic resins, copper, paper board packaging and other raw materials.
- The Company's inability to reduce manufacturing costs.
- The inability of the Company 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 the Company and its existing channels.
- The potential impact of rising interest rates on the Company's LIBOR-based credit facility.
- Labor issues, including union activities that require an increase in production costs or lead to a strike, thus impairing production and decreasing sales.
- Changes in significant laws and government regulations affecting environmental compliance and income taxes.

These and other risks and uncertainties affecting the Company are discussed in greater detail in this report and in the Company's filings with the Securities and Exchange Commission.



## *Quantitative and Qualitative Disclosures About Market Risk*

The Company's exposure to market risk associated with changes in interest rates relates primarily to its debt obligations and temporary cash investments. The Company currently does not use derivative financial instruments relating to either of these exposures. The Company's debt obligations are generally indexed from short-term LIBOR rates, and its temporary cash investments earn rates of interest available on securities with maturities of three months or less. The holder of the preferred interest has a put option which allows, at certain times beginning on January 8, 2001, or upon the occurrence of certain events, the preferred interest to be exchangeable for Katy common stock.

| | Expected Maturity Dates | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| *(In thousands)* | 2000 | 2001 | 2002 | 2003 | 2004 | Thereafter | Total | Fair Value |
| ***Assets*** | | | | | | | | |
| Temporary cash investments | | | | | | | | |
| Fixed rate | $5,400 | $ — | $ — | $ — | $ — | $ — | $ 5,400 | $ 5,400 |
| Average interest rate | 4.5% | — | — | — | — | — | 4.5% | |
| ***Long-term Debt*** | | | | | | | | |
| Fixed rate debt | $ 67 | $ 67 | $ 67 | $ 701 | $ — | $ — | $ 902 | $ 902 |
| Average interest rate | 7.14% | 7.14% | 7.14% | 7.14% | — | — | 7.14% | |
| Variable rate debt | $ — | $150,000 | $ — | $ — | $ — | $ — | $150,000 | $150,000 |
| Average interest rate | 6.86% | 6.86% | 6.86% | 6.86% | — | — | 6.86% | |
| ***Preferred Interest of Subsidiary*** | | | | | | | | |
| Fixed rate obligation | $ — | $ — | $ — | $ — | $ — | $32,900 | $ 32,900 | $ 32,900 |
| Average interest rate | 8.00% | 8.00% | 8.00% | 8.00% | 8.00% | 8.00% | 8.00% | |

## Management Report

Katy Industries, Inc. management is responsible for the fair presentation and consistency of all financial data included in this Annual Report in accordance with generally accepted accounting principles. Where necessary, the data reflects management's best estimates and judgements.

Management also is responsible for maintaining an internal control structure with the objective of providing reasonable assurance that Katy's assets are safeguarded against material loss from unauthorized use or disposition and that authorized transactions are properly recorded to permit the preparation of accurate financial data. Cost-benefit judgements are an important consideration in this regard. The effectiveness of internal controls is maintained by: (1) personnel selection and training; (2) division of responsibilities; (3) establishment and communication of policies; and (4) ongoing internal review programs and audits. Management believes that Katy's system of internal controls is effective and adequate to accomplish the above described objectives.

John R. Prann, Jr.
President and Chief Executive Officer

Stephen P. Nicholson
Vice President, Finance and Chief Financial Officer

## Report of Independent Accountants



TO KATY INDUSTRIES, INC.:

We have audited the accompanying consolidated balance sheets of KATY INDUSTRIES, INC., (a Delaware corporation) and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. The financial statements of Katy Industries, Inc. for the year ended December 31, 1997, were audited by other auditors, whose report dated January 26, 1998, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Katy Industries, Inc. and subsidiaries as of December 31, 1999 and 1998, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

Arthur Andersen LLP

Denver, Colorado
January 26, 2000

## *Consolidated Balance Sheets*

| As of December 31, *(Thousands of dollars)* | **1999** | 1998 |
|---|---|---|
| ***ASSETS*** | | |
| ***Current Assets:*** | | |
| Cash and cash equivalents—Note 1 | **$ 9,988** | $ 12,898 |
| Accounts receivable, trade, net of allowance for doubtful accounts of $1,424 and $963 | **95,153** | 53,449 |
| Notes and other receivables, net of allowance for doubtful notes of $0 and $198 | **1,896** | 3,246 |
| Inventories—Note 1 | **117,400** | 69,394 |
| Deferred income taxes—Note 11 | **8,497** | 13,268 |
| Other current assets | **4,121** | 3,158 |
| Net current assets of operations to be disposed of—Note 3 | **737** | 1,203 |
| Net current assets of discontinued operations—Note 3 | **—** | 10,959 |
| Total current assets | **237,792** | 167,575 |
| ***Other Assets:*** | | |
| Notes receivable, net of allowance for doubtful notes of $1,000 and $2,452 | **2,062** | 953 |
| Cost in excess of net assets acquired, net of accumulated amortization of $6,734 and $4,794—Notes 1 and 2 | **40,037** | 33,576 |
| Other intangibles, net of accumulated amortization—Note 2 | **52,491** | 23,621 |
| Miscellaneous—Note 7 | **4,769** | 2,551 |
| Net noncurrent assets of operations to be disposed of—Note 3 | **15,898** | 15,521 |
| Net noncurrent assets of discontinued operations—Note 3 | **—** | 4,279 |
| Total other assets | **115,257** | 80,501 |
| ***Properties***—Note 1: | | |
| Land and improvements | **1,771** | 1,435 |
| Buildings and improvements | **26,884** | 10,677 |
| Machinery and equipment | **142,627** | 60,340 |
| | **171,282** | 72,452 |
| Accumulated depreciation | **(32,495)** | (27,353) |
| Net properties | **138,787** | 45,099 |
| | **$491,836** | $293,175 |
| ***LIABILITIES AND STOCKHOLDERS' EQUITY*** | | |
| ***Current Liabilities:*** | | |
| Accounts payable | **$ 56,874** | $ 28,017 |
| Accrued compensation | **3,902** | 5,354 |
| Accrued expenses—Note 1 | **52,538** | 31,626 |
| Accrued interest and taxes | **2,887** | 910 |
| Current maturities, long-term debt—Note 6 | **67** | 72 |
| Dividends payable | **631** | 625 |
| Total current liabilities | **116,899** | 66,604 |
| ***Long-Term Debt,*** less current maturities—Note 6 | **150,835** | 39,908 |
| ***Other Liabilities***—Note 7 | **7,359** | 9,310 |
| ***Excess of Acquired Net Assets Over Cost,*** net of accumulated amortization of $5,022 and $3,319—Notes 1 and 2 | **3,495** | 5,198 |
| ***Deferred Income Taxes***—Note 11 | **20,037** | 22,839 |
| ***Commitments and Contingencies***—Notes 6, 12 and 15 | | |
| ***Preferred Interest of Subsidiary***—Note 8 | **32,900** | — |
| ***Stockholders' Equity***—Note 9: | | |
| Common stock, $1 par value; authorized 25,000,000 shares; issued 9,822,204 shares | **9,822** | 9,822 |
| Additional paid-in capital | **51,127** | 51,243 |
| Accumulated other comprehensive income | **(434)** | (2,309) |
| Other adjustments | **(1,010)** | (1,302) |
| Retained earnings | **120,689** | 112,784 |
| Treasury stock, at cost, 1,408,346 and 1,483,890 shares, respectively | **(19,883)** | (20,922) |
| Total stockholders' equity | **160,311** | 149,316 |
| | **$491,836** | $293,175 |

*See Notes to Consolidated Financial Statements.*

## *Consolidated Statements of Operations*

| For the years ended December 31, *(Thousands of dollars, except per share amounts)* | **1999** | 1998 | 1997 |
|---|---|---|---|
| Net sales | **$ 565,941** | $342,315 | $286,023 |
| Cost of goods sold | **391,382** | 243,751 | 207,000 |
| Gross profit | **174,559** | 98,564 | 79,023 |
| Selling, general and administrative expenses | **(146,788)** | (83,289) | (66,000) |
| Operating income | **27,771** | 15,275 | 13,023 |
| Equity in income (loss) of operations to be disposed of—Notes 2, 3 and 5 | **(206)** | 3,144 | (325) |
| Interest expense | **(12,950)** | (1,214) | (236) |
| Interest income | **815** | 1,093 | 1,183 |
| Other, net | **1,620** | 1,523 | 920 |
| Income before provision for income taxes and distributions on preferred interest of subsidiary | **17,050** | 19,821 | 14,565 |
| Provision for income taxes—Note 11 | **(3,217)** | (6,739) | (4,922) |
| Income from operations before distributions on preferred interest | **13,833** | 13,082 | 9,643 |
| Distributions on preferred interest of subsidiary (net of tax)—Note 8 | **(1,678)** | — | — |
| Income from continuing operations | **12,155** | 13,082 | 9,643 |
| Discontinued operations—Note 3: | | | |
| Income (loss) from operations of discontinued businesses (net of tax) | **(1,700)** | — | 1,959 |
| Net income | **$ 10,455** | $ 13,082 | $ 11,602 |
| Earnings per share of common stock—Basic (Note 4): | | | |
| Income from continuing operations | **$ 1.45** | $ 1.58 | $ 1.16 |
| Discontinued operations | **(.20)** | — | .24 |
| Net income | **$ 1.25** | $ 1.58 | $ 1.40 |
| Earnings per share of common stock—Diluted (Note 4): | | | |
| Income from continuing operations | **$ 1.38** | $ 1.55 | $ 1.15 |
| Discontinued operations | **(.17)** | — | .23 |
| Net income | **$ 1.21** | $ 1.55 | $ 1.38 |

