KATY INDUSTRIES INC
Form 10-K/A
August 17, 2007

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United States
Securities and Exchange Commission
Washington, D.C. 20549
FORM 10-K/A
Amendment No. 1

þ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended: December 31, 2006
OR

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission file number 1-5558
Katy Industries, Inc.
(Exact name of registrant as specified in its charter)

Delaware	75-1277589
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

2461 South Clark Street, Suite 630, Arlington, Virginia 22202
(Address of Principal Executive Offices) (Zip Code)
Registrant s telephone number, including area code: (703) 236-4300
Securities registered pursuant to Section 12(b) of the Act:

(Title of each class)	(Name of each exchange on which registered)
Common Stock, $1.00 par value	New York Stock Exchange
Common Stock Purchase Rights	

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES o NO þ
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES o NO þ
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 þ NO o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer o Accelerated filer o Non-accelerated filer þ
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO þ
The aggregate market value of the voting common stock held by non-affiliates of the registrant* (based upon its closing transaction price on the New York Stock Exchange Composite Tape on June 30, 2006), as of June 30, 2006 was $11,223,415. As of February 28, 2007, 7,951,177 shares of common stock, $1.00 par value, were outstanding, the only class of the registrant s common stock.

* Calculated by excluding all shares held by executive officers and directors of the registrant without conceding that all such persons are affiliates of the registrant for purposes of federal securities laws.

DOCUMENTS INCORPORATED BY REFERENCE

Proxy Statement for the 2007 annual meeting Part III.

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EXPLANATORY NOTE

Restatement of Consolidated Financial Statements

We are filing this Amended Annual Report on Form 10-K/A (Amended Filing) to our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 (Original Filing) to amend and restate our consolidated financial statements and the related disclosures for the fiscal years ended 2006 and 2005, as discussed in Note 2. The Original Filing was filed with the Securities and Exchange Commission (SEC) on March 16, 2007.

On August 6, 2007, the Audit Committee of the Board of Directors, or the Audit Committee, of Katy Industries, Inc. (the Company), in consultation with management, concluded that our following previously issued financial statements should no longer be relied upon and should be restated based on identified errors: 1) the consolidated financial statements as of December 31, 2006 and 2005 and for the years then ended contained in the Company s Annual Report on Form 10-K; and 2) the consolidated financial statements for the quarters ending March 31, 2006 and 2007, June 30, 2006, and September 30, 2006 contained in the Company s corresponding Form 10-Qs. The unaudited quarterly financial information included in the Company s Annual Report on Form 10-K as of December 31, 2006 has been updated in this Annual Report on Form 10-K, and the unaudited quarterly financial information included in the Company s Quarterly Reports on Form 10-Q as of March 31, 2006, June 30, 2006 and September 30, 2006 will be updated as the Company files its corresponding Quarterly Reports for 2007.

In the second quarter of 2007, management of the Company noted discrepancies in its physical raw material inventory levels and the corresponding perpetual inventory records. These discrepancies led the Company to initiate an internal investigation which resulted in the identification of errors in the physical inventory count of raw material used for valuation purposes at the Company s wholly-owned subsidiary, Continental Commercial Products, LLC (CCP). The Company has concluded these errors are isolated to fiscal 2005, fiscal 2006 and the three months ended March 31, 2007.

When management became aware of the issues referenced above, the Company, including the Audit Committee, initiated an investigation of the matter. Management has discussed the investigation, the resolution of the problems and the strengthening of internal controls with the Audit Committee.

Based on the results of the investigation, management and the Audit Committee determined that (a) the errors were caused by intentional acts of a CCP employee who improperly accounted for physical quantities raw material inventory and who has since been dismissed; (b) the scope of the errors were contained in fiscal 2005, fiscal 2006 and the three months ended March 31, 2007; and (c) the errors were concentrated in the area discussed above.

Impact of Error on Previously filed Financial Statements

The impact of the raw material inventory error on loss from continuing operations and net loss is approximately ($0.2) million and ($0.6) million for the years ended December 31, 2005 and 2006, respectively. The impact of the raw material inventory error on loss from continuing operations and net loss is approximately ($0.2) million for the three months ended March 31, 2006, ($0.2) million and ($0.4) million for the three and six months ended June 30, 2006, ($0.2) million and ($0.6) million for the three and nine months ended September 30, 2006, and $0.1 million for the three months ended March 31, 2007. In addition, as part of the restatement, the Company has recorded additional items, certain of which were previously identified and determined to be immaterial. The impact of these additional items on net loss is approximately ($0.4) million and $0.2 million for the years ended December 31, 2005 and 2006, respectively, which is allocated entirely to loss from continuing operations.

Internal Control Considerations

In connection with the Company s evaluation of the restatement described above, management has concluded that the restatement is the result of previously unidentified material weaknesses in the Company s internal control over financial reporting, as discussed in Item 9A. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim consolidated financial statements will not be prevented or detected. Management has also determined that the Company s disclosure controls and procedures were ineffective as of December 31, 2005 and 2006, March 31, 2006 and 2007, June 30, 2006, and September 30, 2006.

These control deficiencies resulted in the restatement of the Company s consolidated financial statements for December 31, 2005 and 2006, March 31, 2006 and 2007, June 30, 2006, and September 30, 2006. Additionally, these

control deficiencies could result in further misstatements to the Company s financial statements, which could result in a material misstatement to the annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, management determined that these control deficiencies represented material weaknesses in internal control over financial reporting.

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We have not amended any of our other previously filed annual reports on Form 10-K for the periods affected by the restatement other than this Amended Filing. For this reason, the consolidated financial statements and related financial information contained in such previously filed reports should no longer be relied upon. All of the information in this Amended Filing does not reflect events occurring after the Original Filing.

For the convenience of the reader, this Amended Filing sets forth the Original Filing in its entirety, as modified and superseded where necessary to reflect the restatement. The following items have been amended principally as a result of, and to reflect, the restatement, and no other information in the Original Filing is amended hereby as a result of the restatement:

Part I Item 1: Business;

Part I Item 1A: Risk Factors;

Part II Item 6: Selected Financial Data;

Part II Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations;

Part III Item 8: Financial Statements and Supplementary Data;

Part III Item 9A: Controls and Procedures; and

Part IV Item 15: Exhibits, Financial Statements and Schedules.

In accordance with applicable SEC rules, this amended Annual Report on Form 10-K/A includes current dated certifications from our Chief Executive Officer and Chief Financial Officer.

The remaining items contained within this Amended Filing consist of all other Items originally contained in the Form 10-K and are included for the convenience of the reader. The sections of the Form 10-K which were not amended are unchanged and continue in full force and effect as originally filed. This Amended Filing speaks of the date of the original filing on the Form 10-K and has not been updated to reflect events occurring subsequent to the original filing date.

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PART I

Item 1. BUSINESS

Katy Industries, Inc. (Katy or the Company) was organized as a Delaware corporation in 1967 and has an even longer history of successful operations, with some of its predecessor companies having been established for as long as 75 years. We are organized into two operating groups, Maintenance Products and Electrical Products, and a corporate group. Each majority-owned company in the two groups operates within a broad framework of policies and corporate goals. Katy s corporate group is responsible for overall planning, financial management, acquisitions, dispositions, and other related administrative and corporate matters.

Recapitalization

On June 28, 2001, we completed a recapitalization of the Company following an agreement dated June 2, 2001 with KKTY Holding Company, L.L.C. (KKTY), an affiliate of Kohlberg Investors IV, L.P. (Kohlberg) (the Recapitalization). Under the terms of the Recapitalization, KKTY purchased 700,000 shares of newly issued preferred stock, $100 par value per share (the Convertible Preferred Stock), which is convertible into 11,666,666 common shares, for an aggregate purchase price of $70.0 million. More information regarding the Convertible Preferred Stock can be found in Note 12 to the Consolidated Financial Statements of Katy included in Part II, Item 8. The Recapitalization allowed us to retire obligations we had under the then-current revolving credit agreement. Since the Recapitalization, the Company s management has been focused on various restructuring and cost reduction initiatives. Currently, the Company s focus has shifted to sustaining revenue growth and managing raw material costs. Our future cost reductions, if any, will continue to come from process improvements (such as Lean Manufacturing and Six Sigma), value engineering products, improved sourcing/purchasing and lean administration.

Operations

Selected operating data for each operating group can be found in Management s Discussion and Analysis of Financial Condition and Results of Operations included in Part II, Item 7. Information regarding foreign and domestic operations and export sales can be found in Note 17 to the Consolidated Financial Statements of Katy included in Part II, Item 8. Set forth below is information about our operating groups and investments and about our business in general.

We have restructured many of our operations in order to maintain a low cost structure, which is essential for us to be competitive in the markets we serve. These restructuring efforts include consolidation of facilities, headcount reductions, and evaluation of sourcing strategies to determine the lowest cost method for obtaining finished product. Costs associated with these efforts include expenses for recording liabilities for non-cancelable leases at facilities that are abandoned, severance and other employee termination costs and other exit costs that may be incurred not only with consolidation of facilities, but potentially the complete shut down of certain manufacturing and distribution operations. We have incurred significant costs in this respect, approximately $47 million since the beginning of 2001. As our post-Recapitalization restructuring plan approaches completion, we expect to incur additional costs of approximately $1.1 million in 2007, mostly related to the consolidation of the Washington, Georgia facility into the Wrens, Georgia facility. Additional details regarding severance, restructuring and related charges can be found in Note 19 to the Consolidated Financial Statements of Katy included in Part II, Item 8.

Maintenance Products Group

The Maintenance Products Group s principal business is the manufacturing and distribution of commercial cleaning products as well as consumer home products. Commercial cleaning products are sold primarily to janitorial/sanitary and foodservice distributors that supply end users such as restaurants, hotels, healthcare facilities and schools. Consumer home products are primarily sold through major home improvement and mass market retail outlets. Total revenues and operating income for the Maintenance Products Group during 2006 were $208.4 million and $5.6 million, respectively. The group accounted for 53% of the Company s revenues in 2006. Total assets for the group were $95.1 million at December 31, 2006. The business units in this group are:

Continental Commercial Products, LLC (CCP) is the successor entity to Contico International, L.L.C. (Contico) and includes as divisions all the former business units of Contico (Continental, Contico, and Container), as well as the following business units: Disco, Glit and Wilen. CCP is headquartered in Bridgeton, Missouri near St. Louis, has additional operations in California and Georgia, and was created mainly for the purpose of simplifying our business

transactions and improving our customer relationships by allowing customers to order products from any CCP division on one purchase order.

