KATY INDUSTRIES INC
Form 10-Q
November 17, 2005

THIS DOCUMENT IS A COPY OF THE FORM 10-Q FILED ON NOVEMBER 15, 2005 PURSUANT TO A RULE 201 TEMPORARY HARDSHIP EXEMPTION

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

FORM 10-Q

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

For Quarterly period ended: September 30, 2005

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from_______________ to________________

Commission File Number 001-05558

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

Delaware	75-1277589
(State of Incorporation)	(I.R.S. Employer Identification No.)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

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

Class	Outstanding at November 15, 2005
Common Stock, $1 Par Value	7,951,377

KATY INDUSTRIES, INC.
FORM 10-Q
September 30, 2005

INDEX

			Page
PART I	FINANCIAL INFORMATION		
	Item 1.	Financial Statements:	
		Condensed Consolidated Balance Sheets September 30, 2005 and December 31, 2004 (unaudited)	3
		Condensed Consolidated Statements of Operations Three Months and Nine Months Ended September 30, 2005 and 2004 (unaudited)	5
		Condensed Consolidated Statements of Cash Flows Nine Months Ended September 30, 2005 and 2004 (unaudited)	6
		Notes to Condensed Consolidated Financial Statements (unaudited)	7
	Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	25
	Item 3.	Quantitative and Qualitative Disclosures about Market Risk	42
	Item 4.	Controls and Procedures	43
PART II	OTHER INFORMATION		
	Item 1.	Legal Proceedings	45
	Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	45
	Item 5.	Other Information	45
	Item 6.	Exhibits	45
	Signatures		46
	Certifications		

-2-

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Amounts in Thousands)
(Unaudited)

ASSETS

	September 30, 2005	December 31, 2004
CURRENT ASSETS:		
Cash and cash equivalents	$ 8,627	$ 8,525
Accounts receivable, net	76,084	66,689
Inventories, net	60,536	65,674
Other current assets	4,534	4,233
Total current assets	149,781	145,121
OTHER ASSETS:		
Goodwill	2,239	2,239
Intangibles, net	7,814	7,428
Other	9,036	9,946
Total other assets	19,089	19,613
PROPERTY AND EQUIPMENT		
Land and improvements	1,766	1,897
Buildings and improvements	14,353	13,537
Machinery and equipment	138,056	132,825
	154,175	148,259
Less - Accumulated depreciation	(97,009)	(88,529)
Property and equipment, net	57,166	59,730
Total assets	$ 226,036	$ 224,464

See Notes to Condensed Consolidated Financial Statements.

-3-

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

LIABILITIES AND STOCKHOLDERS' EQUITY

	September 30, 2005	December 31, 2004
CURRENT LIABILITIES:		
Accounts payable	$ 51,284	$ 39,079
Accrued compensation	4,438	5,269
Accrued expenses	41,441	39,939
Current maturities of long-term debt	3,472	2,857
Revolving credit agreement	41,085	40,166
Total current liabilities	141,720	127,310
LONG-TERM DEBT, less current maturities	13,571	15,714
OTHER LIABILITIES	10,772	12,855
Total liabilities	166,063	155,879
COMMITMENTS AND CONTINGENCIES (Note 9)	-	-
STOCKHOLDERS' EQUITY		
15% Convertible Preferred Stock, $100 par value, authorized 1,200,000 shares, issued and outstanding 1,131,551 shares, liquidation value $113,155	108,256	108,256
Common stock, $1 par value, authorized 35,000,000 shares, issued 9,822,204 shares	9,822	9,822
Additional paid-in capital	27,016	25,111
Accumulated other comprehensive income	3,338	4,564
Accumulated deficit	(66,619)	(57,258)
Treasury stock, at cost, 1,870,827 and 1,876,827 shares, respectively	(21,840)	(21,910)
Total stockholders' equity	59,973	68,585
Total liabilities and stockholders' equity	$ 226,036	$ 224,464

See Notes to Condensed Consolidated Financial Statements.