*See Notes to Consolidated Financial Statements.*

# Consolidated Statements of Stockholders' Equity

| *(Thousands of dollars)* | Common Stock Number of Shares | Common Stock Par Value | Additional Paid-in Capital | Other Comprehensive Income (Loss) | Accumulated Other Adjustments | Retained Earnings | Treasury Stock | Comprehensive Income (Loss) |
|---|---|---|---|---|---|---|---|---|
| Balance, January 1, 1997 | 9,822,204 | $9,822 | $51,117 | $(1,288) | $ (490) | $ 93,099 | $(22,214) | |
| Net income | — | — | — | — | — | 11,602 | — | $11,602 |
| Foreign currency translation adjustments | — | — | — | (174) | — | — | — | (174) |
| Comprehensive income | | | | | | | | $11,428 |
| Common stock dividends | — | — | — | — | — | (2,481) | — | |
| Issuance of shares under Stock Purchase Plan—Note 9 | — | — | (31) | — | — | (26) | 295 | |
| Other issuance of shares—Note 9 | — | — | 41 | — | (324) | — | 876 | |
| Purchase of Treasury Shares—Note 9 | — | — | — | — | — | — | (653) | |
| Balance, December 31, 1997 | 9,822,204 | 9,822 | 51,127 | (1,462) | (814) | 102,194 | (21,696) | |
| Net income | — | — | — | — | — | 13,082 | — | $13,082 |
| Foreign currency translation adjustments | — | — | — | (847) | — | — | — | (847) |
| Comprehensive income | | | | | | | | $12,235 |
| Common stock dividends | — | — | — | — | — | (2,492) | — | |
| Issuance of shares under Stock Option Plan—Note 9 | — | — | (54) | — | — | — | 274 | |
| Other issuance of shares—Note 9 | — | — | 170 | — | (488) | — | 717 | |
| Purchase of Treasury Shares—Note 9 | — | — | — | — | — | — | (217) | |
| Balance, December 31, 1998 | 9,822,204 | 9,822 | 51,243 | (2,309) | (1,302) | 112,784 | (20,922) | |
| Net income | — | — | — | — | — | 10,455 | — | $10,455 |
| Foreign currency translation adjustments | — | — | — | 1,875 | — | — | — | 1,875 |
| Comprehensive income | | | | | | | | $12,330 |
| Common stock dividends | — | — | — | — | — | (2,514) | — | |
| Issuance of shares under Stock Option Plan—Note 9 | — | — | (37) | — | — | — | 289 | |
| Other issuance of shares—Note 9 | — | — | (79) | — | 292 | (36) | 988 | |
| Purchase of Treasury Shares—Note 9 | — | — | — | — | — | — | (238) | |
| **Balance, December 31, 1999** | **9,822,204** | **$9,822** | **$51,127** | **$ (434)** | **$(1,010)** | **$120,689** | **$(19,883)** | |

*See Notes to Consolidated Financial Statements.*

## *Consolidated Statements of Cash Flows*

| For the years ended December 31, *(Thousands of dollars)* | **1999** | 1998 | 1997 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income | **$ 10,455** | $ 13,082 | $ 11,602 |
| Depreciation and amortization | **20,172** | 7,162 | 4,568 |
| (Gain) loss on sale of assets | **1,754** | (2,864) | (653) |
| Equity in (income) loss of unconsolidated affiliates | **46** | (534) | — |
| Deferred income taxes | **2,118** | 1,117 | 1,287 |
| Changes in assets and liabilities, net of acquisition/disposition of subsidiaries: | | | |
| Receivables | **(8,201)** | 7,890 | (5,528) |
| Inventories | **(9,978)** | 463 | 2,996 |
| Other current assets | **1,268** | (636) | (553) |
| Accounts payable | **13,467** | (1,828) | 3,881 |
| Accrued liabilities | **9,362** | (223) | (3,199) |
| Other, net | **(2,583)** | (1,096) | 21 |
| Net cash flows provided by operating activities | **37,880** | 22,533 | 14,422 |
| Cash flows from investing activities: | | | |
| Proceeds from sale of assets | **210** | 482 | 1,487 |
| Collections of notes receivable and receivable from sale of business | **684** | 710 | 451 |
| Proceeds from sale of subsidiary | **10,501** | 12,237 | 5,493 |
| Payments for purchase of subsidiaries, net of cash acquired | **(140,088)** | (71,091) | (12,788) |
| Capital expenditures | **(21,066)** | (11,314) | (8,654) |
| Net cash flows used in investing activities | **(149,759)** | (68,976) | (14,011) |
| Cash flows from financing activities: | | | |
| Proceeds from issuance of long-term debt, net of repayments | **110,855** | 38,735 | (657) |
| Payments of dividends | **(2,508)** | (2,492) | (2,481) |
| Purchase of treasury shares | **(238)** | (217) | (653) |
| Other | **530** | — | 359 |
| Net cash flows provided by (used in) financing activities | **108,639** | 36,026 | (3,432) |
| Net decrease in cash and cash equivalents | **(3,240)** | (10,417) | (3,021) |
| Cash and cash equivalents at beginning of year | **13,883** | 24,300 | 27,321 |
| Cash and cash equivalents at end of year | **10,643** | 13,883 | 24,300 |
| Cash of discontinued operations and operations to be disposed of | **655** | 985 | 1,949 |
| Cash and cash equivalents of continuing operations | **$ 9,988** | $ 12,898 | $ 22,351 |

*See Notes to Consolidated Financial Statements.*

### *Note 1 — Significant Accounting Policies*

*Consolidation Policy*—The consolidated financial statements include the accounts of Katy Industries, Inc. and subsidiaries in which it has a greater than a 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 does exercise significant influence are reported using the equity method.

As part of the continuous evaluation of its operations, Katy has acquired and disposed of a number of its operating units in recent years. Those which affected the Consolidated Financial Statements for the years ended December 31, 1999, 1998, and 1997 (see Note 2).

There are no restrictions on the payment of dividends by consolidated subsidiaries to Katy. Katy's consolidated retained earnings as of December 31, 1999 include $6,210,000 of undistributed earnings of 50% or less owned investments accounted for by the equity method. No dividends have been paid by any of these unconsolidated affiliates to Katy.

*Use of Estimates*—The preparation of financial statements in conformity with generally accepted accounting principles 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.

*Cash and Cash Equivalents*—Cash equivalents consist of highly liquid investments with original maturities of three months or less and total $5,400,000 and $3,600,000, as of December 31, 1999 and 1998, respectively, which approximates their fair value. The Company places its temporary cash investments in quality financial institutions. As such, the Company believes no significant concentration of credit risk exists with respect to these investments.

*Supplemental Cash Flow Information*—Noncash investing and financing activities are disclosed in Notes 1, 3, 6 and 10. Cash paid during the year for interest and income taxes is as follows:

| *(Thousands of dollars)* | **1999** | 1998 | 1997 |
|---|---|---|---|
| Interest | **$10,121** | $1,064 | $1,076 |
| Income taxes | **$ 111** | $6,910 | $3,694 |

*Research and Development Costs*—Research and development costs are expensed as incurred.

*Advertising Costs*—Advertising costs are expensed as incurred. Advertising costs expensed in 1999, 1998 and 1997 were $9,500,000, $5,700,000 and $5,000,000, respectively.

*Inventories*—Inventories are stated at the lower of cost or market. At December 31, 1999, approximately 36% of Katy's inventories were accounted for using the last-in, first-out (LIFO) method, while the remaining inventories were accounted for using the first-in, first-out (FIFO) method. All inventories were accounted for using the FIFO method at December 31, 1998. Current cost, as determined using the FIFO method, exceeded LIFO cost by $1,029,000 at December 31, 1999. The components of inventories are:

| December 31, *(Thousands of dollars)* | **1999** | 1998 |
|---|---|---|
| Raw materials | **$ 37,878** | $26,155 |
| Work in process | **5,911** | 6,073 |
| Finished goods | **73,611** | 37,166 |
| | **$117,400** | $69,394 |

*Cost in Excess of Net Assets Acquired*—In connection with certain acquisitions, the Company recorded an intangible asset for the cost of the acquisition in excess of the fair value of the net assets acquired. This intangible asset is being amortized using the straight-line method over periods ranging from 10 to 20 years.

*Excess of Acquired Net Assets Over Cost*—In connection with the acquisition of Woods Industries, Inc., ("Woods") the Company recorded negative goodwill for the excess of the fair value of the net assets acquired over the cost of the acquisition. Negative goodwill is being amortized using the straight-line method over a period of five years.

*Properties*—Properties are stated at cost and depreciated over their estimated useful lives: buildings (10–40 years) generally using the straight-line method; machinery and equipment (3–20 years) and leased machines (lease period) using straight-line, accelerated or composite methods; and leasehold improvements using the straight-line method over the remaining lease period. During 1998, the Company incurred additional debt of $1,018,000 relating to capital equipment. The Company also incurred $3,589,000 of debt for capital equipment relating to C.E.G.F. (USA), Inc., ("CEGF"), which the Company disposed of during 1998. During 1997, the Company incurred additional debt of $2,045,000 relating to capital equipment. These are considered noncash investing and financing activities for purposes of the Consolidated Statements of Cash Flows.

*Impairment of Assets*—Long-lived assets are reviewed for impairment if events or circumstances indicate the carrying amount of these assets may not be recoverable. If this review indicates that the carrying value of these assets will not be recoverable, based on future net cash flows from the use or disposition of the asset, the carrying value is reduced to fair value (see Note 10).

*Accrued Expenses*—The components of accrued expenses are:

| December 31, *(Thousands of dollars)* | 1999 | 1998 |
|---|---|---|
| Accrued insurance | **$ 6,010** | $ 6,509 |
| Accrued environmental costs | **4,150** | 4,931 |
| Other accrued expenses | **41,378** | 20,186 |
| | **$51,538** | $31,626 |

*Foreign Currency Translation*—The results of the Company's self-sustaining foreign subsidiaries are translated to U.S. Dollars using the current-rate method. Assets and liabilities are translated at the year end spot exchange rate, revenue and expenses at average exchange rates and equity transactions at historical exchange rates. Exchange differences arising on translation are recorded as a separate component of stockholders' equity.

*Fair Value of Financial Instruments*—Where the fair values of Katy's financial instrument assets and liabilities differ from their carrying value or Katy is unable to establish the fair value without incurring excessive costs, appropriate disclosures have been given in the Notes to Consolidated Financial Statements. All other financial instrument assets and liabilities not specifically addressed are believed to be carried at their fair value in the accompanying Consolidated Balance Sheets.

*New Accounting Pronouncements*—In September 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities". This statement requires that all derivatives be recognized as either assets or liabilities in the statement of financial position and requires that those assets and liabilities be measured at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and its resulting designation. In September 1999, the FASB issued Statement No. 137, which delays the required implementation of Statement No. 133 to years beginning after June 15, 2000. While the Company is still evaluating the potential effect of this statement, its adoption is not expected to have a significant impact on the Company's financial position or results of operations.

*Revenue Recognition*—Sales are recognized upon shipment of products to customers or when services are performed.

*Reclassifications*—Certain amounts from prior years have been reclassified to conform to the 1999 financial statement presentation.