The Continental business unit is a plastics manufacturer and a distributor of products for the commercial janitorial/sanitary maintenance and food service markets. Continental products include commercial waste receptacles, buckets, mop wringers, janitorial carts, and other products designed for commercial cleaning and food service. Continental products are sold under the following brand names: Continental®, Kleen Aire , Huskee , SuperKan , KingKan®, Unibody®, and Tilt-N-Wheel .

The Contico business unit is a plastics manufacturer and distributor of home storage products, sold primarily through major home improvement and mass market retail outlets. Contico products include plastic home storage units such as domestic storage containers, shelving and hard plastic gun cases and are sold under the following brand names: Contico® and Tuffbin®.

The Container business unit is a plastics manufacturer and distributor of industrial storage drums and pails for commercial and industrial use. Products are sold under the Contico® brand name.

The Disco business unit is a manufacturer and distributor of filtration, cleaning and specialty products sold to the restaurant/food service industry. Disco products include fryer filters, oil stabilizing powder, grill cleaning implements and other food service items and are sold under the Disco® name as well as BriteSorb®, and the Brillo® line of cleaning products. BriteSorb® is a registered trademark used under license from PQ Corporation, and Brillo® is a registered trademark used under license from Church & Dwight Company.

The Glit business unit is a manufacturer and distributor of non-woven abrasive products for commercial and industrial use and also supplies materials to various original equipment manufacturers (the OEMs). The Glit unit s products include floor maintenance pads, hand pads, scouring pads, specialty abrasives for cleaning and finishing and roof ventilation products. Products are sold primarily in the commercial sanitary maintenance, food service and construction markets. Glit products are sold under the following brand names: Glit®, Glit Kleenfast®, Glit/Microtron®, Fiber Naturals®, Big Boss II®, Blue Ice®, Brillo®, BAB-O®, Old Dutch® and Twister brand names. Brillo® is a registered trademark used under license from Church & Dwight Company, Old Dutch® is a registered trademark used under license from Dial Brands, Inc., and BAB-O® is a registered trademark used under license from Fitzpatrick Bros., Inc. Twister is a trademark of HTC Industries, Inc.

This unit s primary manufacturing facilities are in Wrens, Georgia, and Washington, Georgia. The Washington facility is expected to close during 2007 and its operations consolidated into the Wrens facility.

The Wilen business unit is a manufacturer and distributor of professional cleaning products that include mops, brooms, brushes, and plastic cleaning accessories. Wilen products are sold primarily through commercial sanitary maintenance and food service markets, with some products sold through consumer retail outlets. Products are sold under the following brand names: Wax-o-matic , Wilen® and Rototech®.

The Maintenance Products Group also has operations in Canada and the United Kingdom (the U.K.).

The CCP Canada business unit, headquartered in Etobicoke, Ontario, Canada, is a distributor of primarily plastic products for the commercial and sanitary maintenance markets in Canada.

The Gemtex business unit is headquartered in Etobicoke, Ontario, Canada, and is a manufacturer and distributor of resin fiber disks and other coated abrasives for the OEMs, automotive, industrial, and home improvement markets. The most prominent brand name under which the product is sold is Trim-Kut®.

The Contico Manufacturing, Ltd. (CML) business unit is a distributor of a wide range of cleaning equipment, storage solutions and washroom dispensers for the commercial and sanitary maintenance and food service markets primarily in the U.K.

Electrical Products Group

The Electrical Products Group s principal business is the design and distribution of consumer electrical corded products. Products are sold principally to national home improvement and mass merchant retailers, who in-turn sell to consumer end-users. Total revenues and operating income for the Electrical Products Group during 2006 were $187.7 million and $8.7 million, respectively. The group accounted for 47% of the Company s revenues in 2006. Total assets for the group were $74.0 million at December 31, 2006. Woods Industries, Inc. (Woods US) and Woods Industries (Canada), Inc. (Woods Canada) are both subject to seasonal sales trends in connection with the holiday shopping season, with stronger sales and profits realized in the third and early fourth quarters. The business units in this group are:

The Woods US business unit is headquartered in Indianapolis, Indiana, and distributes consumer electrical corded products and electrical accessories. Examples of Woods US products are outdoor and indoor extension cords, work lights, surge protectors, and power strips. Woods US products are sold under the following brand names: Woods®, Yellow Jacket®, Tradesman®, SurgeHawk®, and AC/Delco®. AC/Delco® is a registered trademark of The General Motors Corporation. These products are sold primarily through national home improvement and mass merchant retail outlets in the United States. Woods US products are sourced primarily from Asia.

The Woods Canada business unit is headquartered in Toronto, Ontario, Canada, and distributes consumer electrical corded products and electrical accessories. In addition to the products listed above for Woods US, Woods Canada s primary product offerings include garden lighting and timers. Woods Canada products are sold under the following brand names: MoonRays®, Intercept®, and Pro Power®. These products are sold primarily through major home improvement and mass merchant retail outlets in Canada. Woods Canada s products are sourced primarily from Asia.

See Licenses, Patents and Trademarks below for further discussion regarding the trademarks used by Katy companies.

Other Operations

Katy s other operations include a 45% equity investment in a shrimp farming operation, Sahlman Holding Company, Inc. (Sahlman), and a 100% interest in Savannah Energy Systems Company (SESCO), the limited partner in a waste-to-energy facility.

Sahlman, which owns shrimp farming operations in Nicaragua, has a number of competitors, some of which are larger and have greater financial resources. Katy s interest in Sahlman is an equity investment. During 2006, the Company did not recognize any equity in income from the Sahlman investment. Katy concluded that $2.2 million continues to be a reasonable estimate of the value of its investment in Sahlman. See Note 6 to the Consolidated Financial Statements of Katy included in Part II, Item 8.

In 2006, the Company sold 100% of its partnership interest in Montenay Savannah Limited Partnership, which was held by SESCO in Savannah, Georgia. The general partner of the partnership is an affiliate of Montenay Power Corporation (Montenay). In 2006, Montenay purchased the Company s limited partnership interest for $0.1 million and a reduction of approximately $0.6 million in the face amount due to Montenay as agreed upon in the original partnership agreement. In addition, Montenay removed the Company as the performance guarantor under the service agreement. As a result of the above transaction, the Company recorded a gain of $0.4 million within continuing operations during the year ended December 31, 2006 given the reduction in the face amount due to Montenay as agreed upon in the original partnership interest purchase agreement. In addition, the Company recorded a gain on the sale of the partnership interest of approximately $0.1 million as reflected within continuing operations. See Note 8 to the Consolidated Financial Statements of Katy included in Part II, Item 8.

Discontinued Operations

In 2006, we identified and sold certain business units that we considered non-core to the future operations of the Company. The Metal Truck Box business unit, a manufacturer and distributor of aluminum and steel automotive storage products located in Winters, Texas was sold on June 2, 2006 for net proceeds of $3.6 million, including a note receivable of $1.2 million. A loss of $50 thousand was recognized in 2006 as a result of the Metal Truck Box sale. The Metal Truck Box business unit was formerly part of the Maintenance Products Group.

Also, in 2006, we sold the Contico Europe Limited (CEL) business unit, a manufacturer and distributor of plastic consumer storage and home products sold primarily to major retail outlets in the U.K. The business unit was sold on November 27, 2006 for net proceeds of $3.0 million. A loss (net of tax) of $5.4 million was recognized in 2006. CEL was formerly part of the Maintenance Products Group.

Customers

We have several large customers in the mass merchant/discount/home improvement retail markets. Two customers, Lowe s Companies, Inc. (Lowe s) and Wal-Mart Stores, Inc. (Wal-Mart), accounted for approximately 16% and 14% respectively, of consolidated net sales. Sales to Lowe s are made by the Woods US and Contico business units. Sales to Wal-Mart are made by the Woods US, Contico, Glit, Woods Canada, Wilen, and Continental business units. A significant loss of business from either of these customers could have a material adverse impact on our business, results of operations or prospects.

Backlog

Maintenance Products:

Our aggregate backlog position for the Maintenance Products Group was $3.1 million and $5.5 million as of December 31, 2006 and 2005 respectively. The orders placed in 2006 are believed to be firm, and based on historical experience, substantially all orders are expected to be shipped during 2007.

Electrical Products:

Our aggregate backlog position for the Electrical Products Group was $17.6 million and $8.6 million as of December 31, 2006 and 2005, respectively. The orders placed in 2006 are believed to be firm, and based on historical experience, substantially all orders are expected to be shipped during 2007. The increase in 2006 primarily relates to the timing of a major customer s ordering levels.

Markets and Competition

Maintenance Products:

We market a variety of commercial cleaning products and supplies to the commercial janitorial/sanitary maintenance and foodservice markets. Sales and marketing of these products is handled through a combination of direct sales personnel, manufacturers sales representatives, and wholesale distributors.

The commercial distribution channels for our commercial cleaning products are highly fragmented, resulting in a large number of small customers, mainly distributors of janitorial cleaning products. The markets for these commercial products are highly competitive. Competition is based primarily on price and the ability to provide superior customer service in the form of complete and on-time product delivery. Other competitive factors include brand recognition and product design, quality and performance. We compete for market share with a number of different competitors, depending upon the specific product. In large part, our competition is unique in each product line area of the Maintenance Products Group. We believe that we have established long standing relationships with our major customers based on quality products and service, and our ability to offer a complete line of products. While each product line is marketed under a different brand name, they are sold as complementary products, with customers able to access all products through a single purchase order. We also continue to strive to be a low cost provider in this industry; however, our ability to remain a low cost provider in the industry is highly dependent on the price of our raw materials, primarily resin (see discussion below). Being a low cost producer is also dependent upon our ability to reduce and subsequently control our cost structure, which has benefited from our nearly completed restructuring efforts.

We market branded plastic home storage units, and to a lesser extent, abrasive products and mops and brooms, to mass merchant and discount club retailers in the U.S. Sales and marketing of these products is generally handled by direct sales personnel and external representative groups. The consumer distribution channels for these products, especially the in-home products, are highly concentrated, with several large mass merchant retailers representing a very significant portion of the customer base. We compete with a limited number of large companies that offer a broad array of products and many small companies with niche offerings. With few consumer storage products enjoying patent protection, the primary basis for competition is price. Therefore, efficient manufacturing and distribution capability is critical to success. Ultimately, our ability to remain competitive in these consumer markets is dependent upon our position as a low cost producer, and also upon our development of new and innovative products. We continue to pursue new markets for our products. Our ability to remain a low cost provider in the industry is highly dependent on the price of our raw materials, primarily resin (see discussion below). Being a low cost producer is also dependent upon our ability to reduce and subsequently control our cost structure, which has benefited from our nearly completed restructuring efforts. Our restructuring efforts have and will include consolidation of facilities and headcount reductions.

We also market certain of our products to the construction trade, and resin fiber disks and other abrasive disks to the OEM trade.