KATY INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004
(Thousands of Dollars, Except Share and Per Share Data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net sales	$ 140,557	$ 135,426	$ 334,280	$ 335,843
Cost of goods sold	122,896	117,569	295,310	288,095
Gross profit	17,661	17,857	38,970	47,748
Selling, general and administrative expenses	13,861	14,846	40,100	43,834
Stock option expense	-	-	1,953	-
Severance, restructuring and related charges	662	167	1,975	1,956
(Gain) loss on sale of assets	(187)	3	(353)	(546)
Operating income (loss)	3,325	2,841	(4,705)	2,504
Interest expense	(1,487)	(1,017)	(4,143)	(2,814)
Other, net	219	(30)	209	(261)
Income (loss) before provision for income taxes	2,057	1,794	(8,639)	(571)
Provision for income taxes	724	918	722	1,617
Net income (loss)	1,333	876	(9,361)	(2,188)
Payment-in-kind dividends on convertible preferred stock	-	(3,822)	-	(10,746)
Net income (loss) attributable to common stockholders	$ 1,333	$ (2,946)	$ (9,361)	$ (12,934)
Income (loss) per share of common stock - Basic:				
Net income (loss)	$ 0.17	$ 0.11	$ (1.18)	$ (0.28)
Payment-in-kind dividends on convertible preferred stock	-	(0.48)	-	(1.36)
Net income (loss) attributable to common stockholders	$ 0.17	$ (0.37)	$ (1.18)	$ (1.64)
Income (loss) per share of common stock - Diluted:				
Net income (loss)	$ 0.05	$ 0.11	$ (1.18)	$ (0.28)
Payment-in-kind dividends on convertible preferred stock	-	(0.48)	-	(1.36)

Net income (loss) attributable to common stockholders	$	0.05	$	(0.37)	$	(1.18)	$	(1.64)
Weighted average common shares outstanding (thousands):								
Basic		7,951		7,870		7,948		7,875
Diluted		26,880		7,870		7,948		7,875

See Notes to Condensed Consolidated Financial Statements.

KATY INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004
(Thousands of Dollars)
(Unaudited)

	2005	2004
Cash flows from operating activities:		
Net loss	$ (9,361)	$ (2,188)
Depreciation and amortization	8,606	11,102
Amortization of debt issuance costs	844	804
Stock option expense	1,953	-
Gain on sale of assets	(353)	(546)
	1,689	9,172
Changes in operating assets and liabilities:		
Accounts receivable	(9,596)	(10,637)
Inventories	5,019	(19,072)
Other assets	(471)	(1,136)
Accounts payable	12,456	5,546
Accrued expenses	677	(125)
Other, net	(2,090)	(2,404)
	5,995	(27,828)
Net cash provided by (used in) operating activities	7,684	(18,656)
Cash flows from investing activities:		
Capital expenditures	(5,785)	(10,838)
Acquisition of business, net of cash acquired	(1,658)	-
Collections of note receivable from sale of subsidiary	106	14
Proceeds from sale of assets	931	5,545
Net cash used in investing activities	(6,406)	(5,279)
Cash flows from financing activities:		
Net borrowings on revolving loans	1,045	12,536
Proceeds of term loans	-	18,152
Repayments of term loans	(2,143)	(3,244)
Direct costs associated with debt facilities	(244)	(1,439)
Repurchases of common stock	-	(75)
Net cash (used in) provided by financing activities	(1,342)	25,930
Effect of exchange rate changes on cash and cash equivalents	166	(117)
Net increase in cash and cash equivalents	102	1,878
Cash and cash equivalents, beginning of period	8,525	6,748
Cash and cash equivalents, end of period	$ 8,627	$ 8,626

See Notes to Condensed Consolidated Financial Statements

KATY INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2005

(1) Significant Accounting Policies

Consolidation Policy and Basis of Presentation
The condensed consolidated financial statements include the accounts of Katy Industries, Inc. and subsidiaries in which it has a greater than 50% interest, collectively "Katy" or the Company. All significant intercompany accounts, profits and transactions have been eliminated in consolidation. Investments in affiliates that are not majority owned and where the Company exercises significant influence are reported using the equity method. The condensed consolidated financial statements at September 30, 2005 and December 31, 2004 and for the three and nine month periods ended September 30, 2005 and 2004 are unaudited and reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the financial condition and results of operations of the Company. Interim results may not be indicative of results to be realized for the entire year. The condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto, together with management's discussion and analysis of financial condition and results of operations, contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2004.

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

Inventories
The components of inventories are as follows (amounts in thousands):

	September 30, 2005	December 31, 2004
Raw materials	$ 21,045	$ 23,220
Work in process	1,766	1,826
Finished goods	42,640	45,299
Inventory reserves	(4,915)	(4,671)
	$ 60,536	$ 65,674

At September 30, 2005 and December 31, 2004, approximately 34% and 39%, respectively, of Katy's inventories were accounted for using the last-in, first-out ("LIFO") method of costing, while the remaining inventories were accounted for using the first-in, first-out ("FIFO") method. Current cost, as determined using the FIFO method, exceeded LIFO cost by $4.5 million and $4.7 million at September 30, 2005 and December 31, 2004, respectively.