### *Note 2 — Acquisitions and Dispositions*

*Acquisitions*

On January 8, 1999, the Company purchased all of the common membership interest (the "Common Interest") in Contico International, L.L.C., ("Contico"), the successor to the janitorial, consumer products and industrial packaging businesses of Contico International, Inc., now known as Newcastle Industries, Inc., ("Newcastle"). Newcastle had previously contributed substantially all its assets and certain liabilities to Contico and entered into leases with Contico for certain real property used in the business and retained by Newcastle. The purchase price for the Common Interest was approximately $132,100,000. The payment of the purchase price was financed by the Company's unsecured revolving credit agreement agented by Bank of America. Newcastle has retained a preferred membership interest in Contico (the "Preferred Interest"), having a stated value of $32,900,000, which yields an 8% annual return on its stated value while outstanding (see Note 8). Contico, based in St. Louis, Missouri, manufactures and distributes janitorial equipment and supplies, consumer storage, home and automotive products, as well as food service equipment and supplies. The acquisition has been accounted for under the purchase method and, accordingly, the purchase price is preliminary and adjustments may be recorded through January 2000. The accounts of this acquisition have been included in the Company's Consolidated Financial Statements from the acquisition date. The estimated cost in excess of net assets acquired of approximately $7,000,000, subject to additional purchase accounting adjustments, has been recorded as "Cost in excess of net assets acquired" in the Consolidated Balance Sheets and is being amortized on a straight line basis over 20 years. In addition, Katy has recorded intangible assets of approximately $28,000,000, consisting of customer lists, trademarks and tradenames. These intangible assets are being amortized over periods of 20 years. The following unaudited pro forma information reflects the pro forma results of operations for the Company giving effect to the Contico acquisition as if the Contico acquisition occurred on January 1, 1998. The unaudited pro forma results include the unaudited historical operating results of Newcastle for the one-week ended January 8, 1999 and the twelve months ended December 31, 1998. The Company's historical information presented below excludes net loss of $(1,834,000) or $(0.18) per share (diluted) from Discontinued Operations and Operations to be Disposed Of for December 31, 1999. The Company's historical information presented below excludes net income of $2,075,000 or $0.25 per share (diluted) from Discontinued Operations and other Operations to be Disposed Of for December 31, 1998. Pro forma results may not be indicative of future results.

| | **Year ended December 31, 1999** | | Year ended December 31, 1998 | |
|---|---|---|---|---|
| *(Thousands of dollars, except per share data)* | **Katy Historical** | **Pro Forma** | Katy Historical | Pro Forma |
| Net Sales | **$565,941** | **$569,981** | $342,315 | $567,990 |
| Income from Operations | **$ 27,771** | **$ 28,159** | $ 15,275 | $ 35,486 |
| Net Income | **$ 12,289** | **$ 12,381** | $ 11,007 | $ 15,768 |
| Earnings per share—Basic | **$ 1.47** | **$ 1.48** | $ 1.33 | $ 1.90 |
| Earnings per share—Diluted | **$ 1.39** | **$ 1.40** | $ 1.30 | $ 1.74 |

On December 31, 1998, the Company acquired the assets of the Bay State Gritcloth division of Tyrolit North America, Inc. ("Baystate"). Baystate manufactures an industrial product line of specialty abrasives and has annual sales of approximately $4,000,000. The acquisition has been accounted for under the purchase method. The accounts of this acquisition have been included in the Company's Consolidated Financial Statements from the acquisition date. The estimated aggregate purchase price for this division was approximately $4,000,000. The estimated cost in excess of net assets acquired of approximately $1,950,000, has been recorded as "Cost in excess of net assets acquired" in the Consolidated Balance Sheets and is being amortized on a straight line basis over 20 years.

On August 11, 1998, the Company purchased substantially all of the assets of The Wilen Companies, Inc. The Company operates the business through its Wilen Products, Inc. subsidiary ("Wilen"). Wilen is a manufacturer and distributor of a wide variety of professional cleaning products including mops, brooms and plastic cleaning products. The acquisition has been accounted for under the purchase method. The accounts of this acquisition have been included in the Company's Consolidated Financial Statements from the acquisition date. The estimated aggregate purchase price for the Wilen business was approximately $50,000,000. The estimated cost in excess of net assets acquired of approximately $24,000,000, has been recorded as "Cost in excess of net assets acquired" in the Consolidated Balance Sheets and is being amortized on a straight line basis over 20 years. In addition, Katy has recorded intangible assets of approximately $14,900,000, consisting of customer lists, trademarks and tradenames, and accumulated work force. These intangible assets are being amortized over periods ranging from 7½ to 20 years.

On May 21, 1998, the Company purchased substantially all of the assets of the Consumer Electrical Division of Noma Industries, Limited. The Company operates the business through its Woods Industries (Canada), Inc. subsidiary ("Woods Canada"). Woods Canada is a North American leader in the design, manufacturing and marketing of a wide variety of consumer corded products including low voltage garden lighting, extension cords, multiple outlet and surge strips, specialty cord products, automotive products and electronic timers. On May 11, 1998, the Company purchased substantially all of the assets of Disco, Inc. The Company operates the business through its Glit/Disco, Inc. subsidiary ("Disco"). Disco is a manufacturer and distributor of cleaning and specialty products sold to the restaurant/food service industry. Both acquisitions have been accounted for under the purchase method. The accounts of these acquisitions have been included in the Company's Consolidated Financial Statements from the acquisition date.

The estimated aggregate purchase price for the Woods Canada and Disco businesses was approximately $17,100,000. The estimated costs in excess of the net assets acquired of approximately $700,000 has been recorded as "Cost in excess of net assets acquired" in the Consolidated Balance Sheets and is being amortized on a straight line basis over 20 years.

On August 6, 1997, the Company purchased Loren Products ("Loren"). Loren is a manufacturer and distributor of cleaning and abrasive products for the industrial markets and building products for the consumer markets. The estimated purchase price was $12,788,000. The acquisition has been accounted for under the purchase method, and accordingly, the estimated cost in excess of the net assets acquired of approximately $2,650,000 has been recorded as "Cost in excess of net assets of business acquired" in the Consolidated Balance Sheets and is being amortized over 20 years. In addition, Katy has recorded intangible assets of approximately $4,790,000, consisting of customer lists, trademarks and tradenames, and accumulated work force. These intangible assets are being amortized over periods ranging from 7½ to 20 years. The accounts of Loren have been included in the Company's Consolidated Financial Statements from the acquisition date.

*Dispositions*

During 1999, Katy completed the sales of the businesses classified as Discontinued Operations. As all of these businesses have been divested and the gains and losses from the sale of these companies, combined with deferred income, can now be determined with certainty, Katy has recorded a "Loss from Discontinued Operations" on the 1999 Consolidated Statement of Operations (see Note 3). The sales are summarized below:

On December 27, 1999, the Airtronics division of American Gage & Machine Company ("Airtronics") was sold for $2,300,000, including a note for $500,000, due in six years, and $900,000 in deferred payments based upon the Airtronics business' future sales. On September 24, 1999, the assets of Peters Machinery Inc., ("Peters") were sold for approximately $5,400,000, including a mortgage note of $1,030,000, due in five years, and an estimated $1,500,000 in deferred payments based on the future sales of the Peters business. On May 7, 1999, the Company completed the divestiture of Diehl Machines, Inc. ("Diehl") for approximately $3,700,000. On January 25, 1999, the Company sold the operating assets of Bach Simpson, Ltd. for approximately $550,000. The Company retained ownership of Bach Simpson, Ltd.'s building and leases it to the buyer. On July 14, 1997, the Company completed its divestiture of the Beehive division of Hamilton Precision Metals, Inc., ("Beehive") for net proceeds of approximately $5,493,000. With respect to all of the foregoing divestitures, the purchaser assumed certain liabilities of the seller.

On June 11, 1998, the Company completed its divestiture of CEGF for approximately $12,237,000. The net pre-tax book gain of $6,122,000 had been recorded and included as "Equity in income (loss) of operations to be disposed of" on the accompanying Consolidated Statement of Operations for the year ended December 31, 1998 (see Note 3).

### *Note 3 — Discontinued Operations and Operations to be Disposed Of*

On December 31, 1997, the Board of Directors approved a plan to dispose of the Company's previously reported Machinery Manufacturing segment. The businesses included as "Discontinued Operations" are Airtronics, Beehive, Bach-Simpson, Ltd., Diehl, and Peters. The divestiture of Beehive was completed in July of 1997, the sale of Bach Simpson, Ltd. closed on January 25, 1999, Diehl was sold on May 7, 1999, Peters was sold on September 24, 1999 and Airtronics was sold on December 27, 1999 (see Note 2).

The historical operating results have been segregated as "Discontinued Operations" on the accompanying Consolidated Statements of Operations for all periods presented. The related assets and liabilities have been separately identified on the 1998 Consolidated Balance Sheet as "Net current assets or Net noncurrent assets of discontinued operations". Discontinued Operations have not been segregated on the Consolidated Statements of Cash Flows. As all of these businesses have been divested and the gains and losses from the sale of these companies combined with the deferred income can now be determined with certainty, Katy has recorded a "Loss from Discontinued Operations" on the 1999 Consolidated Statement of Operations. Selected financial data for the Discontinued Operations is summarized as follows:

For the years ended December 31,

| *(Thousands of dollars, except per share data)* | **1999** | 1998 | 1997 |
|---|---|---|---|
| Net sales | **$10,025** | $23,349 | $31,537 |
| Income (loss) before income taxes | **$ (1,722)** | $ — | $ 3,110 |
| Income tax expense (benefit) | **(22)** | — | 1,151 |
| Net income (loss) | **$ (1,700)** | $ — | $ 1,959 |
| Net income (loss) per share—Basic | **$ (.20)** | $ — | $ .24 |
| Net income (loss) per share—Diluted | **$ (.17)** | $ — | $ .23 |

In connection with the previously mentioned divestiture plan, the Board of Directors also approved the disposal of a portion of the Company's previously reported Distribution and Service segment and one of the Company's equity investments. These businesses are reported as "Operations to be Disposed Of" and include CEGF, Savannah Energy Systems Company ("SESCO") and the Company's equity investment in Bee Gee Holding Company, Inc. ("Bee Gee"). The sale of CEGF was closed on June 11, 1998. The Company believes that Bee Gee and SESCO will be fully divested during the year ending December 31, 2000.

The historical operating results of "Operations to be Disposed Of" have been segregated as "Equity in income (loss) of operations to be disposed of" on the accompanying Consolidated Statements of Operations for all periods presented. The related assets and liabilities have been separately identified on the Consolidated Balance Sheets as "Net current assets or Net noncurrent assets of operations to be disposed of". The operating financial data for the year ended December 31, 1998 includes a net pre-tax gain of $6,122,000 offset partially by a pre-tax impairment of $2,800,000 relating to the reduction in the book value of SESCO (see Note 10).