Electrical Products:

We market branded electrical products primarily in North America through a combination of direct sales personnel and manufacturers sales representatives. Our primary customer base consists of major national retail chains that service the home improvement, mass merchant, hardware and electronic and office supply markets, and smaller

regional concerns serving a similar customer base.

Electrical products sold by the Company are generally used by consumers and include such items as outdoor and indoor extension cords, work lights, surge protectors, power strips, garden lighting and timers. We have entered into license agreements pursuant to which we market certain of our products using certain other companies proprietary brand names. Overall demand for our products is highly correlated with the number of suburban homes and the consumer demand for appliances, computers, home entertainment equipment, and other electronic equipment.

The markets for our electrical products are highly competitive. Competition is based primarily on price and the ability to provide a high level of customer service in the form of inventory management, high fill rates and short lead times. Other competitive factors include brand recognition, a broad product offering, product design, quality and performance. Foreign competitors, especially from Asia, provide an increasing level of competition. Our ability to remain competitive in these markets is dependent upon continued efforts to remain a low-cost provider of these products. Woods US and Woods Canada source all of their products almost entirely from international suppliers.

Raw Materials

Our operations have not experienced significant difficulties in obtaining raw materials, fuels, parts or supplies for their activities during the most recent fiscal year, but no prediction can be made as to possible future supply problems or production disruptions resulting from possible shortages. Our Electrical Products businesses are highly dependent upon products sourced from Asia, and therefore remain vulnerable to potential disruptions in that supply chain. We are also subject to uncertainties involving labor relations issues at entities involved in our supply chain, both at suppliers and in the transportation and shipping area. Our Continental and Contico business units (and some others to a lesser extent) use polyethylene, polypropylene and other thermoplastic resins as raw materials in a substantial portion of their plastic products. Prices of plastic resins, such as polyethylene and polypropylene increased steadily from the latter half of 2002 through 2005 with prices in 2006 being relatively stable. Management has observed that the prices of plastic resins are driven to an extent by prices for crude oil and natural gas, in addition to other factors specific to the supply and demand of the resins themselves. We are equally exposed to price changes for copper at our Woods US and Woods Canada business units. Prices for copper began to increase in early 2003 and continued through 2006 until stabilizing at the end of 2006. Prices for corrugated packaging material and other raw materials have also accelerated over the past few years. We have not employed an active hedging program related to our commodity price risk, but are employing other strategies for managing this risk, including contracting for a certain percentage of resin needs through supply agreements and opportunistic spot purchases. We were able to reduce the impact of some of these increases through supply contracts, opportunistic buying, vendor negotiations and other measures. In addition, some price increases were implemented when possible. In a climate of rising raw material costs (and especially in the last three years), we experience difficulty in raising prices to shift these higher costs to our consumer customers for our plastic and electrical products. Our future earnings may be negatively impacted to the extent further increases in costs for raw materials cannot be recovered or offset through higher selling prices. We cannot predict the direction our raw material prices will take during 2007 and beyond.

Employees

As of December 31, 2006, we employed 1,172 people, of which 304 were members of various unions. Our labor relations are generally satisfactory and there have been no strikes in recent years. In January 2007, one of our expiring union contracts was renewed for a term of three years, covering approximately 77 employees. The next union contract set to expire, covering approximately 227 employees, will expire in December, 2007. Our operations can be impacted by labor relations issues involving other entities in our supply chain.

Regulatory and Environmental Matters

We do not anticipate that federal, state or local environmental laws or regulations will have a material adverse effect on our consolidated operations or financial position. We anticipate making additional capital expenditures of $0.2 million for environmental matters during 2007, in accordance with terms agreed upon with the United States Environmental Protection Agency and various state environmental agencies. See Note 18 to the Consolidated Financial Statements in Part II, Item 8.

Licenses, Patents and Trademarks

The success of our products historically has not depended largely on patent, trademark and license protection, but rather on the quality of our products, proprietary technology, contract performance, customer service and the technical

competence and innovative ability of our personnel to develop and introduce salable products. However, we do rely to a certain extent on patent protection, trademarks and licensing arrangements in the marketing of certain products. Examples of key licensed and protected trademarks include Yellow Jacket®, Woods®, Tradesman®, and AC/Delco® (Woods US); Contico®; Continental®; Glit®, Microtron®, Brillo®, and Kleenfast® (Glit); Wilen ; and Trim-Kut® (Gemtex). The business units most reliant upon patented products and technology are CCP, Woods US, Woods Canada and Gemtex. Further, we are renewing our emphasis on new product development, which will increase our reliance on patent and trademark protection across all business units.

Available Information

We file annual, quarterly, and current reports, proxy statements, and other documents with the Securities and Exchange Commission (the SEC) under the Securities Exchange Act of 1934, as amended (the Exchange Act). The public may read and copy any materials that the Company files with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at (800) SEC-0330. Also, the SEC maintains an Internet website that contains reports, proxy and information statements, and other information regarding issuers, including Katy, that file electronically with the SEC. The public can obtain documents that we file with the SEC at http://www.sec.gov.

We maintain a website at http://www.katyindustries.com. We make available, free of charge through our website, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and, if applicable, all amendments to these reports as well as Section 16 reports on Forms 3, 4 and 5, as soon as reasonably practicable after such reports are filed or furnished to the SEC. The information on our website is not, and shall not be deemed to be, a part of this report or incorporated into any other filings we make with the SEC.

Item 1A. RISK FACTORS

In addition to other information and risk disclosures contained in this Form 10-K, the risk factors discussed in this section should be considered in evaluating our business. We work to manage and mitigate risks proactively. Nevertheless, the following risk factors, some of which may be beyond our control, could materially impact our result of operations or cause future results to materially differ from current expectations. Please also see Cautionary Statement Pursuant to Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995.

Our inability to achieve product price increases, especially as they relate to potentially higher raw material costs, may negatively impact our earnings.

Costs for certain raw materials used in our operations, including copper products, remain at unprecedented high levels. In addition, prices for thermoplastic resin have demonstrated volatility over the past few years. Increasing costs for raw material supplies will increase our production costs and harm our margins and results of operations if we are unable to pass the higher production costs on to our customers in the form of price increases. Further, if we are unable to obtain adequate supplies of raw materials in a timely manner, our operations could be interrupted.

The loss of a significant customer or the financial weakness of a significant customer could negatively impact our results of operations.

We have several large customers in the mass merchant/discount/home improvement retail markets. Two customers accounted for approximately 30% of consolidated net sales. While no other customer accounted for more than 10% of our total net sales in 2006, we do have other significant customers. The loss of any of these customers, or a significant reduction in our sales to any of such customers, could adversely affect our sales and results of operations. In addition, if any of such customers became insolvent or otherwise failed to pay its debts, it could have an adverse affect on our results of operations.

Increases in the cost of, or in some cases continuation of, the current price levels of plastic resins, copper, and other raw materials may negatively impact our earnings.

Our reliance on foreign suppliers and commodity markets to secure raw materials used in our products exposes us to volatility in the prices and availability of raw materials. In some instances, we depend upon a single source of supply or participate in commodity markets that may be subject to allocations by suppliers. A disruption in deliveries from our suppliers, price increases, or decreased availability of raw materials or commodities, could have an adverse effect on our ability to meet our commitments to customers or increase our operating costs. We believe that our supply management practices are based on an appropriate balancing of the foreseeable risks and the costs of alternative practices. Nonetheless, price increases or the unavailability of some raw materials, should they occur, may have an adverse effect on our results of operations or financial condition.

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The Company s success depends on its ability to continuously improve productivity and streamline operations, principally by reducing its manufacturing overhead.

We have restructured many of our operations in order to maintain a low cost structure, which is essential for us to be competitive in the markets we serve. The Company needs to continuously improve its manufacturing efficiencies by the use of Lean Manufacturing and other methods in order to reduce its overhead structure. In addition, we will need to develop efficiencies within sourcing/purchasing as well as administration. We run the risk that these programs may not be completed substantially as planned, may be more costly to implement than expected or may not have the positive profit enhancing impact anticipated.

Disruption of our information technology and communications systems or our failure to adequately maintain our information technology and communications systems could have a material adverse effect on our business and operations.

We extensively utilize computer and communications systems to operate our business and manage our internal operations including demand and supply planning and inventory control. Any interruption of this service from power loss, telecommunications failure, failure of our computer system or other interruption caused by weather, natural disasters or any similar event could disrupt our operations and result in lost sales. In addition, hackers and computer viruses have disrupted operations at many major companies. We may be vulnerable to similar acts of sabotage, which could have a material adverse effect on our business and operations.

We rely on our management information systems to operate our business and to track our operating results. Our management information systems will require modification and refinement as we grow and our business needs change. If we experience a significant system failure or if we are unable to modify our management information systems to respond to changes in our business needs, our ability to properly run our business could be adversely affected.

Our inability to execute our acquisition integration and consolidation of facilities plans could adversely affect our business and results of operations.

We had sought to grow through strategic acquisitions. In addition, we have consolidated several manufacturing, distribution and office facilities. The success of these acquisitions and consolidations will depend on our ability to integrate assets and personnel, apply our internal controls processes to these businesses, and cooperate with our strategic partners. We may encounter difficulties in integrating business units with our operations, and in managing strategic investments. Furthermore, we may not realize the degree, or timing, of benefits we anticipate when we first enter into these organizational changes. Any of the foregoing could adversely affect our business and results of operations.

Fluctuations in the price, quality and availability of certain portions of our finished goods due to greater reliance on third parties could negatively impact our results of operations.

Because we are dependent on outside suppliers for a certain portion of our finished goods, we must obtain sufficient quantities of quality finished goods from our suppliers at acceptable prices and in a timely manner. We have no long-term supply contracts with our key suppliers. Unfavorable fluctuations in the price, quality and availability of these products could negatively affect our ability to meet demands of our customers and could result in a decrease in our sales and earnings.

Labor issues, including union activities that require an increase in production costs or lead to a strike, thus impairing production and decreasing sales. We are also subject to labor relations issues at entities involved in our supply chain, including both suppliers and those entities involved in transportation and shipping.

Katy s relationships with its union employees could deteriorate. At December 31, 2006, the Company employed approximately 1,172 persons in its various businesses of which approximately 26% were subject to collective bargaining or similar arrangements. The next union contract set to expire, covering approximately 227 employees, will expire in December, 2007. If Katy s union employees were to engage in a strike, work stoppage or other slowdown, the Company could experience a significant disruption of its operations or higher ongoing labor costs.

Our future performance is influenced by our ability to remain competitive.