Property, Plant and Equipment
Property and equipment 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) using straight-line or composite methods; tooling (5 years) using the straight-line method; and leasehold improvements using the straight-line method over the remaining lease period or useful life, if shorter. Costs for repair and maintenance of machinery and equipment are expensed as incurred, unless the result significantly increases the useful life or functionality of the asset, in which case capitalization is considered. Depreciation expense from continuing operations was $2.6 million and $3.0 million

and $8.1 million and $9.8 million for the three and nine month periods ended September 30, 2005 and 2004, respectively.

Katy adopted Statement of Financial Accounting Standards ("SFAS") No. 143, *Accounting for Asset Retirement Obligations*, on January 1, 2003. SFAS No. 143 requires that an asset retirement obligation associated with the retirement of a tangible long-lived asset be recognized as a liability in the period in which it is incurred or becomes determinable, with an associated increase in the carrying amount of the related long-term asset. The cost of the tangible asset, including the initially recognized asset retirement cost, is depreciated over the useful life of the asset. In accordance with SFAS No. 143, the Company has recorded as of September 30, 2005 an asset of $0.8 million and related liability of $1.1 million for retirement obligations associated with returning certain leased properties to the respective lessors upon the termination of the lease arrangements. A summary of the changes in asset retirement obligation since December 31, 2004 is included in the table below (amounts in thousands):

SFAS No. 143 Obligation at December 31, 2004	$ 1,237
Additions	330
Accretion expense	36
Changes in estimates, including timing	32
Payments	(580)
SFAS No. 143 Obligation at September 30, 2005	$ 1,055

Stock Options and Other Stock Awards

The Company follows the provisions of Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*, regarding accounting for stock options and other stock awards. APB Opinion No. 25 dictates a measurement date concept in the determination of compensation expense related to stock awards including stock options, restricted stock, and stock appreciation rights. The Company's outstanding stock options historically have had established measurement dates and therefore, fixed plan accounting was applied, generally resulting in no compensation expense for these stock option awards. In March 2004, the Company's Board of Directors approved the vesting of all previously outstanding and unvested stock options. The Company did not recognize any compensation expense upon this vesting of options because, based on the information available at that time, the Company did not have an expectation that the holders of the previously unvested options would terminate their employment with the Company prior to the original vesting period. In the second quarter of 2005, the Company's former President and Chief Executive Officer retired from the Company. Upon this event, the Company recognized $2.0 million of compensation expense related to his 1,050,000 options using the intrinsic method of accounting under APB 25, because he would not have otherwise vested in these options but for the March 2004 accelerated vesting. Upon his retirement, our former President and Chief Executive Officer immediately forfeited 750,000 options while 300,000 options remain unexercised. 150,000 options and zero options were granted during the three months ended September 30, 2005 and 2004, respectively, while 906,000 options and 6,000 options were granted during the nine months ended September 30, 2005 and 2004, respectively.

The Company has also issued stock appreciation rights and restricted stock awards which are accounted for as variable stock compensation awards and compensation expense or income has been recorded for these awards. Compensation expense recorded relative to stock awards was $22.1 thousand and $9.0 thousand for the nine month periods ended September 30, 2005 and 2004, respectively. No compensation expense was recorded relative to stock awards for the three months ended September 30, 2005 and 2004, respectively. Compensation income (expense) recorded associated with the vesting of stock appreciation rights was $0.1 million and ($0.1) million for the three month periods ended September 30, 2005 and 2004, respectively. Compensation income recorded associated with the vesting of stock appreciation rights was $0.9 million and $0.1 million for the nine month periods ended September 30, 2005 and 2004, respectively. No compensation expense was recorded relative to restricted stock awards during the three and nine months ended September 30, 2005 and 2004, respectively. Compensation expense or income for stock awards and stock appreciation rights is recorded in selling, general and administrative expenses in the Condensed Consolidated Statements of Operations.

-8-

SFAS No. 123, *Accounting for Stock-Based Compensation,* changes the method for recognition of expense related to option grants to employees. Under SFAS No. 123, compensation cost would be recorded based upon the fair value of each option at the date of grant using an option-pricing model that takes into account as of the grant date the exercise price and expected life of the option, the current price of the underlying stock and its expected volatility, expected dividends on the stock and the risk-free interest rate for the expected term of the option. The fair value of each option grant is estimated on the date of grant using a Black-Scholes option-pricing model with an expected life of five to ten years for all grants. Had compensation cost been determined based on the fair value method of SFAS No. 123, the Company's net loss and loss per share would have been adjusted to the pro forma amounts indicated below (amounts in thousands, except per share data).