Selected financial data for "Operations to be Disposed Of" is summarized as follows:

| For the years ended December 31, *(Thousands of dollars, except per share data)* | **1999** | 1998 | 1997 |
|---|---|---|---|
| Net sales | **$3,900** | $6,297 | $9,568 |
| Income (loss) before income taxes | **$ (206)** | $3,144 | $ (325) |
| Income taxes (benefit) | **(72)** | 1,069 | (146) |
| Net income (loss) | **$ (134)** | $2,075 | $ (179) |
| Net income (loss) per share—Basic | **$ (.02)** | $ .25 | $ (.03) |
| Net income (loss) per share—Diluted | **$ (.01)** | $ .25 | $ (.02) |

Net assets held for sale for "Discontinued Operations" as of December 31, 1998 were carried at cost, which exceeded estimated net realizable value, as follows:

| December 31, 1998 *(Thousands of dollars)* | |
|---|---|
| Current assets | $13,431 |
| Current liabilities | (2,472) |
| Net current assets of discontinued operations | $10,959 |
| Noncurrent assets | $ 4,288 |
| Noncurrent liabilities | (9) |
| Net noncurrent assets of discontinued operations | $ 4,279 |

Net assets held for sale for "Operations to be Disposed Of" are valued in accordance with SFAS No. 121, lower of cost or estimated proceeds less cost to sell, as follows:

| December 31, *(Thousands of dollars)* | **1999** | 1998 |
|---|---|---|
| Current assets | **$ 2,005** | $ 1,414 |
| Current liabilities | **(1,268)** | (211) |
| Net current assets of operations to be disposed of | **$ 737** | $ 1,203 |
| Noncurrent assets | **$15,898** | $15,521 |
| Noncurrent liabilities | **—** | — |
| Net noncurrent assets of operations to be disposed of | **$15,898** | $15,521 |

***Note 4 — Earnings Per Share***

The Company's diluted earnings per share were calculated using the Treasury Stock method in accordance with the SFAS No. 128. The basic and diluted earnings per share calculations are as follows:

| For the years ended December 31, *(In thousands, except per share data)* | **1999** | 1998 | 1997 |
|---|---|---|---|
| Basic EPS: | | | |
| Income from continuing operations | **$12,155** | $13,082 | $ 9,643 |
| Income (loss) from discontinued operations | **(1,700)** | — | 1,959 |
| Net income | **$10,455** | $13,082 | $11,602 |
| Shares—Basic | **8,366** | 8,290 | 8,273 |
| Per-share amount—Basic: | | | |
| Continuing operations | **$ 1.45** | $ 1.58 | $ 1.16 |
| Discontinued operations | **(0.20)** | — | .24 |
| Total—Basic | **$ 1.25** | $ 1.58 | $ 1.40 |
| Effect of potentially dilutive securities: | | | |
| Options | **82** | 152 | 132 |
| Preferred interest | **1,567** | — | — |
| Diluted EPS: | | | |
| Income from continuing operations | **$12,155** | $13,082 | $ 9,643 |
| Preferred interest, net of tax | **1,678** | — | — |
| Income (loss) from discontinued operations | **(1,700)** | — | 1,959 |
| Net income | **$12,133** | $13,082 | $11,602 |
| Shares—Diluted | **10,015** | 8,442 | 8,405 |
| Per-share amount—Diluted: | | | |
| Continuing operations | **$ 1.38** | $ 1.55 | $ 1.15 |
| Discontinued operations | **(0.17)** | — | .23 |
| Total—Diluted | **$ 1.21** | $ 1.55 | $ 1.38 |

Rights to purchase one common share of stock for $35 for each common share of stock held were not included in the computation of diluted EPS because the rights' exercise price was greater than the average price of the common shares (see Note 9).

*Note 5 — Investments in Unconsolidated Affiliates*

The Company's investments in unconsolidated affiliates are comprised of the following:

| *(Thousands of dollars)* | **1999** | 1998 |
|---|---|---|
| Bee Gee Holding Company, Inc. | **$ 6,988** | $ 7,034 |
| Less amounts classified with net noncurrent assets of operations to be disposed of | **(6,988)** | (7,034) |
| | **$ —** | $ — |

*Bee Gee Holding Company, Inc.*

At December 31, 1999, the Company owns 30,000 shares of common stock, a 43% interest, of Bee Gee, which consists of several subsidiaries engaged in the business of harvesting shrimp off the coast of South and Central America and shrimp farming in Nicaragua. In January 1997, Bee Gee sold its processing operations to a major competitor in the same geographical area. Goodwill related to the Bee Gee investment was amortized over ten years and was completed in 1997.

*Financial Information*

The condensed financial information that follows reflects the Company's proportionate share in the financial position and results of operations of Bee Gee:

| *(Thousands of dollars)* | **1999** | 1998 |
|---|---|---|
| Current assets | **$ 2,871** | $ 3,619 |
| Current liabilities | **(2,042)** | (2,063) |
| Working capital | **829** | 1,556 |
| Properties, net | **9,839** | 9,034 |
| Other assets | **238** | 417 |
| Long-term debt | **(2,045)** | (2,444) |
| Other liabilities | **(1,873)** | (1,529) |
| Stockholders' equity | **$ 6,988** | $ 7,034 |
| Investments, at equity, in unconsolidated affiliates | **$ 6,988** | $ 7,034 |

| *(Thousands of dollars)* | **1999** | 1998 | 1997 |
|---|---|---|---|
| Sales | **$ 8,524** | $ 7,597 | $11,648 |
| Costs and expenses | **(8,122)** | (7,063) | (11,129) |
| Net income from continuing operations | **402** | 534 | 519 |
| Amortization of excess of cost over net assets acquired | **—** | — | 401 |
| Income taxes | **157** | 208 | 46 |
| Equity in net income of unconsolidated affiliates | **$ 245** | $ 326 | $ 72 |

*Note 6 — Indebtedness*

On December 11, 1998, the Company amended and restated its unsecured revolving credit agreement (the "Credit Agreement") agented by Bank of America, with LaSalle National Bank acting as the managing agent. The Credit Agreement provided for borrowings of up to $215,000,000. On March 22, 2000, the Company amended this agreement and lowered the borrowing level to $185,000,000. The Company had $150,000,000 outstanding under the Credit Agreement as of December 31, 1999. Interest accrues on these obligations at LIBOR rates plus 2%.

Under the Credit Agreement, the Company must meet certain net worth and other financial covenants, which limit the Company's borrowing capacity. At December 31, 1999, the Company is in compliance with all such covenants.

Letters of credit totaling $5,425,000 were outstanding at December 31, 1999.

Long-term debt at December 31 includes:

| *(Thousands of dollars)* | **1999** | 1998 |
|---|---|---|
| Revolving loans payable, interest at various LIBOR Rates (6.73%– 8.13%), due through 2001, unsecured | **$150,000** | $39,000 |
| Real estate and chattel mortgages, with interest at fixed rates (7.14%), due through 2013 | **902** | 980 |
| Less current maturities | **(67)** | (72) |
| | **$150,835** | $39,908 |

Aggregate scheduled maturities of long-term debt are as follows:

| *(Thousands of dollars)* | |
|---|---|
| 2000 | $ 67 |
| 2001 | 150,067 |
| 2002 | 67 |
| 2003 & beyond | 701 |
| Total | $150,902 |

Long-term debt increased in 1999 primarily as a result of the financing of the Contico acquisition in January 1999.

All of the long-term debt was re-priced to current rates in January 2000. Therefore, its fair value approximated its carrying value at December 31, 1999.

### *Note 7 — Retirement Benefit Plans*

*Pension and Other Postretirement Plans*

Several domestic subsidiaries have pension plans covering substantially all of their employees. These plans are noncontributory, defined benefit pension plans. The benefits to be paid under these plans are generally based on employees' retirement age and years of service. The companies' funding policies, subject to the minimum funding requirements of the applicable U.S. or foreign employee benefit and tax laws, are to contribute such amounts as are determined on an actuarial basis to provide the plans with assets sufficient to meet the benefit obligations. Plan assets consist primarily of fixed income investments, corporate equities and government securities. The Company also provides certain health care and life insurance benefits for some of its retired employees.

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| *(Thousands of dollars)* | **1999** | 1998 | **1999** | 1998 |
| Change in benefit obligation: | | | | |
| Benefit obligation at beginning of year | **$ 3,530** | $ 3,614 | **$ 2,064** | $ 2,105 |
| Service cost | **157** | 232 | **16** | 20 |
| Interest cost | **105** | 257 | **97** | 139 |
| Actuarial (gain)/loss | **74** | (35) | **(676)** | — |
| Effect of sale | **(1,737)** | — | **(14)** | — |
| Benefits paid | **(268)** | (538) | **(67)** | (200) |
| Benefit obligation at end of year | **1,861** | 3,530 | **1,420** | 2,064 |
| Change in plan assets: | | | | |
| Fair value of plan assets at beginning of year | **4,049** | 4,111 | **—** | — |
| Actuarial return on plan assets | **296** | 303 | **—** | — |
| Employer contribution | **135** | 173 | **67** | 200 |
| Effect of sale | **(2,067)** | — | **—** | — |
| Benefits paid | **(268)** | (538) | **(67)** | (200) |
| Fair value of plan asset at end of year | **2,145** | 4,049 | **—** | — |
| Reconciliation of prepaid (accrued) benefit cost: | | | | |
| Funded status | **284** | 519 | **(1,420)** | (2,064) |
| Unrecognized net actuarial (gain)/loss | **436** | 328 | **(1,047)** | (493) |
| Unrecognized prior service cost | **—** | 70 | **24** | 29 |
| Unrecognized net transition asset/(obligation) | **52** | (328) | **—** | — |
| Prepaid/(Accrued) benefit cost | **772** | 589 | **(2,443)** | (2,528) |
| Components of net periodic benefit cost: | | | | |
| Service cost | **157** | 232 | **16** | 20 |
| Interest cost | **105** | 257 | **97** | 139 |
| Expected return on plan assets | **(102)** | (313) | **—** | — |
| Amortization of net transition asset | **(6)** | (38) | **—** | — |
| Amortization of prior service cost | **—** | (6) | **5** | 5 |
| Amortization of net gain/(loss) | **23** | 29 | **(91)** | (45) |
| Curtailment/settlement recognition | **(343)** | — | **—** | — |
| Net periodic benefit cost | **$ (166)** | $ 161 | **$ 27** | $ 119 |
| Assumptions as of December 31: | | | | |
| Discount rates | **7–7.5%** | 7–7.5% | **7%** | 7% |
| Expected return on plan assets | **7–7.5%** | 7.5–8% | **0%** | 0% |
| Assumed rates of compensation increases | **0–5%** | 0–5% | | |
| Impact of one-percent increase in health care trend rate: | | | | |
| Increase in accumulated postretirement benefit obligation | | | **$ 176** | $ 213 |
| Increase in service cost and interest cost | | | **$ 5** | $ 4 |
| Impact of one-percent decrease in health care trend rate: | | | | |
| Decrease in accumulated postretirement benefit obligation | | | **$ 143** | $ 171 |
| Decrease in service cost and interest cost | | | **$ 4** | $ 3 |

The assumed health care cost trend rate used in measuring the accumulated postretirement benefit obligation as of December 31, 1999 was 6% decreasing linearly each successive year until it reaches 4.5% in 2001, after which it remains constant.