As discussed in Business Competition , we operate in markets that are highly competitive and face substantial competition in each of our product lines from numerous competitors. The Company s competitive position in the

markets in which it participates is, in part, subject to external factors. For example, supply and demand for certain of the Company s products is driven by end-use markets and worldwide capacities which, in turn, impact demand for and pricing of the Company s products. Many of the Company s direct competitors are part of large multi-national companies and may have more resources than the Company. Any increase in competition may result in lost market share or reduced prices, which could result in reduced gross profit margins. This may impair the ability to grow or even to maintain current levels of revenues and earnings. If we are not as cost efficient as our competitors, or if our competitors are otherwise able to offer lower prices, we may lose customers or be forced to reduce prices, which could negatively impact our financial results.

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We may not be able to protect our intellectual property rights adequately.

Part of our success depends upon our ability to use and protect proprietary technology and other intellectual property, which generally covers various aspects in the design and manufacture of our products and processes. We own and use tradenames and trademarks worldwide. We rely upon a combination of trade secrets, confidentiality policies, nondisclosure and other contractual arrangements and patent, copyright and trademark laws to protect our intellectual property rights. The steps we take in this regard may not be adequate to prevent or deter challenges, reverse engineering or infringement or other violation of our intellectual property, and we may not be able to detect unauthorized use or take appropriate and timely steps to enforce our intellectual property rights to the same extent as the laws of the United States.

We have a high amount of debt, and the cost of servicing that debt could adversely affect our ability to take actions or our liquidity or financial condition.

We have a high amount of debt for which we are required to make interest and principal payments. As of December 31, 2006, we had $56.9 million of debt. Subject to the limits contained in some of the agreements governing our outstanding debt, we may incur additional debt in the future.

Our level of debt places significant demands on our cash resources, which could: make it more difficult for us to satisfy our outstanding debt obligations; require us to dedicate a substantial portion of our cash for payments on our debt, reducing the amount of our cash flow available for working capital, capital expenditures, acquisitions, and other general corporate purposes; limit our flexibility in planning for, or reacting to, changes in the industries in which we compete; place us at a competitive disadvantage compared to our competitors, some of which have lower debt service obligations and greater financial resources than we do; limit our ability to borrow additional funds; or increase our vulnerability to general adverse economic and industry conditions.

If we are unable to generate sufficient cash flow to service our debt and fund our operating costs, our liquidity may be adversely affected.

Our inability to meet covenants associated with the Company s Amended and Restated Loan with Bank of America, N.A. (the Bank of America Credit Agreement) could result in acceleration of all or a substantial portion of our debt.

Our outstanding debt generally contains various restrictive covenants. These covenants include, among others, provisions restricting our ability to: incur additional debt; make certain distributions, investments and other restricted payments; limit the ability of restricted subsidiaries to make payments to us; enter into transactions with affiliates; create certain liens; sell assets and if sold, use of proceeds; and consolidate, merge or sell all or substantially all of our assets.

Our secured debt also contains other customary covenants, including, among others, provisions: relating to the maintenance of the property securing the debt, and restricting our ability to pledge assets or create other liens.

In addition, certain covenants in our bank facilities require us and our subsidiaries to maintain certain financial ratios. Any of the covenants described in this risk factor may restrict our operations and our ability to pursue potentially advantageous business opportunities. Our failure to comply with these covenants could also result in an event of default that, if not cured or waived, could result in the acceleration of all or a substantial portion of our debt. We have not been able to meet certain affirmative covenants in our Bank of America Credit Agreement, which has resulted in eight amendments temporarily relieving us from these obligations. See Management s Discussion and Analysis of Financial Condition and Results of Operations Bank of America Credit Agreement for further discussion of these amendments.

If we cannot meet the New York Stock Exchange (NYSE) continued listing requirement, the NYSE may delist our common stock, which could negatively affect the price of the common stock and your ability to sell the common stock.

In the future, we may not be able to meet the continued listing requirements of the NYSE, and NYSE rules, which require, among other things, market capitalization or stockholders equity of at least $75.0 million level over 30 consecutive trading days. The Company s shareholders equity was less than $75.0 million as of March 15, 2007.

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On October 11, 2005, we announced that we received notification from the NYSE that the Company was not in compliance with the NYSE s continued listing standards. The Company s plan to demonstrate how the Company intends to comply with the continued listing standards within 18 months of its receipt was accepted by the NYSE.
If we are unable to satisfy the NYSE criteria for continued listing, our common stock would be subject to delisting. Trading, if any, of our common stock would thereafter be conducted on another exchange or quotation system. As a consequence of any such delisting, a stockholder would likely find it more difficult to dispose of, or to obtain accurate quotations as to the prices of our common stock.

If our internal controls over financial reporting are found not to be effective or if we make disclosure of existing or potential significant deficiencies or material weaknesses in those controls, Investors could lose confidence in our financial reports, and our stock price may be adversely affected.

Beginning with our Annual Report for the year ending December 31, 2007, Section 404 of the Sarbanes-Oxley Act of 2002 requires us to include an internal control report with our Annual Report on Form 10-K. That report must include management s assessment of the effectiveness of our internal control over financial reporting as of the end of the fiscal year. Additionally, our independent registered public accounting firm will be required to issue a report on management s assessment of our internal control over financial reporting and a report on their evaluation of the operating effectiveness of our internal control over financial reporting beginning with our Annual Report for the year ending December 31, 2008.
We continue to evaluate our existing internal control over financial reporting against the standards adopted by the Public Company Accounting Oversight Board, or PCAOB. During the course of our ongoing evaluation of the internal controls, we may identify areas requiring improvement, and may have to design enhanced processes and controls to address issues identified through this review. Despite the existence of material weaknesses or significant deficiencies in our internal control over financial reporting, we may fail to identify them. Remedying any deficiencies, significant deficiencies or material weaknesses that we or our independent registered public accounting firm may identify, may require us to incur significant costs and expend significant time and management resources. Further, any of the measures we implement to remedy any such deficiencies may not effectively mitigate or remedy such deficiencies.
Any failure to remedy the deficiencies identified by management, any failure to implement required new or improved controls and the discovery of unidentified deficiencies could harm our operating results, cause us to fail to meet our reporting obligations, subject us to increased risk of errors and fraud related to our financial statements or result in material misstatements in, and untimely filing of, our financial statements. The existence of a material weakness could also cause a restatement of future presented financial statements. Investors could lose confidence in our financial reports, and our stock price may be adversely affected, if our internal controls over financial reporting are found not to be effective by management or by an independent registered public accounting firm or if we make disclosure of existing or potential significant deficiencies or material weaknesses in those controls.

Changes in significant laws and government regulations affecting environmental compliance and income taxes.

Katy is subject to many environmental and safety regulations with respect to its operating facilities that may result in unanticipated costs or liabilities. Most of the Company s facilities are subject to extensive laws, regulations, rules and ordinances relating to the protection of the environment, including those governing the discharge of pollutants in the air and water and the generation, management and disposal of hazardous substances and wastes or other materials. Katy may incur substantial costs, including fines, damages and criminal penalties or civil sanctions, or experience interruptions in its operations for actual or alleged violations or compliance requirements arising under environmental laws. The Company s operations could result in violations under environmental laws, including spills or other releases of hazardous substances to the environment. Given the nature of Katy s business, violations of environmental laws may result in restrictions imposed on its operating activities or substantial fines, penalties, damages or other costs, including as a result of private litigation. In addition, the Company may incur significant expenditures to comply with existing or future environmental laws. Costs relating to environmental matters will be subject to evolving regulatory requirements and will depend on the timing of promulgation and enforcement of specific standards that impose requirements on Katy s operations. Costs beyond those currently anticipated may be required under existing and future environmental laws.

At any point in time, many tax years are subject to audit by various taxing jurisdictions. The results of these audits and negotiations with tax authorities may affect tax positions taken. Additionally, our effective tax rate in a given financial statement period may be materially impacted by changes in the geographic mix or level of earnings.

We are subject to litigation that could adversely affect our operating results.

From time to time we may be a party to lawsuits and regulatory actions relating to our business. Due to the inherent uncertainties of litigation and regulatory proceedings, we cannot accurately predict the ultimate outcome of any such proceedings. An unfavorable outcome could have a material adverse impact on our business, financial condition and results of operations. In addition, regardless of the outcome of any litigation or regulatory proceedings, such proceedings could result in substantial costs and may require that we devote substantial resources to defend the Company. Further, changes in government regulations both in the United States and in the foreign countries in which we operate could have adverse effects on our business and subject us to additional regulatory actions. The Company is currently a party to various lawsuits. See Legal Proceedings.

Because we translate foreign currency from international sales into U.S. dollars and are required to make foreign currency payments, we may incur losses due to fluctuations in foreign currency exchange rates.

We are exposed to fluctuations in the Euro, British pound, Canadian dollar and various Asian currencies such as the Chinese Renminbi. We recognize foreign currency gains or losses arising from our operations in the period incurred. As a result, currency fluctuations between the U.S. dollar and the currencies in which we do business will cause foreign currency translation gains and losses, which may cause fluctuations in our future operating results. We do not currently engage in foreign exchange hedging transactions to manage our foreign currency exposure.

Item 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

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Item 2. PROPERTIES

As of December 31, 2006, our total building floor area owned or leased was 2,679,000 square feet, of which 185,000 square feet were owned and 2,494,000 square feet were leased. The following table shows a summary by location of our principal facilities including the nature of the facility and the related business unit.

Location	Facility	Business Unit
UNITED STATES		
California		
Norwalk	Manufacturing, Distribution	Continental, Contico, Container
Chino	Distribution	Continental, Contico, Glit, Wilen, Disco
Georgia		
Atlanta	Manufacturing, Distribution	Wilen
McDonough	Manufacturing, Distribution	Glit, Wilen, Disco
Wrens*	Manufacturing, Distribution	Glit
Washington**	Manufacturing	Glit
Indiana		
Carmel	Manufacturing	Woods US
Indianapolis	Office, Distribution	Woods US
Missouri		
Bridgeton	Office, Manufacturing, Distribution	Continental, Contico
Hazelwood	Manufacturing	Continental, Contico
Virginia		
Arlington	Corporate Headquarters	Corporate
CANADA		
Ontario		
Toronto	Office, Manufacturing, Distribution	Gemtex
Toronto	Office, Distribution	Woods Canada, CCP Canada
CHINA		
Shenzhen	Office	Woods US
UNITED KINGDOM		
Cornwall		
Redruth***	Office, Distribution	CML
Berkshire		
Slough	Office	CML

* Facility is owned.

** During 2007, we expect to

consolidate all of our abrasives operations in Washington, Georgia into our Wrens, Georgia (Wrens) facility.

*** Facility was sold in January, 2007; however, we will lease a portion of the facility.

We believe that our current facilities have been adequately maintained, generally are in good condition, and are suitable and adequate to meet our needs in our existing markets for the foreseeable future.