	Three Months Ended September 30,				Nine Months Ended September 30,			
		2005		2004		2005		2004
Net income (loss) attributable to common stockholders, as reported	$	1,333	$	(2,946)	$	(9,361)	$	(12,934)
Add: Stock-based employee compensation expense included in reported net income (loss), with no related tax effects		-		-		1,953		-
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, with no related tax effects		(120)		-		(134)		(1,855)
Pro forma net income (loss)	$	1,213	$	(2,946)	$	(7,542)	$	(14,789)
Income (loss) per share - Basic:								
As reported	$	0.17	$	(0.37)	$	(1.18)	$	(1.64)
Pro forma	$	0.15	$	(0.37)	$	(0.95)	$	(1.88)
Income (loss) per share - Diluted:								
As reported	$	0.05	$	(0.37)	$	(1.18)	$	(1.64)
Pro forma	$	0.05	$	(0.37)	$	(0.95)	$	(1.88)

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement No. 123 (revised 2004), *Share-Based Payment* ("SFAS 123R"), which is a revision of SFAS No. 123. SFAS 123R supersedes APB Opinion No. 25, and amends FASB Statement No. 95, *Statement of Cash Flows*. The approach to quantifying stock-based compensation expense in SFAS 123R is similar to SFAS No. 123. However, the revised statement requires all share-based payments to employees, including grants of employee stock options, to be recognized as an expense in the Consolidated Statements of Operations based on their fair values as they are earned by the employees under the vesting terms. Pro forma disclosure of stock-based compensation expense, as is the Company's practice under SFAS No. 123, will not be permitted after 2005, since SFAS 123R must be adopted no later than the first interim or annual period beginning after December 15, 2005. The Company expects to follow the "modified prospective" method of adoption of SFAS 123R in the first quarter of 2006, whereby earnings for prior periods will not be restated as though stock based compensation had been expensed. Although the Company has not yet fully evaluated the effect of SFAS 123R on its results of operations, the Company believes that the impact on the Consolidated Statements of Operations will be similar to the pro forma impact shown above for the quarter ended September 30, 2005.

Derivative Financial Instruments

Effective August 17, 2005, the Company entered into an interest rate swap agreement designed to limit exposure to increasing interest rates on its floating rate indebtedness. The differential to be paid or received is recognized as an adjustment of interest expense related to the debt upon settlement. In connection with the Company's adoption of Statement of Financial Accounting Standards No. 133 ("FAS 133"), *Accounting for Derivative Financial Instruments and Hedging Activities*, the Company is required to recognize all derivatives on its balance sheet at fair value. As the derivative instrument held by the Company is classified as a hedge under FAS 133, changes in the fair value of the derivative will be offset against the change in fair value of the hedged liability through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. Hedge ineffectiveness associated with the swap will be reported by the Company in interest expense.

The Company accounts for its interest rate swap in accordance with FAS 133. The agreement has an effective date of August 17, 2005 and a termination date of August 17, 2007 with a notional amount of $25.0 million in the first year declining to $15.0 million in the second year. The Company is hedging its variable LIBOR-based interest rate for a fixed interest rate of 4.49% for the term of the swap agreement to protect the Company from potential interest rate increases. The Company has designated its benchmark variable LIBOR-based interest rate on a portion of the Bank of America Credit Agreement as a hedged item under a cash flow hedge. In accordance with FAS 133, the Company recorded a liability of less than $0.1 million on its balance sheet at September 30, 2005, with changes in fair market value included in other comprehensive income.

The Company reported insignificant losses for the three and nine months ended September 30, 2005, as a result of hedge ineffectiveness. Future changes in this swap arrangement, including termination of the agreement, may result in a reclassification of any gain or loss reported in other comprehensive income into earnings as an adjustment to interest expense.

Details regarding the swap as of September 30, 2005 are as follows (amounts in thousands):

Notional Amount	Maturity	Rate Paid	Rate Received	Fair Value (2)
$25,000	August 17, 2007	4.49%	LIBOR (1)	$ (40)

(1) LIBOR rate is determined on the 23rd of each month and continues up to and including the maturity date.
(2) The fair value is the mark-to-market value.

Earnings Per Share

The condensed consolidated financial statements include basic and diluted earnings per share. Diluted per share information is calculated by also considering the impact of potential common stock on the weighted average shares outstanding. Potential common stock consists of (a) stock options "in the money" based on the average stock price for the respective period and (b) convertible preferred shares accounted for using the "if converted" basis, which assumes their conversion to common stock at a ratio of 16.6:1.