In addition to the plans described above, in 1993 the Company's Board of Directors approved a retirement compensation program for certain officers and employees of the Company and a retirement compensation arrangement for the Company's then Chairman and Chief Executive Officer. The Board approved a total of $3,500,000 to fund such plans. This amount represented the best estimate of the obligation that vested immediately upon Board approval and is to be paid for services rendered to date. The Company had $2,200,000 accrued at December 31, 1999 for this obligation.

*401(k) Plans*

The Company offers its employees the opportunity to voluntarily participate in one of six 401(k) plans administered by the Company or one of its subsidiaries. The Company makes matching and other contributions in accordance with the provisions of the plans and, under certain provisions, at the discretion of the Company. The Company made annual matching and other contributions of $769,000, $632,000 and $623,000 in 1999, 1998 and 1997, respectively.



### *Note 8 — Preferred Interest of Subsidiary*

Upon the Company's purchase of the Common Interest of Contico on January 8, 1999, Newcastle retained a Preferred Interest in Contico, represented by 329 preferred units, each with a stated value of $100,000, for an aggregate stated value of $32,900,000. The Preferred Interest yields an 8% cumulative annual return on its stated value while outstanding, payable in cash. The holder of the Preferred Interest has a put option which allows, at certain times beginning on January 8, 2001, or upon the occurrence of certain events, each preferred unit to be exchangeable for 4,762 shares of Katy common stock. Upon the exercise of the put, Katy has the option to settle in cash, in lieu of delivering Katy common stock, in an amount equal to the then market value of Katy common stock multiplied by the number of shares implied by the exchange. Conversely, at any time on or after January 2, 2012, Katy may exercise a call option, requiring holders of the Preferred Interest to sell their units to Katy at the stated value.

The fair value of the Preferred Interest is impacted by two factors: the rate of interest paid on the stated amount, and the market price of Katy's common stock. During 1999, market rates for similar instruments increased, which would have the effect of reducing the fair value of the Preferred Interest. Also during 1999, the value of Katy's common stock fell, which would also cause the fair value of the Preferred Interest to decrease. Upon exercise of the put option, the holder would receive 1,566,698 shares of Katy common stock, implying a value when divided into the stated value of $21.00 per share. Katy's stock closed at $17.00 on January 8, 1999, the date of the Contico acquisition, and closed at $8.69 at December 31, 1999. While the combination of those factors contribute to a reduced fair value, it is impractical to provide an exact amount given the unique nature of the instrument.

### *Note 9 — Stockholders' Equity*

*Share Repurchase*

On February 26, 2000, the Company's Board of Directors authorized management to spend up to $5,000,000 over a twelve month period for the repurchase of Katy common stock in the open market.

On May 19, 1998, Katy's Board of Directors authorized the Company to repurchase an additional 250,000 common shares, bringing the total authorized shares to 1,150,000 since 1995. Katy repurchased 15,200, 12,000 and 38,000 of its common shares during the years ended December 31, 1999, 1998 and 1997, at a total cost of $238,000, $217,000 and $566,000, respectively. As of December 31, 1999, the repurchase program had been completed.

During 1997, the Company initiated an "Odd Lot Buyback" program to repurchase common shares held by stockholders owning fewer than 100 shares. During the year ended December 31, 1997, Katy repurchased 4,695 of its common shares at a cost of $87,000.

*Stockholder Rights Plan*

In January 1995, the Board of Directors adopted a Stockholder Rights Plan and distributed one right for each outstanding share of the Company's common stock. Each right entitles the stockholder to acquire one share of the Company's common stock at an exercise price of $35, subject to adjustment. The rights are not and will not become exercisable unless certain change of control events occur. As of December 31, 1999, there are 8,413,858 rights outstanding, of which none are exercisable.

*Stock Purchase Plan for Key Employees and Directors*

In 1994, the Board of Directors approved the Stock Purchase Plan for Key Employees and Directors ("Stock Purchase Plan"). Under the Stock Purchase Plan, shares of the Company's common stock, held in the treasury, were reserved for issuance at a purchase price equal to 65% (50% in certain cases) of the market value of the shares as determined based upon the offering period established by the Compensation Committee of the Board of Directors. As of December 31, 1999, 83,000 common shares have been issued at prices ranging from $6.17 to

$8.02 per share. There has been no activity in this plan since 1996, and the Plan has been terminated. The issuance of shares in 1996 for total notes receivable of $141,000, was a noncash financing transaction.

Proceeds from the sale of these shares consisted of cash or notes receivable due on demand but no later than sixty months from date of purchase with an interest rate equal to the Federal Short-Term Funds Rate. The Company is holding the shares as collateral for all notes receivable. Further, these shares cannot be sold until 24 months from the date of purchase provided the notes have been repaid. Notes receivable from plan participants are included in the Consolidated Balance Sheets under the caption "Other adjustments". The excess of the cost of the treasury shares over the market value of the shares at the date of purchase of $43,000 was charged to retained earnings in 1996. The excess of the market value of the shares over the purchase price of $113,000 was charged to compensation expense in 1996.

*Restricted Stock Grant*

During 1999, 1998 and 1997, the Company issued restricted stock grants in the amount of 45,100, 37,800 and 44,250 shares, respectively, to certain key employees of the Company. These stock grants vest over a three-year period, of which 25% vested immediately upon distribution. As a result of this transaction, the Company has recognized compensation expense for 1999, 1998 and 1997 in the amount of $539,000, $162,000 and $324,000, respectively.

*Director Stock Grant*

During 1999, 1998 and 1997, the Company granted all non employee Directors 500 shares of Company common stock as part of their compensation. The total grant to the Directors for the years ended December 31, 1999, 1998 and 1997 was 4,500, 4,000 and 4,500 shares, respectively.

*Stock Options and Stock Appreciation Rights*

At the 1998 Annual Meeting, the Company's stockholders approved a Long-Term Incentive Plan (the "Incentive Plan"), authorizing the issuance of up to 875,000 shares of Company common stock pursuant to the grant or exercise of stock options, including incentive stock options, nonqualified stock options, stock appreciation rights ("SARs"), restricted stock, performance units or shares and other incentive awards. The Board of Directors administers the Incentive Plan and determines to whom awards may be granted, the type of award as well as the number of shares of Company common stock to be covered by each award, and the terms and conditions of such awards. The exercise price of stock options granted under the Incentive Plan cannot be less than 100 percent of the fair market of such stock on the date of grant. The restricted stock grants in 1999 and 1998 referred to above were made under the Incentive Plan. Related to the Incentive Plan, the Company granted SARs as described below.

SARs (204,473) become exercisable at any time after the earliest that (a) up to and including July 22, 2001, the Company's average closing stock price over a 45 calendar day period has equaled or exceeded $39.125 per share; or (b) up to and including January 22, 2005, the Company's average closing stock price over a 45 calendar day period has equaled or exceeded $53.80 per share. In addition, in the event that goal (a) above is met, only 50% of the SARs thus vested will be immediately exercisable, with, 25% exercisable upon the first anniversary of the performance vesting date, and 25% exercisable upon the second anniversary of the performance vesting date. In addition, SARs (163,579) become exercisable at such time up to and including January 22, 2005, the Company's average closing stock price over a 45-calendar day period has equaled or exceeded $53.80 per share. All SARs which have met the performance goals above, as the case may be, will expire December 9, 2007. As a result of the underlying stock price, no compensation expense was recorded in 1999 or 1998 related to these SARs.

The Incentive Plan also provides that in the event of the Change in Control of the Company, as defined below, (i) any SARs and stock options outstanding as of the date of the Change in Control which are neither exercisable or vested will become fully exercisable and vested (The payment received upon the exercise of the SARs shall be equal to the excess of the fair market value of a share of the Company's Common Stock on the date of exercise over the grant date price multiplied by the number of SARs exercised); (ii) the restrictions applicable to restricted stock will lapse and such restricted stock will become free of all restrictions and fully vested; and (iii) all performance units or shares will be considered to be fully earned and any other restrictions will lapse, and such performance units or shares will be settled in cash or stock, as applicable, within 30 days following the effective date of the Change in Control. For purposes of subsection (iii), the payout of awards subject to performance goals will be a pro rata portion of all targeted award opportunities associated with such awards based on the number of complete and partial calendar months with the performance period which had elapsed as of the effective date of the Change in Control. The Committee will also have the authority, subject to the limitations set forth in the Incentive Plan, to make any modifications to awards as determined by the Committee to be appropriate before the effective date of the Change in Control.

For purposes of the Incentive Plan, "Change in Control" of the Company means, and shall be deemed to have occurred upon, any of the following events: (a) any person (other than those persons in control of the Company as of the effective date of the Incentive Plan, a trustee or other fiduciary holding securities under an employee benefit plan of the Company or a corporation owned directly or indirectly by the stockholders of the Company in substantially the same proportions as their ownership of stock of the Company) becomes the beneficial owner, directly or indirectly, of securities of the Company representing 30 percent or more of the combined voting power of the Company's then outstanding securities; or (b) during any period of two (2) consecutive years (not including any period prior to the effective date), the individuals who at the beginning of such period constitute the Board of Directors (and any new director, whose election by the Company's stockholders was approved by a vote of at least two-thirds of the directors then still in office who either were directors at the beginning of the period or whose election or nomination for election was so approved), cease for any reason to constitute a majority thereof; or (c) the stockholders of the Company approve: (i) a plan of complete liquidation of the Company; or (ii) an agreement for the sale or disposition of all or substantially all the Company's assets; or (iii) a merger, consolidation, or reorganization of the Company with or involving any other corporation, other than a merger, consolidation, or reorganization that would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent at least 50 percent of the combined voting power of the voting securities of the Company (or such surviving entity) outstanding immediately after such merger, consolidation, or reorganization.