Item 3. LEGAL PROCEEDINGS

Information regarding legal proceedings is included in Note 18 to the Consolidated Financial Statements in Part II, Item 8 and is incorporated by reference herein.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of the security holders during the fourth quarter of 2006.

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PART II

Item 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our 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.

Period	High	Low
2006		
First Quarter	$3.75	$2.80
Second Quarter	3.61	2.24
Third Quarter	3.23	1.85
Fourth Quarter	3.40	2.51
2005		
First Quarter	$5.41	$3.80
Second Quarter	3.98	2.35
Third Quarter	3.70	2.25
Fourth Quarter	3.50	1.80

As of February 28, 2007, there were 567 holders of record of our common stock, in addition to approximately 1,173 holders in street name, and there were 7,951,177 shares of common stock outstanding.

Dividend Policy

Dividends are paid at the discretion of the Board of Directors. Since the Board of Directors suspended quarterly dividends on March 30, 2001 in order to preserve cash for operations, the Company has not declared or paid any cash dividends on its common stock. In addition, the Bank of America Credit Agreement prohibits the Company from paying dividends on its securities, other than dividends paid solely in securities. The Company currently intends to retain its future earnings, if any, to fund the development and growth of its business and, therefore, does not anticipate paying any dividends, either in cash or securities, in the foreseeable future. Any future decision concerning the payment of dividends on the Company s common stock will be subject to its obligations under the Bank of America Credit Agreement and will depend upon the results of operations, financial condition and capital expenditure plans of the Company, as well as such other factors as the Board of Directors, in its sole discretion, may consider relevant. For a discussion of our Bank of America Credit Agreement, see Management s Discussion and Analysis of Financial Condition and Results of Operations .

Equity Compensation Plan Information

Information regarding securities authorized for issuance under the Company s equity compensation plans as of December 31, 2006 is set forth in Item 12, Security Ownership of Certain Beneficial Owners and Management.

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Share Repurchase Plan

On April 20, 2003, the Company announced a plan to repurchase up to $5.0 million in shares of its common stock. In 2004, 12,000 shares of common stock were repurchased on the open market for approximately $0.1 million, while in 2003, 482,800 shares of common stock were repurchased on the open market for approximately $2.5 million. We suspended further repurchases under the plan on May 10, 2004. On December 5, 2005, the Company announced the resumption of the above plan to repurchase $1.0 million in shares of its common stock. In 2005, 3,200 shares of common stock were repurchased on the open market for $7.5 thousand. In 2006, 40,800 shares of common stock, of which 4,900 shares were completed in the fourth quarter, were repurchased on the open market for $0.1 million. The following table sets forth the repurchases made under this program:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
2005	3,200	$ 2.35	3,200	333,333
2006	40,800	$ 2.71	40,800	
Total	44,000	$ 2.68	44,000	

The Company s share repurchase program is conducted under authorizations made from time to time by the Company s Board of Directors. The shares reported in the table are covered by Board authorizations to repurchase shares of common stock, as follows: 333,333 shares announced on December 5, 2005. This authorization does not have an expiration date.

Performance Graph

The following information in this Item 5 of this Annual Report on Form 10-K is not deemed to be soliciting material or to be filed with the SEC or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 or to the liabilities of Section 18 of the Securities Exchange Act of 1934, and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically incorporate it by reference into such a filing.

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The graph below compares the yearly percentage change in the cumulative total stockholder return on the shares of Katy common stock with the cumulative total returns of the Russell 2000 Index, the Dow Jones US Industrial Diversified Index and the S&P Smallcap 600 Industrial Conglomerates Index for the fiscal years ending December 31, 2001 through 2006. The calculations in the graph below assume $100 was invested on December 31, 2001 in Katy s common stock and each index, and also assume reinvestment of dividends.

	12/01	12/02	12/03	12/04	12/05	12/06
Katy Industries, Inc.	**100.00**	**100.58**	**166.96**	**151.46**	**90.64**	**78.36**
Russell 2000	**100.00**	**79.52**	**117.09**	**138.55**	**144.86**	**171.47**
Dow Jones US Diversified Industrials	**100.00**	**64.93**	**87.84**	**104.69**	**101.95**	**111.68**
S & P SmallCap Industrial Conglomerates	**100.00**	**59.47**	**80.21**	**95.65**	**92.02**	**99.94**

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Item 6. SELECTED FINANCIAL DATA

	Years Ended December 31,				
	As Restated, see Note 2				
	2006	2005	2004	2003	2002
	(Amounts in Thousands, except per share data and percentages)				
Net sales	$ 396,166	$ 423,390	$ 416,681	$ 398,249	$ 403,599
Loss from continuing operations [a]	$ (4,789)	$ (11,619)	$ (36,528)	$ (17,255)	$ (55,149)
Discontinued operations [b]	(6,834)	(2,178)	407	7,891	914
Cumulative effect of a change in accounting principle [b] [c]	(756)				(2,514)
Net loss	(12,379)	(13,797)	(36,121)	(9,364)	(56,749)
Gain on early redemption of preferred interest of subsidiary [d]				6,560	
Payment-in-kind of dividends on convertible preferred stock [e]			(14,749)	(12,811)	(11,136)
Net loss attributable to common stockholders	$ (12,379)	$ (13,797)	$ (50,870)	$ (15,615)	$ (67,885)
(Loss) earnings per share of common stock Basic and diluted:					
Loss from continuing operations attributable to common stockholders	$ (0.60)	$ (1.47)	$ (6.50)	$ (2.86)	$ (7.92)
Discontinued operations	(0.86)	(0.27)	0.05	0.96	0.11
Cumulative effect of a change in accounting principle	(0.09)				(0.30)
Net loss attributable to common stockholders	$ (1.55)	$ (1.74)	$ (6.45)	$ (1.90)	$ (8.11)
Total assets	$ 182,694	$ 212,094	$ 224,464	$ 241,708	$ 275,977
Total liabilities	140,662	157,390	155,879	139,416	157,405
Preferred interest in subsidiary					16,400
Stockholders equity	42,032	54,704	68,585	102,292	102,172
Long-term debt, including current maturities	56,871	57,660	58,737	39,663	45,451
		2,112	30,056	11,525	21,204

Impairments of long-lived assets [f]					
Severance, restructuring and related charges [f]	(112)	1,090	3,505	8,132	19,155
Depreciation and amortization [f]	8,640	8,968	12,145	18,877	17,732
Capital expenditures [f]	4,614	8,925	10,782	11,062	8,714
Working capital [g]	48,610	48,132	59,855	43,439	35,206
Ratio of debt to capitalization	57.5%	51.3%	46.1%	27.9%	27.7%
Weighted average common shares outstanding Basic and diluted	7,966,742	7,948,749	7,883,265	8,214,712	8,370,815
Number of employees	1,172	1,544	1,793	1,808	2,261
Cash dividends declared per common share	$	$	$	$	$

[a] Includes distributions on preferred securities in 2003 and 2002.

[b] Presented net of tax.

[c] In 2006, this amount is stock compensation expense recorded with the adoption of Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment*. In 2002, this amount is a transitional impairment of goodwill recorded with the adoption of SFAS No. 142, *Goodwill and Other Intangible Assets*.

[d]

Represents the gain recognized on a redemption of a preferred interest of our CCP subsidiary.

[e] Represents a 15% payment-in-kind dividend on our Convertible Preferred Stock. See Note 12 to the Consolidated Financial Statements in Part II, Item 8.

[f] From continuing operations only.

[g] Defined as current assets minus current liabilities, exclusive of deferred tax assets and liabilities and debt classified as current.

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Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Restatement of Prior Financial Information

As a result of accounting errors in the raw material inventory records, management and the Company s Audit Committee determined on August 6, 2007 that the Company s consolidated financial statements for fiscal 2005 and 2006 should no longer be relied upon. The Company s decision to restate its consolidated financial statements is based on facts obtained by management and the results of an internal investigation of the physical raw material inventory counting process at CCP. These procedures resulted in the identification of an intentional overstatement of raw material inventory when completing the physical inventory. At the time of the physical inventories, the Company did not have sufficient controls in place to ensure that the accurate physical raw material inventory on hand was properly accounted for and reported in the proper period.

In addition, as part of the restatement, the Company has recorded additional items, certain of which were previously identified and determined to be immaterial. The impact of these additional items on net loss is approximately ($0.4) million and $0.2 million for the years ended December 31, 2005 and 2006, respectively, which is allocated entirely to loss from continuing operations.

Refer to Note 2 of the Consolidated Financial Statements for additional discussion related to the effects of the restatement.

COMPANY OVERVIEW

For purposes of this discussion and analysis section, reference is made to the table below and the Company s Consolidated Financial Statements included in Part II, Item 8. We have two principal operating groups: Maintenance Products and Electrical Products. The group labeled as Other consists of Sahlman and SESCO. Two businesses formerly included in the Maintenance Products Group, Metal Truck Box and CEL, have been classified as Discontinued Operations for the periods prior to their sale. These business units were sold in 2006.

Since the Recapitalization, the Company s management has been focused on various restructuring and cost reduction initiatives. Currently, the Company s focus has shifted to sustaining revenue growth and managing raw material costs. Our future cost reductions, if any, will continue to come from process improvements (such as Lean Manufacturing and Six Sigma), value engineering products, improved sourcing/purchasing and lean administration.

End-user demand for our Maintenance and Electrical products is relatively stable and recurring. Demand for products in our markets is strong and supported by the necessity of the products to users, creating a steady and predictable market. In the core janitorial/sanitary and foodservice segments, sanitary and health standards create a steady flow of ongoing demand. The consumable or short-life nature of most of the products used for cleaning applications (primarily floor pads, hand pads, and mops, brooms and brushes) means that they are replaced frequently, creating further demand stability. However, we continue to see a trend of just in time inventory being maintained by our customers. This has resulted in smaller, more frequent orders coming from our distribution base. The unstable resin market has created a need to increase prices to commercial customers, and to date, they have been accepted. But, commercial customers now believe resin prices are coming down and future increases may be difficult to implement.

In addition, many of our Electrical products can be characterized as value items that are frequently lost or discarded, with subsequent replacement ensuring continuing and stable demand. This is particularly the case with electrical cords, which consistently experience strong sales ahead of the holiday season.

Certain of the markets in which we compete are expected to experience steady growth over the next several years. Our core commercial cleaning product markets are expected to grow at rates approximating gross domestic product (GDP), driven by increasing sanitary standards as a result of heightened health concerns. The consumer plastics market as a whole is relatively mature, with its growth characteristics linked to household expenditures. Demand is driven by the increasing acquisition of material possessions by North American households and the desire of consumers to store those possessions in an attractive and orderly manner. Demand for consumer plastic storage products is closely linked to value items and the ability to pass resin increases has been a significant challenge. End-users are sensitive to the price/value relationship more than brand-name and are seeking alternative solutions when the price/value relationship does not meet their expectations.