The following table sets forth the computation of diluted earnings per share for the three months ended September 30, 2005 (amounts in thousands):

	For the three months ended September 30, 2005		
Basic EPS	Income	Shares	Per-share amount
Net income attributable to common stockholders	$ 1,333	7,951	$ 0.17
Effect of Dilutive Securities [a]			
Stock options		70	
Convertible preferred stock		18,859	
Diluted EPS	$ 1,333	26,880	$ 0.05

[a] For the nine months ended September 30, 2005 and 2004, respectively, and the three months ended September 30, 2004, the stock options and convertible preferred stock were not reflected, as their effect on earnings (loss) per share for the periods were anti-dilutive.

Reclassifications

Certain amounts from prior periods have been reclassified to conform to the current period presentation.

(2) New Accounting Pronouncements

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") became law in the U.S. The Act introduces a prescription drug benefit under Medicare, as well as a federal subsidy to sponsors of retiree health care benefit plans that provide retiree benefits in certain circumstances. FASB Staff Position (FSP) 106-2, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003* ("FSP 106-2"), issued in May 2004, requires measures of the accumulated postretirement benefit obligation ("APBO") and net periodic postretirement benefit cost ("NPPBC") to reflect the effects of the Act. FSP 106-2 became effective for the Company in the third quarter of fiscal 2004; however Katy had chosen to defer adoption until its next measurement date, subject to the final provisions of the Act. While the Company expects that it may be entitled to the federal subsidy for certain of its plans, the effect of the Act on the Company's accumulated postretirement benefit obligations is not material. While the Company may be entitled to the federal subsidy for certain of its plans, we have determined that the administrative costs of obtaining the subsidy meet or exceed any potential subsidy benefit.

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs, an amendment of ARB No. 43, Chapter 4* (SFAS 151). SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and spoilage. In addition, SFAS 151 requires that allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. The provisions of SFAS 151 are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company expects that the adoption of SFAS 151 will not have a material impact on its results of operations and financial position.

In December 2004, the FASB issued FSP No. 109-1, *Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004*. The American Jobs Creation Act of 2004 includes a tax deduction of up to 9% of the lesser of qualified production activities income, as defined, or taxable income, after the deduction for the utilization of any net operating loss carryforwards. The FSP clarified that this deduction should be accounted for as a special tax deduction in accordance with SFAS No. 109. The Company expects that due to its net operating loss carryforwards and its full domestic valuation allowance, the new deduction will have no impact on income tax expense for fiscal years 2005 and 2006.

In December 2004, the FASB issued FSP No. 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004.* The Company has completed its review of the Repatriation Provision and has concluded that it will not benefit from the Act due to the Company's current tax position. As a result, the Repatriation Provision has not had any impact on income tax expense during fiscal 2004 and through the nine months ended September 30, 2005.

(3) Intangible Assets

The following table sets forth information regarding Katy's intangible assets (amounts in thousands):

	September 30, 2005			December 31, 2004		
	Gross Amount	Accumulated Amortization	Net Carrying Amount	Gross Amount	Accumulated Amortization	Net Carrying Amount
Patents	$ 1,380	$ (800)	$ 580	$ 1,114	$ (727)	$ 387
Customer lists	10,647	(7,795)	2,852	10,666	(7,619)	3,047
Tradenames	5,508	(1,794)	3,714	5,531	(1,537)	3,994
Other	679	(11)	668	-	-	-
Total	$ 18,214	$ (10,400)	$ 7,814	$ 17,311	$ (9,883)	$ 7,428

All of Katy's intangible assets are definite long-lived intangibles. Katy recorded amortization expense on intangible assets of $0.2 million and $0.4 million for the three-month periods ended September 30, 2005 and 2004, respectively, and $0.5 million and $1.3 million for the nine-month periods ended September 30, 2005 and 2004, respectively. Estimated aggregate future amortization expense related to intangible assets is as follows (amounts in thousands):

2005	$331
2006	756
2007	752
2008	746
2009	732
2010	714

(4) Acquisition

During the third quarter of 2005, the Company's Continental Commercial Products LLC subsidiary ("CCP") acquired substantially all of the assets and assumed certain liabilities of Washington International Non-Wovens, LLC ("WIN"), based in Washington, GA. The purchase price was approximately $2.1 million and was allocated to the acquired net tangible assets and intangible lease asset at their estimated fair values. The WIN acquisition is not material for purposes of presenting pro forma financial information. This acquired business is part of the Abrasives business unit in the Maintenance Products Group.