During 1995, the Company established stock option plans providing for the grant of options to purchase common shares to outside directors, executives and certain key employees. The Compensation Committee of the Board of Directors administers the plans and approves stock option grants. Stock options granted under the plans are exercisable at a price equal to the market value of the stock at the date of grant. The options, in the case of non-employee directors, are immediately exercisable, and in the case of executives and key employees, become exercisable from one to four years from the date of grant, and generally expire 10 years from the date of grant. The following table summarizes option activity:

| | Options | Exercise Price | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price |
|---|---|---|---|---|
| Outstanding at December 31, 1996 | 489,750 | $ 8.50 – 13.57 | 9.5 years | $11.60 |
| Granted | 33,000 | $16.13 – 19.56 | | $17.87 |
| Exercised | (21,850) | $ 8.50 – 13.19 | | $11.25 |
| Canceled | (17,500) | $ 8.50 – 9.25 | | $12.69 |
| Outstanding at December 31, 1997 | 483,400 | $ 8.50 – 19.56 | 8.5 years | $11.99 |
| Granted | 16,000 | $ 18.13 | | $18.13 |
| Exercised | (19,436) | $ 8.50 – 13.19 | | $11.31 |
| Canceled | (8,864) | $ 8.50 – 19.56 | | $12.74 |
| Outstanding at December 31, 1998 | 471,100 | $ 8.50 – 19.56 | 7.6 years | $12.21 |
| Granted | 222,100 | $ 9.88 – 17.00 | | $13.65 |
| Exercised | (20,650) | $ 8.50 – 13.19 | | $12.22 |
| Canceled | (16,700) | $13.19 – 19.56 | | $14.40 |
| Outstanding at December 31, 1999 | 655,850 | $ 8.50 – 19.56 | 7.6 years | $12.64 |
| Vested and Exercisable at December 31, 1999 | 400,656 | | | $12.13 |

The following table summarizes information about stock options outstanding at December 31, 1999:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | **Number Outstanding at 12/31/99** | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | **Number Exercisable at 12/31/99** | Weighted Average Exercise Price |
| $ 8.50 – 9.88 | **263,900** | 7.5 | $ 9.32 | **159,500** | $ 8.96 |
| $12.69 – 13.57 | **230,950** | 6.9 | 13.21 | **182,606** | 13.21 |
| $16.13 – 17.00 | **130,500** | 8.9 | 16.89 | **34,800** | 16.60 |
| $18.13 – 19.56 | **30,500** | 8.2 | 18.81 | **23,750** | 18.60 |
| | **655,850** | 7.6 | $12.64 | **400,656** | $12.13 |

The Company applies Accounting Principles Bulletin Opinion No. 25, "Accounting for Stock Issued to Employees" and related Interpretations in accounting for stock options. Accordingly, no compensation cost has been recognized. SFAS No. 123, "Accounting for Stock-Based Compensation" was issued and, if fully adopted by the Company, would change the method for recognition of cost. Under SFAS No. 123, cost is 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. Had compensation cost been determined based on the fair value method of SFAS No. 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below. The weighted average fair values of options granted in 1999, 1998 and 1997 were $7.19, $5.67 and $7.02, respectively.

The fair value of each option grant is estimated on the date of grant using the binomial option-pricing model with the following assumptions used for grants on June 8, 1995, December 29, 1995, May 20, 1996, July 30, 1996, December 9, 1996, May 19, 1997, December 9, 1997, May 19, 1998, January 8, 1999, May 19, 1999, and December 10, 1999 respectively: dividend yield of 2.25%, 1.65% and 1.82% for the periods 1999, 1998 and 1997, respectively; expected volatility ranging from 17.8% to 43.2% for all grants, risk free interest rates ranging from of 4.66% to 6.92% for all grants; and expected lives of five years for all grants.

| *(In thousands, except per share data)* | **1999** | 1998 | 1997 |
|---|---|---|---|
| Net income as reported | **$10,455** | $13,082 | $11,602 |
| Net income—pro forma | **$ 9,993** | $12,762 | $11,334 |
| Earnings per share as reported—Basic | **$ 1.25** | $ 1.58 | $ 1.40 |
| Earnings per share—pro forma—Basic | **$ 1.19** | $ 1.54 | $ 1.37 |
| Earnings per share as reported—Diluted | **$ 1.21** | $ 1.55 | $ 1.38 |
| Earnings per share—pro forma—Diluted | **$ 1.17** | $ 1.52 | $ 1.35 |

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts.

### *Note 10 — Waste-to-Energy Facility*

The Company owns a waste-to-energy facility, SESCO, in Savannah, Georgia. SESCO is under contract with the Resource Recovery Development Authority ("the Authority") of the City of Savannah ("the City") to receive and dispose of the City's solid waste through 2007. The contract provides for minimum levels of SESCO's disposal fee income to be used to retire the $50,700,000 of industrial revenue bonds issued by the Authority of the City to finance construction of the plant.

In substance, the City desired a solid waste disposal and resource recovery facility, issued bonds to finance construction of the facility, and contracted SESCO to construct, operate and maintain the facility. In return for its services, it was intended that the Company would receive a reasonable profit and the facility upon the termination of the various agreements. SESCO is obligated to perform under the various agreements. SESCO is therefore merely the operator of the facility and has not recorded the cost of the facility or the obligations related to its construction in its Consolidated Financial Statements.

Under terms of the contract, SESCO made contributions to the Authority totaling $9,200,000. In consideration for these contributions, the waste-to-energy facility will revert to the Company, subject to collateral agreements under the bond indentures, when the service agreement expires. The Company is not required to make any additional payments to the Authority. SESCO has made capital expenditures to improve the operating facility which have been accounted for as deferred expenses. Deferred expenses, net of impairment, are being amortized through 2007 (see Note 3).

During 1998, Katy evaluated the carrying value of SESCO. Continued operating and cash flow losses combined with the efforts to dispose of SESCO led to the Company's determination to conduct such review. Accordingly, during the fourth quarter of 1998, Katy adjusted the carrying value of SESCO's long-lived assets to their estimated fair value, resulting in a pre-tax impairment of $2,800,000. The estimated fair value was based upon comparable asset values and anticipated future cash flows discounted at a rate commensurate with the risk involved. SESCO is one of the "Operations to be Disposed Of" included in the previously reported Divestiture and Reorganization Plan. SESCO's historical operating results have been segregated as "Equity in income (loss) of operations to be disposed of" on the accompanying Consolidated Statements of Operations for the years ended December 31, 1999, 1998 and 1997.

### *Note 11 — Income Taxes*

The domestic and foreign components of income (loss) before income taxes, exclusive of distribution on preferred interest in subsidiary, are:

| *(Thousands of dollars)* | **1999** | 1998 | 1997 |
|---|---|---|---|
| Domestic | | | |
| Continuing | **$14,075** | $19,179 | $14,148 |
| Discontinued | **2,087** | — | 3,159 |
| Total domestic | **$16,162** | $19,179 | $17,307 |
| Foreign | | | |
| Continuing | **$ 2,975** | $ 642 | $ 417 |
| Discontinued | **(3,809)** | — | (49) |
| Total foreign | **$ (834)** | $ 642 | $ 368 |
| Total worldwide | **$15,328** | $19,821 | $17,675 |

The components of the net provision (benefit) for income taxes are:

| *(Thousands of dollars)* | **1999** | 1998 | 1997 |
|---|---|---|---|
| Continuing operations: | | | |
| Current: | | | |
| Federal | **$ (2,108)** | $ 4,240 | $ 2,786 |
| State | **228** | 590 | 340 |
| Foreign | **1,761** | 285 | 47 |
| Total | **(119)** | 5,115 | 3,173 |
| Deferred: | | | |
| Federal | **1,369** | 1,585 | 1,315 |
| State | **758** | 171 | 269 |
| Foreign | **306** | (132) | 165 |
| Total | **2,433** | 1,624 | 1,749 |
| Total continuing operations | **$ 2,314** | $ 6,739 | $ 4,922 |
| Discontinued operations: | | | |
| Federal | **$ 730** | $ — | $ 1,065 |
| State | **33** | — | 104 |
| Foreign | **(785)** | — | (18) |
| Total | **(22)** | — | 1,151 |
| Net provision for income taxes | **$ 2,292** | $ 6,739 | $ 6,073 |

The total income tax provision for continuing operations differed from the amount computed by applying the statutory federal income tax rate to pre-tax income from continuing operations. The computed amount and the differences for the years ended December 31, 1999, 1998 and 1997 were as follows:

| *(Thousands of dollars)* | **1999** | 1998 | 1997 |
|---|---|---|---|
| Provision for income taxes at statutory rate | **$ 5,968** | $6,937 | $5,098 |
| Revision of prior years' tax estimates | **(2,750)** | — | — |
| State income taxes, net of federal benefit | **906** | 476 | 492 |
| Foreign tax rate differential | **(40)** | 10 | 20 |
| Amortization of negative goodwill | **(596)** | (596) | (596) |
| Benefit of net operating loss carryforwards | **—** | (66) | (49) |
| Other, net | **(271)** | (22) | (43) |
| Provision for income taxes from continuing consolidated operations | **3,217** | 6,739 | 4,922 |
| Distribution on preferred interest of subsidiary | **(903)** | — | — |
| Net provision for income taxes from continuing operations | **$ 2,314** | $6,739 | $4,922 |

The tax effects of significant items comprising the Company's net deferred tax liability as of December 31, 1999 and 1998 are as follows:

| *(Thousands of dollars)* | **1999** | 1998 |
|---|---|---|
| Deferred tax liabilities: | | |
| Difference between book and tax basis of property | **$ 5,605** | $ 449 |
| Waste-to-energy facility | **17,598** | 18,763 |
| Inventory costs | **1,070** | — |
| Undistributed earnings of equity investees | **1,538** | 10,372 |
| | **25,811** | 29,584 |
| Deferred tax assets: | | |
| Allowance for doubtful receivables | **1,501** | 2,156 |
| Inventory costs | **—** | 3,470 |
| Accrued expenses and other items | **11,285** | 11,708 |
| Operating loss carryforwards—domestic | **2,499** | 2,574 |
| Operating loss carryforwards—foreign | **1,503** | 555 |
| Tax credit carryforwards | **686** | — |
| | **17,474** | 20,463 |
| Less valuation allowance | **(3,203)** | (450) |
| | **14,271** | 20,013 |
| Net deferred income tax liability | **$11,540** | $ 9,571 |

The caption entitled "Revision of prior years' tax estimates", as shown in the table above, includes amounts for the reversal of reserves which the Company no longer believes are necessary, other changes in prior year tax estimates and changes in valuation allowances with respect to deferred income tax assets. Generally, the reversal of reserves relate to the expiration of the relevant statute of limitations with respect to certain income tax returns, or the resolution of specific income tax matters with the relevant tax authorities.

The domestic and foreign net operating loss carryforwards primarily relate to SESCO and the Company's Canadian operations, respectively, and can only be used to offset income from these operations. The Company's Canadian subsidiaries have Canadian net operating loss carryforwards of approximately $4,174,000 at December 31, 1999 that expire in the years 2002 through 2006. SESCO has state net operating loss carryforwards of $49,974,000 at December 31, 1999 that expire in the years 2003 through 2019. The tax credit carryforwards relate to certain foreign tax credit carryovers that expire in 2004.