We estimate that the North American market for cords and work lights will grow at above-GDP growth rates, driven by the growing number of suburban homes (particularly those with outdoor spaces) and the growth in the use of outdoor appliances. The market for surge protectors and multiple outlet products is also expected to grow at above-GDP growth rates driven by the continued use in consumer purchasers of appliances, computers, home entertainment equipment, and other electronic equipment, as well as the growing public awareness of the need to protect these products from power surges.

Key elements in achieving profitability in the Maintenance Products Group include 1) maintaining a low cost structure, from a production, distribution and administrative standpoint, 2) providing outstanding customer service and 3) containing raw material costs (especially plastic resins) or raising prices to shift these higher costs to our customers for our plastic products. In addition to continually striving to reduce our cost structure, we are seeking to offset pricing challenges by developing new products, as new products or beneficial modifications of existing products increase demand from our customers, provide novelty to the consumer, and offer an opportunity for favorable pricing from customers. Retention of customers, or more specifically, product lines with those customers, is also very important in the mass merchant retail area, given the vast size of these national accounts. Since the fourth quarter of 2003, we centralized our customer service and administrative functions for CCP divisions Continental, Glit, Wilen, and Disco in one location, allowing customers to order products from any CCP commercial unit on one purchase order. We believe that operating these business units as a cohesive unit will improve customer service in that our customers purchasing processes will be simplified, as will follow up on order status, billing, collection and other related functions. We believe that this may increase customer loyalty, help in attracting new customers and lead to increased top line sales in future years.

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Key elements in achieving profitability in the Electrical Products Group are in many ways similar to those mentioned for our Maintenance Products Group. The achievement and maintenance of a low cost structure is critical given the significant level of foreign competition, primarily from Asia and Latin America. For this reason, Woods US and Woods Canada, respectively, executed a fully outsourced strategy for their consumer electrical products. Customer service, specifically the ability to fill orders at a rate designated by our customers, is very important to customer retention, given seasonal sales pressures in the consumer electrical area. Woods US and Woods Canada are both subject to seasonal sales trends in connection with the holiday shopping season, with stronger sales and profits realized in the third and fourth quarters. Retention of customers is critical in the Electrical Products Group, given the size of national accounts.

See Outlook for 2007 in this section for discussion of recent developments related to the Maintenance Products Group and the Electrical Products Group.

	Years Ended December 31, As Restated, see Note 2					
	2006		2005		2004	
	(Amounts in Millions, except per share data and percentages)					
	$	% to Sales	$	% to Sales	$	% to Sales
Net sales	$ 396.2	100.0	$ 423.4	100.0	$ 416.7	100.0
Cost of goods sold	345.5	87.2	372.9	88.0	361.7	86.8
Gross profit	50.7	12.8	50.5	12.0	55.0	13.2
Selling, general and administrative expenses	46.5	(11.7)	52.7	(12.5)	52.7	(12.6)
Impairments of long-lived assets			2.1	(0.5)	30.0	(7.2)
Severance, restructuring and related charges	(0.1)	0.0	1.1	(0.3)	3.5	(0.9)
Loss (gain) on sale of assets	0.5	(0.1)	(0.3)	0.1	(0.3)	0.1
Operating income (loss)	3.8	1.0	(5.1)	(1.2)	(30.9)	(7.4)
Equity in income of equity method investment			0.6			
Gain on SESCO joint venture transaction	0.6					
Interest expense	(7.1)		(5.7)		(4.0)	
Other, net	0.2		0.2		(1.0)	
Loss from continuing operations before provision for income taxes	(2.5)		(10.0)		(35.9)	
Provision for income taxes from continuing operations	(2.3)		(1.6)		(0.6)	
Loss from continuing operations	(4.8)		(11.6)		(36.5)	
(Loss) income from operations of discontinued businesses (net of tax)	(1.4)		(2.2)		1.2	

Loss on sale of discontinued businesses (net of tax)	(5.4)		(0.8)
Loss before cumulative effect of a change in accounting principle	(11.6)	(13.8)	(36.1)
Cumulative effect of a change in accounting principle (net of tax)	(0.8)		
Net loss	(12.4)	(13.8)	(36.1)
Payment-in-kind of dividends on convertible preferred stock			(14.8)
Net loss attributable to common stockholders	$ (12.4)	$ (13.8)	$ (50.9)
Loss per share of common stock Basic and diluted			
Loss from continuing operations	$ (0.60)	$ (1.47)	$ (4.63)
Payment-in-kind of dividends on convertible preferred stock			(1.88)
Loss from continuing operations attributable to common stockholders	(0.60)	(1.47)	(6.50)
Discontinued operations (net of tax)	(0.86)	(0.27)	0.05
Cumulative effect of a change in accounting principle	(0.09)		
Net loss attributable to common stockholders	$ (1.55)	$ (1.74)	$ (6.45)

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RESULTS OF OPERATIONS

2006 COMPARED TO 2005

Overview

Our consolidated net sales in 2006 decreased $27.2 million, or 6.4%, from 2005. Lower net sales resulted from a lower volume of 17.0% offset by higher pricing of 9.6% and favorable currency translation of 1.0%. Gross margins were 12.8% in the year ended December 31, 2006, an increase of 0.8 percentage point from the year ended December 31, 2005. Margins were positively impacted by improved operating performance at our Glit business offset by higher material costs, a portion of which could not be passed on through as price increases within our Electrical Group. Selling, general and administrative expenses (SG&A) as a percentage of sales were 11.7% in 2006 which is lower than 12.5% in 2005. In 2006, operating income was $3.8 million compared to an operating loss of ($5.1) million in 2005. The improvement was principally due to increased gross margins, lower selling, general and administrative expenses, along with the reduction of charges associated with impairment of long-lived assets and severance, restructuring and other charges of $3.3 million.

Overall, we reported a net loss attributable to common shareholders of ($12.4) million [($1.55) per share] for the year ended December 31, 2006, versus a net loss attributable to common shareholders of ($13.8) million [($1.74) per share] in the same period of 2005. In 2006, we reported a net loss from discontinued businesses of ($6.8) million [($0.86) per share] versus a net loss from discontinued businesses of ($2.2) million [($0.27) per share] in 2005. We also reported a cumulative effect of change in accounting principle of ($0.8) million [($0.09 per share)] related to the adoption of FAS 123R, *Shared Based Payments*, effective January 1, 2007.

Net Sales

Maintenance Products Group

Net sales from the Maintenance Products Group decreased from $216.1 million during the year ended December 31, 2005 to $208.4 million during the year ended December 31, 2006, a decrease of 3.5%. Overall, this decline was primarily due to lower volume of 8.3% offset by higher pricing of 4.6% and favorable currency translation of 0.2%. Sales volume for the Contico business unit in the U.S., which sells primarily to mass merchant customers, was significantly lower due to our decision to exit certain unprofitable business lines. We also experienced volume declines in our Glit business unit in the U.S. primarily due to activity with a major customer being adversely impacted from the overall slowdown in the building industry and the lower number of major hurricanes in 2006.

Higher pricing resulted from the implementation of selling price increases across the Maintenance Products Group, which took effect throughout the last half of 2005 and throughout 2006. The implementation of price increases was in response to the accelerating cost of our primary raw materials, packaging materials, utilities and freight.

Electrical Products Group

The Electrical Products Group s sales decreased from $207.3 million for the year ended December 31, 2005 to $187.7 million for the year ended December 31, 2006, a decrease of 9.4%. Sales decreased as a result of a reduction in volume of 26.0% offset by higher pricing of 15.0%, and favorable currency translation of 1.6%.

Volume in 2006 at Woods US was adversely impacted by the absence of 2005 sales with one of its major customers which did not repeat in 2006. In addition, the current year was adversely impacted by the loss of certain product lines with
certain customers along with a milder hurricane season in the United States. Sales at Woods Canada were favorably impacted by a stronger Canadian dollar versus the U.S. dollar in 2006 versus 2005.

Multiple selling price increases were implemented throughout 2006 to offset the rising cost of copper and PVC. We have continued to implement price increases; however, there can be no assurance that such increases will be accepted.

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Operating Income

	As Restated, see Note 2					
	2006		2005		Change	
	$	% Margin	$	% Margin	$	% Margin
Maintenance Products Group	$ 5.7	2.7	$ (6.4)	(3.0)	$ 12.1	5.7
Electrical Products Group	8.7	4.6	17.4	8.4	(8.7)	(3.8)
Unallocated corporate expense	(10.2)		(13.2)		3.0	
	4.2	1.0	(2.2)	(0.5)	6.4	1.5
Impairments of long-lived assets			(2.1)		2.1	
Severance, restructuring and related charges	0.1		(1.1)		1.2	
(Loss) gain on sale of assets	(0.5)		0.3		(0.8)	
Operating income (loss)	$ 3.8	1.0	$ (5.1)	(1.2)	$ 8.9	2.2

Maintenance Products Group

The Maintenance Products Group s operating income increased from an operating loss of ($6.4) million (-3.0% of net sales) during the year ended December 31, 2005 to operating income of $5.7 million (2.7% of net sales) for the year ended December 31, 2006. The improvement was primarily attributable to production efficiencies gained at our Glit business as well as higher pricing levels in 2006 as well as positive impact from the liquidation of last-in, first-out inventory. In 2005, lower volumes and higher raw material costs adversely impacted our business units which sell plastic products. SG&A expenses as a percentage of net sales in 2006 were slightly lower versus 2005 due to mostly cost containment measures.

Electrical Products Group

The Electrical Products Group s operating income decreased from $17.4 million (8.4% of net sales) for the year ended December 31, 2005 to $8.7 million (4.6% of net sales) for the year ended December 31, 2006. Operating margins have been negatively impacted, primarily during the last half of 2006, from the accelerated change in material costs and the inability to recover these costs from the customer. In addition, the reduced volume levels from 2005 have impacted operating income. SG&A as a percentage of net sales in 2006 was comparable to 2005 levels.

Corporate

Corporate operating expenses decreased from $13.2 million in 2005 to $10.2 million in 2006 principally due to compensation cost associated with the acceleration of vesting of stock options in 2005 and favorable self-insured costs performance in 2006.