(5) Savannah Energy Systems Company Partnership

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

The partnership, with Montenay's leadership, assumed SESCO's position in various contracts relating to the facility's operation. Under the partnership agreement, SESCO contributed its assets and liabilities (except for its liability under

the loan agreement with the Resource Recovery Development Authority (the "Authority") of the City of Savannah and the related receivable under the service agreement with the Authority) to the partnership. While SESCO has a 99% interest as a limited partner, Montenay has the day to day responsibility for administration, operations, financing and other matters of the partnership, and accordingly, the partnership will not be consolidated. Katy agreed to pay Montenay $6.6 million over the span of seven years under a note payable as part of the partnership and related agreements. Certain amounts may be due to SESCO upon expiration of the service agreement in 2008; also, Montenay may purchase SESCO's interest in the partnership at that time. Katy has not recorded any amounts receivable or other assets relating to amounts that may be received at the time the service agreement expires, given their uncertainty. The Company does not consolidate the partnership and, as such, there is no income statement activity related to the day-to-day operation of the partnership.

The Company made a payment of $1.1 million in June 2005 on the remaining portion of the $6.6 million note. The table below schedules the remaining payments as of September 30, 2005, which are reflected in accrued expenses and other liabilities in the Condensed Consolidated Balance Sheet (amounts in thousands):

2006	$ 1,100
2007	1,100
2008	550
	$ 2,750

In the first quarter of 2002, the Company recognized a charge of $6.0 million consisting of 1) the discounted value of the $6.6 million note, 2) the carrying value of certain assets contributed to the partnership, consisting primarily of machinery spare parts, and 3) costs to close the transaction. It should be noted that all of SESCO's long-lived assets were reduced to a zero value during the year ended December 31, 2001, so no additional impairment was required. The Company expects that in the future, the only income statement activity associated with the partnership is the accretion of the discounted note payable, and Katy's Condensed Consolidated Balance Sheet will carry the liability mentioned above.

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

Management has determined that SESCO has a legally enforceable right to offset amounts it owes to the Authority under the loan agreement against amounts that are owed from the Authority under the service agreement. At September 30, 2005, this amount was $23.7 million. Accordingly, the amounts owed to and due from SESCO have been netted for financial reporting purposes and are not shown on the Condensed Consolidated Balance Sheets.

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

Following are scheduled principal repayments on the loan agreement (and the Industrial Revenue Bonds) as of September 30, 2005 (amounts in thousands):

2005	$ 8,370
2006	15,300
Total	$ 23,670

(6) Indebtedness

On April 20, 2004, the Company completed a refinancing of its outstanding indebtedness (the "Refinancing") and entered into a new agreement with Bank of America Business Capital (formerly Fleet Capital Corporation) (the "Bank of America Credit Agreement"). Like the previous credit agreement with Fleet Capital Corporation, the Bank of America Credit Agreement is a $110 million facility with a $20 million term loan ("Term Loan") and a $90 million revolving credit facility ("Revolving Credit Facility") with essentially the same terms as the previous credit agreement. The Bank of America Credit Agreement is an asset-based lending agreement and involves a syndicate of four banks, all of which participated in the syndicate from the previous credit agreement. In addition, the Bank of America Credit Agreement contains credit sub-facilities in Canada and the United Kingdom which allows the Company to borrow funds locally in these countries and provide a natural hedge against currency fluctuations.

Under the Bank of America Credit Agreement, the Term Loan has a final maturity date of April 20, 2009 with quarterly payments of $0.7 million. The Term Loan is collateralized by the Company's property and equipment. The Revolving Credit Facility also has an expiration date of April 20, 2009 and its borrowing base is determined by eligible inventory and accounts receivable. Letters of credit, which reduce the unused borrowing availability under the Revolving Credit Facility, were $9.6 million at September 30, 2005. Unused borrowing availability on the Revolving Credit Facility, after considering letters of credit, was $35.5 million at September 30, 2005. All extensions of credit under the Bank of America Credit Agreement are collateralized by a first priority security interest in and lien upon the capital stock of each material domestic subsidiary (65% of the capital stock of each material foreign subsidiary), and all present and future assets and properties of Katy. The Bank of America Credit Agreement contains various financial and operating covenants, which among other things, require the Company to maintain a fixed charge coverage ratio and certain other financial ratios (see discussion below). It also includes customary restrictions and default provisions.