The valuation allowance primarily relates to domestic state and foreign net operating loss carryforwards of SESCO and the Company's Canadian operations, respectively, the tax benefits from which may not be realized. The valuation allowance increased $2,753,000 during the year ended December 31, 1999, due to past losses from these operations and uncertainties as to their ability to generate future taxable income.

### *Note 12 — Lease Obligations*

The Company has entered into noncancelable leases for manufacturing and data processing equipment and real property with lease terms of up to ten years. Future minimum lease payments as of December 31, 1999 are as follows:

| *(Thousands of dollars)* | |
|---|---|
| 2000 | $12,847 |
| 2001 | 12,124 |
| 2002 | 10,935 |
| 2003 | 10,258 |
| 2004 | 9,454 |
| Later years | 27,222 |
| Total minimum payments | $82,840 |

Rental expense for 1999, 1998 and 1997 for operating leases was $13,247,000, $5,138,000 and $3,928,000, respectively.

### *Note 13 — Related Party Transactions*

In connection with the Contico acquisition on January 8, 1999, Katy entered into building leases with Newcastle. Newcastle is majority-owned by Lester I. Miller, who was appointed to Katy's Board of Directors on January 8, 1999. Also, several additional properties utilized by Contico are leased directly from Lester I. Miller. Aggregate rental expense of approximately $5,500,000 was recorded in 1999 relating to these leases. Rental expense for these properties approximates market rates. In October of 1999, certain of the above properties were sold by Newcastle to an unrelated third party. Related party rental expense for the year ending December 31, 2000 is expected to approximate $1,500,000.

The Company paid Newcastle $2,581,000 of preferred dividends for the year ended December 31, 1999 (see Note 8).

### *Note 14 — Industry Segments and Geographic Information*

The Company is a manufacturer and distributor of a variety of industrial and consumer products, including sanitary maintenance supplies, coated abrasives, stains, electrical and electronic components, and nonpowered hand tools. Principal markets are in the United States, Canada, and Europe and include the sanitary maintenance, restaurant supply, retail, electronic, automotive, and computer markets. These activities are grouped into two industry segments: Electrical/Electronics and Maintenance Products. During 1999, Katy had several large customers in the mass merchant/discount/home improvement retail markets.

While no single customer accounted for 10% of Katy's consolidated sales, several approached this threshold, and a significant loss of business at any of these retail outlets would have an adverse impact on the Company's results. Katy had one major customer in its Electrical/Electronics segment that accounted for approximately $46,796,000 or 14% of the Company's consolidated 1998 annual sales. On November 4, 1998, the Company announced that this major customer withdrew its commitment to purchase electric corded products from Woods at or about year end 1998.

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

| Years ended December 31, *(Thousands of dollars)* | **1999** | 1998 | 1997 |
|---|---|---|---|
| *Electrical/ Electronics Group* | | | |
| Net external sales | **$204,180** | $230,927 | $218,237 |
| Net intercompany sales | **59,992** | 32,103 | 175 |
| Income from operations [a] | **8,303** | 14,839 | 13,191 |
| Operating margin | **4.1%** | 6.4% | 6.0% |
| Identifiable assets | **133,890** | 126,362 | 112,156 |
| Depreciation and amortization | **2,557** | 1,652 | 398 |
| Capital expenditures | **3,434** | 7,348 | 5,138 |
| *Maintenance Products Group* | | | |
| Net external sales | **$361,761** | $111,388 | $ 67,786 |
| Net intercompany sales | **11,141** | 6,389 | 4,306 |
| Income from operations [a] | **29,458** | 8,401 | 6,328 |
| Operating margin | **8.1%** | 7.5% | 9.3% |
| Identifiable assets | **318,906** | 110,317 | 46,333 |
| Depreciation and amortization | **17,065** | 3,779 | 1,854 |
| Capital expenditures | **16,936** | 2,725 | 1,234 |
| *Operations to be Disposed Of* | | | |
| Net external sales | **$ 3,900** | $ 6,297 | $ 9,568 |
| Net intercompany sales | **—** | — | — |
| Income (loss) from operations | **(190)** | (3,262) | 122 |
| Operating margin | **(4.9)%** | (7.3)% | 1.3% |
| Identifiable assets | **17,903** | 17,680 | 31,599 |
| Equity Investments | **6,988** | 7,034 | 6,500 |
| Depreciation and amortization | **5** | 1,009 | 1,549 |
| Capital expenditures | **429** | 5,126 | 3,034 |

| Years ended December 31, *(Thousands of dollars)* | **1999** | 1998 | 1997 |
|---|---|---|---|
| *Discontinued Operations* | | | |
| Net external sales | **$ 10,025** | $ 23,349 | $ 31,537 |
| Net intercompany sales | **—** | 146 | — |
| Income (loss) from operations | **(191)** | 1,663 | 3,046 |
| Operating margin | **(1.9)%** | 7.1% | 9.7% |
| Identifiable assets | **—** | 16,975 | 18,486 |
| Depreciation and amortization | **454** | 631 | 681 |
| Capital expenditures | **80** | 547 | 1,252 |
| *Corporate* | | | |
| Corporate expenses [a] | **$ 9,990** | $ 7,965 | $ 6,496 |
| Identifiable assets | **22,405** | 24,535 | 43,818 |
| Depreciation and amortization | **91** | 91 | 86 |
| Capital expenditures | **187** | 175 | 41 |
| *Company* | | | |
| Net external sales [b] | **$579,866** | $371,961 | $327,128 |
| Net intercompany sales | **71,133** | 38,638 | 4,481 |
| Income from operations [b] | **27,390** | 13,676 | 16,191 |
| Operating margin [b] | **4.7%** | 4.4% | 4.9% |
| Identifiable assets [b] | **493,104** | 295,869 | 252,392 |
| Depreciation and amortization [b] | **20,172** | 7,162 | 4,568 |
| Capital expenditures | **21,066** | 15,921 | 10,699 |

*[a] Salaries and related costs for certain executive officers were included in Maintenance Products and Electrical/Electronics in 1998 and 1997, but have been included in Corporate Expense in 1999. These amounts were approximately $1,500,000 in 1999, $1,400,000 in 1998 and $900,000 in 1997.*

*[b] Company balances include amounts separately classified as "Discontinued Operations" and "Operations to be Disposed Of" in the consolidated financial statements for 1999, 1998 and 1997. The "Income (loss) from operations" for "Discontinued Operations" has been recorded in the line item "Income (loss) from operations of discontinued businesses (net of tax)" on the 1999 Consolidated Statement of Operations (see Note 3).*

The Company follows generally accepted accounting principles in preparing its segment information. The following tables reconcile the Company's total revenues, operating income and assets to the Company's Consolidated Statements of Operations and Consolidated Balance Sheets.

| *(Thousands of dollars)* | **1999** | 1998 | 1997 |
|---|---|---|---|
| Revenues | | | |
| Total revenues for reportable segments | **$650,999** | $410,599 | $331,609 |
| Elimination of intercompany revenues | **(71,133)** | (38,638) | (4,481) |
| Revenues included in Equity in (income) loss of operations to be disposed of | **(3,900)** | (6,297) | (9,568) |
| Revenues included in discontinued operations | **(10,025)** | (23,349) | (31,537) |
| Total consolidated revenues | **$565,941** | $342,315 | $286,023 |
| Operating Income | | | |
| Total operating income for reportable segments | **$ 27,390** | $ 13,676 | $ 16,191 |
| Operating income included in Equity in (income) loss of operations to be disposed of | **190** | 462 | (122) |
| Loss from impairment of assets | **—** | 2,800 | — |
| Operating (income) loss included in discontinued operations | **191** | (1,663) | (3,046) |
| Total consolidated operating income | **$ 27,771** | $ 15,275 | $ 13,023 |
| Total Assets | | | |
| Total assets for reportable segments | **$493,104** | $295,869 | |
| Liabilities included in Net current and Net noncurrent assets of operations to be disposed of | **(1,268)** | (956) | |
| Liabilities included in Net current and Net noncurrent assets of discontinued operations | **—** | (1,738) | |
| Total consolidated assets | **$491,836** | $293,175 | |

Export sales of products, primarily to Canada, Mexico, Europe, and the Far East, were $17,862,000, $19,641,000, and $15,197,000 in 1999, 1998 and 1997, respectively.

The Company operates businesses in the United States and foreign countries. The operations for 1999, 1998 and 1997 of businesses within major geographic areas are summarized as follows:

| *(Thousands of dollars)* | United States | Canada/ Mexico | Europe | Far East & Other | Consolidated |
|---|---|---|---|---|---|
| **1999:** | | | | | |
| Sales to unaffiliated customers | $478,105 | $52,957 | $31,002 | $3,877 | $565,941 |
| Operating income | $ 20,670 | $ 3,881 | $ 2,834 | $ 386 | $ 27,771 |
| Identifiable assets | $441,054 | $29,055 | $21,727 | $ — | $491,836 |
| 1998: | | | | | |
| Sales to unaffiliated customers | $298,572 | $35,876 | $ 5,246 | $2,621 | $342,315 |
| Operating income | $ 12,539 | $ 1,852 | $ 626 | $ 258 | $ 15,275 |
| Identifiable assets | $261,309 | $31,866 | $ — | $ — | $293,175 |
| 1997: | | | | | |
| Sales to unaffiliated customers | $266,403 | $13,526 | $ 3,541 | $2,553 | $286,023 |
| Operating income | $ 11,551 | $ 958 | $ 299 | $ 215 | $ 13,023 |
| Identifiable assets | $222,300 | $14,860 | $ — | $ — | $237,160 |

Net sales for each geographic area include sales of products produced in that area and sold to unaffiliated customers, as reported in the Consolidated Statements of Operations.

*Note 15 — Contingent Liabilities*

In December 1996, Banco del Atlantico, a bank located in Mexico, filed a lawsuit against Woods, and 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 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 the Company's purchase of Woods. The plaintiff also alleges that it made loans to an entity controlled by certain officers and directors based upon fraudulent representations. The plaintiff seeks to hold Woods liable for its alleged damage under principles of respondeat superior and successor liability. The plaintiff is claiming damages in excess of $24,000,000 and is requesting treble damages under the statutes. The defendants have filed a motion, which has not been ruled on, to dismiss this action on jurisdictional grounds. Because the litigation is in preliminary stages, it is not possible at this time for the Company to determine an outcome or reasonably estimate the range of potential exposure. The Company 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 the Company 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. The extent or limit of any such recourse cannot be predicted at this time.

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. It can take up to 10 years from the date of the injury to reach a final outcome for such 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, 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 the final outcome.