Impairments of Long-lived Assets

During 2006, we did not recognize any impairment in our businesses. During the fourth quarter of 2005, we recognized an impairment loss of $2.1 million related to the Glit business unit of our Maintenance Products Group (see discussion of impairment in Note 5 of the Consolidated Financial Statements in Part II, Item 8) including $1.6 million related to goodwill, $0.2 million related to a tradename intangible, $0.2 million related to a customer list intangible, and $0.1 million related to patents. Our Glit business unit sustained a lower than expected profitability level throughout the last half of 2005 which resulted from increased costs due to operational disruptions at our Wrens, Georgia facility. The operational disruptions were the result of both the integration of other manufacturing operations into the facility as well as a fire in the fourth quarter of 2004. Not only did the facility have increased costs, the disruptions triggered the loss or reduction of customer activity. As a result, an impairment analysis was completed on the business unit and its long-lived assets. In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Intangible Assets*, we (with the assistance of an independent third party valuation firm) performed an analysis of discounted future cash flows which indicated that the book value of the Glit unit was greater

than the fair value of the business. In addition, as a result of the goodwill analysis, we also assessed whether there had been an impairment of the long-lived assets in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The Company concluded that the book value of tradename, customer list and patents associated with the Glit business units exceeded the fair value and impairment had occurred.

Severance, Restructuring and Related Charges
Operating results for the year ended December 31, 2006 include a reduction of the non-cancelable lease liability for our Hazelwood, Missouri facility. This reduction in the liability was offset by costs associated with the restructuring of the Glit business ($0.3 million) and costs associated with the relocation of corporate headquarters ($0.2 million). Operating results for the Company during the year ended December 31, 2005 were negatively impacted by severance, restructuring and related charges of $1.1 million. Charges in 2005 related to the restructuring of the Glit business ($0.7 million), costs associated with the relocation of corporate headquarters ($0.2 million) and costs associated with various restructuring activities ($0.2 million). Refer to further discussion on severance and restructuring charges on Page 31 and Note 19 to the Consolidated Financial Statements in Part II, Item 8.

Other

In 2005, the Company recognized $0.6 million in equity income from the Sahlman investment compared to no income or loss being recognized in 2006. Interest expense increased by $1.4 million in 2006 versus 2005 primarily as a result of higher average borrowings as well as higher interest rates.

On June 27, 2006, the Company and Montenay amended the partnership interest purchase agreement in order to allow the Company to completely exit from the SESCO operations and related obligations. In addition, Montenay became the guarantor under the loan obligation for the IRBs. Montenay purchased the Company s limited partnership interest for $0.1 million and a reduction of approximately $0.6 million in the face amount due to Montenay as agreed upon in the original partnership agreement. In addition, Montenay removed the Company as the performance guarantor under the service agreement. As a result of the above transaction, the Company recorded a gain of $0.4 million within continuing operations during the year ended December 31, 2006 given the reduction in the face amount due to Montenay as agreed upon in the original partnership interest purchase agreement. In addition, the Company recorded a gain on the sale of the partnership interest of approximately $0.1 million as reflected within continuing operations.

The provision for income taxes for 2006 and 2005 reflects current expense for state and foreign income taxes. The increase in the provision for income taxes reflects the improved operating performance for certain foreign businesses. In both 2006 and 2005, tax benefits were not recorded in the U.S. (for federal and certain state income taxes) and for certain foreign subsidiaries on pre-tax losses as valuation allowances were recorded related to deferred tax assets created as a result of operating losses in the United States and in certain foreign jurisdictions.

Loss from operations of discontinued businesses includes activity from the U.K. consumer plastics business plus the Metal Truck Box business unit, which were all sold in 2006. For the year ended December 31, 2006, we sold these business units for a loss of $5.4 million. In 2006, the Company incurred a loss from operations of discontinued businesses of $1.4 million compared to a loss from operations of discontinued businesses of $2.2 million for 2005.

Effective January 1, 2006, the Company adopted SFAS No. 123R, *Share-Based Payments*. As a result, a cumulative effect of this adoption of $0.8 million was recognized associated with the fair value of all vested stock appreciation rights (SARs).

2005 COMPARED TO 2004

Overview

Our consolidated net sales in 2005 increased $6.7 million, or 1.6%, from 2004. Higher net sales resulted from higher pricing of 4.6%, favorable currency translation of 0.8% offset by lower volume of 3.8%. Gross margins were 12.0% in the year ended December 31, 2005, a decrease of 1.2 percentage points from the year ended December 31, 2004. Margins were negatively impacted by higher material costs, a portion of which could not be passed on through price increases, and higher operating costs in our Glit business. SG&A as a percentage of sales were 12.5% in 2005 which is slightly lower than 12.6% in 2004. The operating loss decreased by $25.8 million to $5.1 million, principally due to the reduction of charges associated with impairment of long-lived assets and severance, restructuring and other charges of $30.3 million. However, these reductions were offset by lower gross margins as discussed above.

Overall, we reported a net loss attributable to common shareholders of ($13.8) million [($1.74) per share] for the year ended December 31, 2005, versus a net loss attributable to common shareholders of ($50.9) million [($6.45) per share] in the same period of 2004. In 2005, we reported net loss from discontinued businesses of ($2.2) million [($0.27) per share] versus net income from discontinued businesses of $0.4 million [$0.05 per share] in 2004. During the year ended December 31, 2004, we recorded the impact of paid-in-kind dividends earned on our convertible preferred stock

of ($14.8) million [($1.88) per share].

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Net Sales

Maintenance Products Group

Net sales from the Maintenance Products Group decreased from $237.9 million during the year ended December 31, 2004 to $216.1 million during the year ended December 31, 2005, a decrease of 9.2%. Overall, this decline was primarily due to lower volume of 13.3% offset by higher pricing of 3.9% and favorable currency translation of 0.2%. Sales volume for the Contico business unit in the U.S., which sells primarily to mass merchant customers, was significantly lower due to our decision to exit certain unprofitable business lines. We also experienced volume declines in our Glit business unit in the U.S. due to certain operational disruptions including inefficiencies caused by the consolidation of two additional Glit facilities into the Wrens, Georgia facility as well as a fire in Wrens, Georgia early in the fourth quarter of 2004. These decreases in Glit sales were partially offset by stronger sales of roofing products to the construction industry.

Higher pricing resulted from the implementation of selling price increases across the Maintenance Products Group, which took effect throughout 2005. The implementation of price increases was in response to the accelerating cost of our primary raw materials, packaging materials, utilities and freight starting in 2004 and continuing in 2005.

Electrical Products Group

The Electrical Products Group s sales improved from $178.8 million for the year ended December 31, 2004 to $207.3 million for the year ended December 31, 2005, an increase of 16.0%. Sales improved as a result of an increase in volume of 8.9%, higher pricing of 5.4%, and favorable currency translation of 1.7%.

Volume at Woods US benefited principally from increased promotional activity at one of its largest mass merchant retailers in the first quarter of 2005, increases in store growth at some of our large mass merchant retailers, hurricane related orders, and the timing of purchases by customers switching to direct import (direct import sales represent merchandise shipped directly from our suppliers to our customers). Woods Canada experienced a volume increase due to an increased demand at its largest customer (a national mass merchant retailer in Canada). Sales at Woods Canada were also favorably impacted by a stronger Canadian dollar versus the U.S. dollar in 2005 versus 2004. Multiple selling price increases were implemented throughout 2005 at Woods US (and to a lesser extent at Woods Canada) to offset the rising cost of copper and PVC.

Operating Income

	As Restated, see Note 2					
	2005		2004		Change	
	$	% Margin	$	% Margin	$	% Margin
Maintenance Products Group	$ (6.4)	(3.0)	$ (4.1)	(1.7)	$ (2.3)	(1.3)
Electrical Products Group	17.4	8.4	16.8	9.4	0.6	(1.0)
Unallocated corporate expense	(13.2)		(10.4)		(2.8)	
	(2.2)	(0.5)	2.3	0.6	(4.5)	(1.1)
Impairments of long-lived assets	(2.1)		(30.0)		27.9	
Severance, restructuring and related charges	(1.1)		(3.5)		2.4	
Gain on sale of assets	0.3		0.3			
Operating loss	$ (5.1)	(1.2)	$ (30.9)	(7.4)	$ 25.8	6.2

Maintenance Products Group

The Maintenance Products Group s operating loss increased from ($4.1) million (-1.7% of net sales) during the year ended December 31, 2004 to an operating loss of ($6.4) million (-3.0% of net sales) for the year ended December 31, 2005. The change was primarily attributable to lower volumes in the Contico and Glit units. In addition, higher raw material costs in 2005 versus 2004 were substantially recovered through higher selling prices. We continued to

experience declines in the profitability of our Glit business resulting from increased costs which were principally due to certain operational disruptions at our Wrens Georgia facility. SG&A expenses were lower in 2005 versus 2004, but as a percentage of net sales, SG&A expenses have remained essentially unchanged.

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Electrical Products Group
The Electrical Products Group s operating income increased from $16.8 million (9.4% of net sales) for the year ended December 31, 2004 to $17.4 million (8.4% of net sales) for the year ended December 31, 2005, an increase of 4%. The increase in operating income was due to the strong volume increases at the Woods US business unit during the fourth quarter of 2005. Operating income as a percentage of net sales decreased due to a higher mix of direct import sales.
Corporate
Corporate operating expenses increased from $10.4 million in 2004 to $13.2 million in 2005 primarily due to non-cash stock compensation expense related to the former chief executive officer of $2.0 million and higher insurance costs of $0.5 million offset by a credit recognized on SARs of $0.8 million attributable to the lower stock price.
Impairments of Long-lived Assets
During the fourth quarter of 2005, we recognized an impairment loss of $2.1 million related to the Glit business unit of our Maintenance Products Group (see discussion of impairment in Note 5 of the Consolidated Financial Statements in Part II, Item 8) including $1.6 million related to goodwill, $0.2 million related to a tradename intangible, $0.2 million related to a customer list intangible, and $0.1 million related to patents. During the fourth quarter of 2004, we recognized an impairment loss of $29.9 million related to the US Plastics business units of our Maintenance Products Group (see discussion of impairment in Note 5 to the Consolidated Financial Statements in Part II, Item 8) including $8.0 million related to goodwill, $8.4 million related to machinery and equipment, $10.9 million related to a customer list intangible, and $2.6 million related to a trademark. In the fourth quarter of 2004, the profitability of the Contico business unit declined sharply as we were unable to pass along sufficient selling price increases to combat the accelerating cost of resin (a key raw material used in all of the US Plastics units). We believe that our future earnings and cash flow could be negatively impacted to the extent further increases in resin and other raw material costs cannot be offset or recovered through higher selling prices. The Company concluded that the book value of equipment, a customer list intangible and trademark associated with the US Plastics business unit significantly exceeded the fair value and impairment had occurred. Also in 2004, we recorded impairment charges of $0.1 million related to certain assets at the Woods US business unit of our Electrical Products Group.
Severance, Restructuring and Related Charges
Operating results for the Company during the years ended December 31, 2005 and 2004 were negatively impacted by severance, restructuring and related charges of $1.1 million and $3.5 million, respectively. Charges in 2005 related to the restructuring of the Glit business ($0.7 million), costs associated with the relocation of corporate headquarters ($0.2 million) and costs associated with various restructuring activities ($0.2 million). Refer to further discussion on severance and restructuring charges on Page 31 and Note 19 to the Consolidated Financial Statements in Part II, Item 8.
Charges in 2004 related to adjustments to previously established non-cancelable lease liabilities for abandoned facilities ($0.9 million); a non-cancelable lease accrual and severance as a result of the shutdown of manufacturing and severance at Woods Canada ($0.9 million); the restructuring of the Glit business ($0.8 million); costs for the movement of inventory and equipment in connection with the consolidation of St. Louis, Missouri manufacturing and distribution facilities ($0.3 million); the shutdown and relocation of a procurement office in Asia ($0.3 million); costs incurred for the consolidation of administrative functions for CCP ($0.2 million); and expenses for the closure of CCP Canada s facility and the subsequent consolidation into the Woods Canada facility ($0.1 million).
Other
In 2005, the Company recognized $0.6 million in equity income from the Sahlman investment compared to no equity income being recognized in 2004.
Interest expense increased by $1.8 million in 2005 versus 2004, primarily as a result of higher average borrowing as well as higher interest rates and increased margins over LIBOR pursuant to the Bank of America Credit Agreement.
Other, net for the year ended December 31, 2004 included the net write-off of amounts related to divested business ($0.9 million) and the write-off of fees and expenses ($0.5 million) associated with a financing which the Company chose not to pursue.