From September 30, 2004, interest rate margins (i.e. the interest rate spread above LIBOR) on our Bank of America Credit Agreement borrowings have risen from 175 basis points over applicable LIBOR rates for Revolving Credit Facility borrowings and 200 basis points over LIBOR for borrowings under the Term Loan to 275 and 300 basis points, respectively. Current margins reflect the highest spread under the Bank of America Credit Agreement, as specified by the Third Amendment (see below). Additionally, margins on the Term Loan will drop 25 basis points if the balance of the Term Loan is reduced below $10.0 million.

Effective August 17, 2005, the Company entered into a two-year interest rate swap on a notional amount of $25.0 million in the first year and $15.0 million in the second year. The purpose of the swap was to limit the Company's exposure to interest rate increases on a portion of the Revolving Credit Facility over the two-year term of the swap. The fixed interest rate under the swap at September 30, 2005 and over the life of the agreement is 4.49%. (See Note 1 for further information regarding this transaction).

Long-term debt consists of the following (amounts in thousands):

	September 30, 2005	December 31, 2004
Term loan payable under the Bank of America Credit Agreement, interest based on LIBOR and Prime Rates (6.875% - 8%), due through 2009	$ 16,428	$ 18,571
Revolving loans payable under the Bank of America Credit Agreement, interest based on LIBOR and Prime Rates (6.5% - 7.75%)	41,085	40,166
Other	615	-
Total debt	58,128	58,737
Less revolving loans, classified as current (see below)	(41,085)	(40,166)
Less current maturities	(3,472)	(2,857)
Long-term debt	$ 13,571	$ 15,714

Aggregate remaining scheduled maturities of the Term Loan as of September 30, 2005 are as follows (amounts in thousands):

2005	$ 714
2006	2,857
2007	2,857
2008	2,857
2009	7,143

The Revolving Credit Facility under the Bank of America Credit Agreement requires lockbox agreements which provide for all receipts to be swept daily to reduce borrowings outstanding. These agreements, combined with the existence of a material adverse effect (“MAE”) clause in the Bank of America Credit Agreement, cause the Revolving Credit Facility to be classified as a current liability per guidance in Emerging Issues Task Force Issue No. 95--22, *Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements that Include Both a Subjective Acceleration Clause and a Lock-Box Arrangement*. The Company does not expect to repay, or be required to repay, within one year, the balance of the Revolving Credit Facility classified as a current liability. The MAE clause, which is a typical requirement in commercial credit agreements, allows the lenders to require the loan to become due if they determine there has been a material adverse effect on the Company’s operations, business, properties, assets, liabilities, condition or prospects. The classification of the Revolving Credit Facility as a current liability was a result only of the combination of the lockbox agreements and the MAE clause. The Revolving Credit Facility does not expire or have a maturity date within one year, but rather has a final expiration date of April 20, 2009. The lender has not notified Katy of any indication of a MAE at September 30, 2005, and to management’s knowledge, the Company was not in violation of any provision of the Bank of America Credit Agreement, as amended, at September 30, 2005.

The Company determined that due to declining profitability in the fourth quarter of 2004, potentially lower profitability in the first half of 2005 and the timing of certain restructuring payments, it would not meet its Fixed Charge Coverage Ratio (as defined in the Bank of America Credit Agreement) and could potentially exceed its maximum Consolidated Leverage Ratio (also as defined in the Bank of America Credit Agreement) as of the end of the first, second and third quarters of 2005. In anticipation of not achieving the minimum Fixed Charge Coverage Ratio or exceeding the maximum Consolidated Leverage Ratio, the Company obtained an amendment to the Bank of America Credit Agreement (the “Second Amendment”). The Second Amendment applied only to the first three quarters of 2005 and the covenants would have returned to their original levels for the fourth quarter of 2005. Specifically, the Second Amendment eliminated the Fixed Charge Coverage Ratio, increased the maximum Consolidated Leverage Ratio, established a Minimum Consolidated EBITDA (on a latest twelve months basis) for each of the periods and also established a Minimum Availability (the eligible collateral base less outstanding borrowings and letters of credit) on each day within the nine-month period.