The Company and certain of its current and former direct and indirect corporate predecessors, subsidiaries and divisions have been identified by the United States Environmental Protection Agency, 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 in the aggregate amount of approximately $4,100,000 at December 31, 1999. The ultimate cost 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. The Company expects this amount to be substantially paid over the next one to four years.

The most significant environmental matters in which the Company is currently involved are as follows:

1. In 1993, the United States Environmental Protection Agency ("USEPA") 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 USEPA 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.

2. During 1995, the Company reached agreement with the Oregon Department of Environmental Quality ("ODEQ") as to a cleanup plan for PCB contamination at the Medford, Oregon facility of the former Standard Transformer division of American Gage. The agreement required the Company to pay $1,300,000 of the first $2,000,000 in cleanup costs. Those funds were expended in 1998. Another former occupant of the site, Balteau Standard, Inc. was responsible for the remaining $700,000 of the first $2,000,000 and the next $450,000 in cleanup costs above the $2,000,000. The parties are now sharing equally in cleanup costs. Katy believes the

cleanup plan has been successful and has requested that the ODEQ inspect and approve the remediation work. Katy has received such approval with respect to a portion of the cleanup plan. Further monitoring of groundwater and testing and cleanup of adjacent property may be required before approval can be obtained with respect to the remainder of the plan. Pending such approval, the liability of Katy and its subsidiary cannot be determined at this time.

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

### *Note 16 — Quarterly Results of Operations (Unaudited)*

Quarterly results of operations have been affected by unusual or infrequently occurring items as discussed below.

| *(Thousands of dollars, except per share data)* | 1st Qtr | 2nd Qtr | 3rd Qtr | 4th Qtr |
|---|---|---|---|---|
| **1999** | | | | |
| Net sales | $126,429 | $129,394 | $145,548 | $164,570 |
| Gross profit | $ 40,144 | $ 41,300 | $ 46,570 | $ 46,545 |
| Income from continuing operations | $ 1,490 | $ 198 | $ 4,308 | $ 6,159 |
| Discontinued operations | — | — | — | (1,700) |
| Net income | $ 1,490 | $ 198 | $ 4,308 | $ 4,459 |
| Earnings per share—Basic | | | | |
| Continuing operations | $ .18 | $ .02 | $ .52 | $ .73 |
| Discontinued operations | — | — | — | (.20) |
| Net income | $ .18 | $ .02 | $ .52 | $ .53 |
| Earnings per share—Diluted | | | | |
| Continuing operations | $ .18 | $ .02 | $ .48 | $ .66 |
| Discontinued operations | — | — | — | (.17) |
| Net income | $ .18 | $ .02 | $ .48 | $ .49 |

| | 1st Qtr | 2nd Qtr | 3rd Qtr | 4th Qtr |
|---|---|---|---|---|
| 1998 | | | | |
| Net sales | $ 68,856 | $ 71,626 | $ 94,814 | $107,019 |
| Gross profit | $ 19,171 | $ 22,344 | $ 28,182 | $ 28,867 |
| Income from continuing operations | $ 1,873 | $ 2,785 | $ 3,800 | $ 4,624 |
| Discontinued operations | — | — | — | — |
| Net income | $ 1,873 | $ 2,785 | $ 3,800 | $ 4,624 |
| Earnings per share—Basic | | | | |
| Continuing operations | $ .23 | $ .34 | $ .46 | $ .56 |
| Discontinued operations | — | — | — | — |
| Net income | $ .23 | $ .34 | $ .46 | $ .56 |
| Earnings per share—Diluted | | | | |
| Continuing operations | $ .22 | $ .33 | $ .45 | $ .55 |
| Discontinued operations | — | — | — | — |
| Net income | $ .22 | $ .33 | $ .45 | $ .55 |

During the fourth quarter of 1999, the Company recorded a pre-tax gain of $800,000 from the collection of previously reserved notes, a pre-tax charge of $1,029,000 to increase the LIFO inventory reserve (see Note 1) and a pre-tax charge of $559,000 relating to the potential sale of Electrical/ Electronics segment and other restructuring. During the second quarter, a $600,000 restructuring charge was recorded relating to the elimination of 22 management positions in the Electrical/Electronics Segment (see Note 17). In addition, the Company reversed $2,750,000 of income tax liabilities in the fourth quarter of 1999 as a result of the closure for audit purposes of certain tax years (see Note 11).

During 1998, the Company recorded a pre-tax gain of $6,122,000 from the sale of CEGF. In addition, Katy recorded a pre-tax impairment loss of $2,800,000 reducing SESCO's book value.

### *Note 17 — Restructuring Charge*

During the second quarter of 1999, the Company undertook a restructuring of the Electrical/Electronics businesses, which included severance and related costs for certain employees. Approximately 22 employees accepted severance packages. Total severance and related costs were $600,000, which are included in Selling, general and administrative costs on the Consolidated Statement of Operations. Substantially all of these costs were paid during the third quarter of 1999.

## *Market for Common Equity and Related Stockholder Matters*

Katy's common stock is traded on the New York Stock Exchange ("NYSE"). The following table sets forth high and low sales prices for the common stock in composite transactions as reported on the NYSE composite tape for the prior two years and dividends declared during such periods.

| Period | High | Low | Cash Dividends Declared |
|---|---|---|---|
| **1999** | | | |
| First Quarter | $17 5/16 | $12 3/4 | $.075 |
| Second Quarter | 17 5/8 | 12 3/4 | .075 |
| Third Quarter | 12 15/16 | 10 7/8 | .075 |
| Fourth Quarter | 12 1/16 | 8 | .075 |
| 1998 | | | |
| First Quarter | $20 1/4 | $17 5/8 | $.075 |
| Second Quarter | 19 15/16 | 17 7/8 | .075 |
| Third Quarter | 18 13/16 | 13 7/8 | .075 |
| Fourth Quarter | 21 | 15 1/16 | .075 |

Dividends are paid at the discretion of the Board of Directors and are reviewed on a quarterly basis.

As of March 17, 2000, there were 2,231 record holders of the Common Stock and there were 8,410,658 shares of Common Stock outstanding.

# Corporate Information

### Board of Directors

JACOB SALIBA(1)(3)
*Chairman of the Board*

WILLIAM F. ANDREWS(2)
*Chairman of the Board, Scovill Fasteners*

AMELIA M. CARROLL
*Investor*

DANIEL B. CARROLL(2)(3)
*Member and Manager, Newgrange LLC*

WALLACE E. CARROLL(1)
*Chairman of the Board, CRL, Inc.*

ARTHUR R. MILLER(1)
*Executive Vice President, Corporate Development, Secretary and General Counsel*

LESTER I. MILLER
*Former Chairman, Contico International, Inc.*

WILLIAM H. MURPHY(1)(2)
*Former President, Chief Operating Officer and Chief Financial Officer*

JOHN R. PRANN, JR.(1)
*President, Chief Executive Officer*

LUTZ RAETTIG
*Chairman, Management Board, Morgan Stanley Bank AG*

CHARLES W. SAHLMAN(1)(3)
*President, Bee Gee Holding Company, Inc.*

GLENN W. TURCOTTE
*Executive Vice President, Chief Operating Officer*

*(1) Executive Committee*
*(2) Audit Committee*
*(3) Compensation Committee*

### Executive Management

JOHN R. PRANN, JR.
*President, Chief Executive Officer*

ROBERT M. BARATTA
*Senior Vice President*

ROGER G. ENGLE
*Vice President*

LARRY D. HUDSON
*Vice President, Operations*

ARTHUR R. MILLER
*Executive Vice President, Corporate Development, Secretary and General Counsel*

PETER S. MORE
*Group Vice President, Finance*

STEPHEN P. NICHOLSON
*Vice President, Finance, Chief Financial Officer*

GLENN W. TURCOTTE
*Executive Vice President, Chief Operating Officer*

### Corporate Staff Officers

RICHARD G. BERNET
*Associate General Counsel*

MARK P. INGEBRITSON
*Controller*

RONALD J. KLUMP
*Treasurer*

ROBERT S. WERT
*Associate General Counsel*

### Operating Management

#### Electrical/Electronics

BARRY A. BRANDT
*President, Hamilton Precision Metals*

RAYMOND A. CHAMPI
*General Manager, GC/Waldom, Inc.*

DANIEL J. ESPOSITO
*President, Woods North America*

#### Maintenance Products

LUIS A. ALVARADO
*General Manager, Contico Container*

FRANK P. COMPARONE
*General Manager, Loren Products*

ROGER G. ENGLE
*Chairman, Contico International, LLC*
*President, Continental Manufacturing*

VERNON L. HOLMES
*Managing Director, Contico Manufacturing, Ltd.*

MICHAEL H. KANE
*President, Contico Manufacturing Company*

THOMAS MATHERS
*Managing Director, Contico Europe Holdings*

RICHARD D. MAZZOLI
*President, Glit, Inc.*
*President, Microtron Abrasives, Inc.*

KEITH MILLS
*President, Wilen Products, Inc.*
*President, Glit/Disco, Inc.*

PATRICK K. WEVER
*President, Duckback Products, Inc.*

MICHAEL S. WILSON
*General Manager, Glit/Gemtex, Ltd.*

ERNEST R. BENNETT
*President, Savannah Energy Systems Company*

### Headquarters
6300 South Syracuse Way, Suite 300
Englewood, Colorado 80111-6723
Telephone: (303) 290-9300
Fax: (303) 290-9344

### Investor Relations
Stockholders and prospective investors are welcome to call, write or visit our web site (www.katyindustries.com) with questions or requests for additional information.

Contact: Stephen P. Nicholson, Vice President, Finance and Chief Financial Officer.

### Outside Counsel
Shiff Hardin & Waite
6600 Sears Tower
Chicago, Illinois 80606

### Independent Auditors
Arthur Andersen LLP
1225 17th Street, Suite 3100
Denver, Colorado 80202

### Principal Transfer Agent and Registrar
LaSalle Bank N.A.
135 South LaSalle Street
Room 1811
Chicago, Illinois 60603
1-800-246-5761

### Shares Listed
Common—New York Stock Exchange (Symbol: KT) Daily stock prices are listed in major newspapers, generally alphabetically under "KatyInd."

### Form 10-K Available on Request
A copy of the Company's annual report on form 10-K filed with the Securities and Exchange Commission may be obtained, without charge, through written request to:

Mr. Stephen P. Nicholson,
Vice President, Finance and
Chief Financial Officer, Katy Industries, Inc.
6300 South Syracuse Way, Suite 300
Englewood, Colorado 80111-6723.

### Stockholder Inquiry Service
Correspondence concerning stockholder accounts or dividend payments should be directed to:

LaSalle Bank N.A.
135 South LaSalle Street
Room 1811
Chicago, Illinois 60603
1-800-246-5761

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