Subsequent to the Second Amendment’s effective date, the Company determined that it would likely not meet its amended financial covenants. On April 13, 2005, the Company obtained a further amendment to the Bank of America Credit Agreement (the “Third Amendment”). The Third Amendment eliminates the maximum Consolidated Leverage Ratio and the Minimum Consolidated EBITDA as established by the Second Amendment and adjusts the Minimum Availability such that our eligible collateral must exceed the sum of the Company’s outstanding borrowings and letters of credit under the Revolving Credit Facility by at least $5 million from the effective date of the Third Amendment through September 29, 2005 and by at least $7.5 million from September 30, 2005 until the date the Company delivers its financial statements for the first quarter of 2006 to its lenders. Subsequent to the delivery of the financial statements for the first quarter of 2006 the Third Amendment reestablishes the minimum Fixed Charge Coverage Ratio as originally set forth in the Bank of America Credit Agreement. The Third Amendment also reduces the maximum allowable capital expenditures for 2005 from $15 million to $10 million, and increases the interest rate margins on all of the Company’s outstanding borrowings and letters of credit to the largest margins set forth in the Bank of America Credit Agreement. Effective April 13, 2005, interest accrues on the Revolving Credit Facility and Term Loan borrowings at 275 and 300 basis points over LIBOR, respectively. Interest rate margins will return to levels set forth in the Bank of America Credit Agreement subsequent to the delivery of the Company’s financial statements for the first quarter of 2006 to its lenders.

As a result of the Third Amendment, the Company’s current debt covenants under the Bank of America Credit Agreement are as follows (see further discussion below):

Minimum Availability - At September 30, 2005, the Company was required to have a borrowing base (collateral) in excess of borrowings and outstanding letters of credit by at least $7.5 million. Pursuant to the Third Amendment, this

covenant is in effect through the first quarter of 2006.

Fixed Charge Coverage Ratio - The Company is required to maintain a Fixed Charge Coverage Ratio (as defined in the Bank of America Credit Agreement) of 1.1:1. Pursuant to the Third Amendment, this covenant was suspended and will be reinstated following the first quarter of 2006.

Capital Expenditures - For the year ended December 31, 2005, the Company is not to exceed $10.0 million in capital expenditures. Subsequent to 2005, the Company is not to exceed $15.0 million during a single fiscal year.

Leverage Ratio - The Third Amendment to the Bank of America Credit Agreement eliminated the Leverage Ratio (as defined in the Bank of America Credit Agreement) as a financial covenant. Following the first quarter of 2006, the Leverage Ratio will be utilized to determine the interest rate margin over the applicable LIBOR rate.

The Company has recently indicated to the syndicate of banks in the Bank of America Credit Agreement, that it may be unable to attain the required Fixed Charge Coverage Ratio as of the end of the first quarter of 2006. If the Company is unable to comply with the terms of the Fixed Charge Coverage Ratio or any of the other amended covenants, it may be required to obtain further amendments and pursue increased liquidity through additional debt financing and/or the sale of assets. The Company believes that given its strong working capital base, additional liquidity could be obtained through additional debt financing, if necessary. However, there is no guarantee that such amendments or financing could be obtained. In addition, the Company is continually evaluating alternatives relating to the sale of excess assets and divestitures of certain of its business units. Asset sales and business divestitures present opportunities to provide additional liquidity by de-leveraging our financial position.

All of the debt under the Bank of America Credit Agreement is re-priced to current rates at frequent intervals. Therefore, its fair value approximates its carrying value at September 30, 2005.

During the nine months ended September 30, 2005, the company incurred debt issuance costs of $0.2 million, primarily related to the Second Amendment to the Bank of America Credit Agreement.

Katy incurred additional debt issuance costs in 2004 associated with the Bank of America Credit Agreement. Additionally, at the time of the inception of the Bank of America Credit Agreement, Katy had approximately $4.0 million of unamortized debt issuance costs associated with the previous credit agreement. The remainder of the previously capitalized costs, along with the capitalized costs incurred in connection with the Bank of America Credit Agreement, will be amortized over the life of the Bank of America Credit Agreement through April 2009. Future quarterly amortization expense is expected to be approximately $0.3 million. During the nine months ended September 30, 2004, Katy incurred fees and expenses of $0.4 million (reported in Other, net on the Condensed Consolidated Statements of Operations) associated with a financing which the Company chose not to pursue.

(7) Retirement Benefit Plans

Several of the Company's 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 requirement of employee benefit and tax laws, are to contribute such amounts as 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. The post-retirement health plans are unfunded. Katy uses an annual measurement date of December 31 for the majority of its pension and other postretirement benefit plans for all years presented. Information regarding the Company's net periodic benefit cost for pension and other postretirement benefit plans for the three and nine months ended September 30, 2005 and 2004, is as follows (amounts in thousands):

	Pension Benefits			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Components of net periodic benefit cost:				
Service cost	$ 2	$ 1	$ 6	$ 3
Interest cost	23	33	70	97
Expected				