The provision for income taxes for 2005 and 2004 reflects current expense for state and foreign income taxes offset by changes in certain tax reserves and foreign deferred tax assets.

Loss from operations of discontinued businesses includes activity from the United Kingdom consumer plastics business plus the Metal Truck Box business unit, which were all sold in 2006. For the year ended December 31, 2005, the Company incurred a loss from operations of discontinued businesses of $2.2 million compared to income from operations of discontinued businesses of $1.2 million for 2004. In 2004, the loss on sale of discontinued businesses includes impairment charges associated with the Metal Truck Box business of $0.8 million.

LIQUIDITY AND CAPITAL RESOURCES

We require funding for working capital needs and capital expenditures. We believe that our cash flow from operations and the use of available borrowings under the Bank of America Credit Agreement (as defined below) provide sufficient liquidity for our operations going forward. As of December 31, 2006, we had cash and cash equivalents of $7.4 million versus cash and cash equivalents of $8.4 million at December 31, 2005. Also as of December 31, 2006, we had outstanding borrowings of $56.9 million [58% of total capitalization], under the Bank of America Credit Agreement with unused borrowing availability on the Revolving Credit Facility of $13.7 million. As of December 31, 2005, we had outstanding borrowings of $57.7 million [51% of total capitalization] with unused borrowing availability of $13.9 million. We provided cash flow from operations of $1.8 million during the year ended December 31, 2006 versus the $6.6 million provided by operations during the year ended December 31, 2005. Cash flow from operations was lower in 2006 than 2005 as a result of the level of accounts payable reduction in late 2006.

We have a number of obligations and commitments, which are listed on the schedule later in this section entitled Contractual and Commercial Obligations. We have considered all of these obligations and commitments in structuring our capital resources to ensure that they can be met. See the notes accompanying the table in that section for further discussions of those items. We believe that given our strong working capital base, additional liquidity could be obtained through additional debt financing, if necessary. However, there is no guarantee that such financing could be obtained. In addition, we are continually evaluating alternatives relating to the sale of excess assets and divestitures of certain of our business units. Asset sales and business divestitures present opportunities to provide additional liquidity by de-leveraging our financial position.

Bank of America Credit Agreement

On April 20, 2004, we completed a refinancing of our 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 was a $110.0 million facility with a $20.0 million term loan (Term Loan) and a $90.0 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. The Bank of America Credit Agreement, and the additional borrowing ability under the Revolving Credit Facility obtained by incurring new term debt, resulted in three important benefits related to our long-term strategy: (1) additional borrowing capacity to invest in capital expenditures and/or acquisitions key to our strategic direction, (2) increased working capital flexibility to build inventory when necessary to accommodate lower cost outsourced finished goods inventory and (3) the ability to borrow locally in Canada and in the UK and provide a natural hedge against currency fluctuations.

The $20.0 million Term Loan proceeds were applied as follow: $1.8 million to the rollover of existing term debt; $16.7 million to reduce the Revolving Credit Facility; and $1.5 million to cover costs associated with the Bank of America Credit Agreement.

The Revolving Credit Facility has an expiration date of April 20, 2009 and its borrowing base is determined by eligible inventory and accounts receivable. 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 certain foreign subsidiaries), and all of our present and future assets and properties. The Term Loan, as amended, also has a final maturity date of April 20, 2009 with quarterly payments of $0.4 million beginning April 1, 2007. A final payment of $10.0 million is scheduled to be paid in April 2009. The term loan is collateralized by our property, plant and equipment.

Our borrowing base under the Bank of America Credit Agreement is reduced by the outstanding amount of standby and commercial letters of credit. Vendors, financial institutions and other parties with whom we conduct business may require letters of credit in the future that either (1) do not exist today or (2) would be at higher amounts than those that exist today. Currently, our largest letters of credit relate to our casualty insurance programs. At December 31, 2006, total outstanding letters of credit were $7.9 million.

Primarily due to declining profitability and the timing of certain restructuring payments, the Company amended the Bank of America Credit Agreement seven times from April 20, 2004, the date of the Refinancing, through

December 31, 2006. The amendments adjusted certain financial covenants such that the fixed charge coverage ratio and consolidated leverage ratio were eliminated and the minimum availability (eligible collateral base less outstanding borrowings and letters of credit) was set such that our eligible collateral must exceed the sum of our outstanding borrowings and letters of credit under the Revolving Credit Facility by at least $5.0 million to $7.5 million, at various points during that time period. In addition, the Company was limited on maximum allowable capital expenditures for $12.0 million and $10.0 million for 2006 and 2005, respectively.

Until September 30, 2004, interest accrued on the Revolving Credit Facility borrowings at 175 basis points over applicable LIBOR rate and at 200 basis points over LIBOR for borrowings under the Term Loan. In accordance with the Bank of America Credit Agreement, our margins (i.e. the interest rate spread above LIBOR) increased by 25 basis points in the fourth quarter of 2004 based upon certain leverage measurements. Margins increased an additional 25 basis points in the first quarter of 2005. Effective since April 2005, interest rate margins have been set at the largest margins set forth in the Bank of Credit Agreement, 275 basis points over applicable LIBOR rate and at 300 basis points over LIBOR for borrowings under the Term Loan. In accordance with the Bank of America Credit Agreement, margins on the term borrowings will drop 25 basis points if the balance of the Term Loan is reduced below $10.0 million. Interest accrues at higher margins on prime rates for swing loans, the amounts of which were nominal at December 31, 2006 and 2005.

As a result of the Seventh Amendment, the Company s debt covenants, as of December 31, 2006 and thereafter, under the Bank of America Credit Agreement were to be as follows:

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, beginning December 31, 2006.

Capital Expenditures For the year ended December 31, 2007, the Company is not to exceed $15.0 million in capital expenditures.

Leverage Ratio As noted above, interest rate margins are currently set at the largest margins set forth in the Bank of America Credit Agreement. Following the first quarter of 2007, the Leverage Ratio will be utilized to determine the interest rate margin over the applicable LIBOR rate. No maximum Consolidated Leverage Ratio requirement is present.

We were in compliance with the above financial covenants in the Bank of America Credit Agreement, as amended above, at December 31, 2006.

While the Company was in compliance with the covenants of the Bank of America Credit Agreement as of December 31, 2006, it obtained, on March 8, 2007, the Eighth Amendment. The Eighth Amendment eliminates the Fixed Charge Coverage Ratio for the remaining life of the debt agreement and requires the Company to maintain a minimum level of availability such that its eligible collateral must exceed the sum of its outstanding borrowings and letters of credit by at least $5.0 million from the effective date of the Eighth Amendment through September 29, 2007 and by $7.5 million through December 31, 2007. Thereafter, the Company is required to maintain a minimum level of availability of $5.0 million for the first three quarters of the year and $7.5 million for the fourth quarter. In addition, we reduced our Revolving Credit Facility from $90.0 million to $80.0 million.

If we are unable to comply with the terms of the amended covenants, we could seek to obtain further amendments and pursue increased liquidity through additional debt financing and/or the sale of assets (see discussion above). However, the Company believes that we will be able to comply with all covenants, as amended, throughout 2007.

We 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, we 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 from the Bank of America Credit Agreement, will be amortized over the life of the Bank of America Credit Agreement through April 2009. Also, during the first quarter of 2004, we incurred fees and expenses of $0.5 million associated with a financing which we chose not to pursue. The Company had the amortization of debt issuance costs of $1.2 million, $1.1 million and $1.1 million in 2006, 2005 and 2004, respectively. In addition, the Company incurred $0.3 million and $0.2 million associated with amending the Bank of America Credit Agreement, as discussed above, in 2006 and 2005, respectively.

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, caused the revolving credit facility to be classified as a current liability, per guidance in the 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*. We do not expect to repay, or be required to repay, within one year, the balance of the revolving credit facility classified as a current liability. The MAE clause, which is

a fairly typical requirement in commercial credit agreements, allows the lenders to require the loan to become due if they determine there has been a material adverse effect on our operations, business, properties, assets, liabilities, condition, or prospects. The classification of the revolving credit facility as a current liability is a result only of the combination of the lockbox agreements and MAE clause. The Bank of America Credit Agreement does not expire or have a maturity date within one year, but rather has a final expiration date of April 20, 2009. The lender had not notified us of any indication of a MAE at December 31, 2006, and we were not in default of any provision of the Bank of America Credit Agreement at December 31, 2006.

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Contractual Obligations

We have contractual obligations associated with our debt, operating lease agreements, severance and restructuring, and other obligations. Our obligations as of December 31, 2006, are summarized below (amounts in thousands):

Contractual Cash Obligations	Total	Due in less than 1 year	Due in 1-3 years	Due in 3-5 years	Due after 5 years
Revolving credit facility [a]	$ 43,879	$ 43,879	$	$	$
Term loans	12,992	1,125	11,867		
Interest on debt [b]	10,128	4,500	5,628		
Operating leases [c]	22,090	7,663	10,571	3,242	614
Severance and restructuring [c]	653	247	280	126	
SESCO payable to Montenay [d]	400	400			
Postretirement benefits [e]	6,203	901	1,505	1,257	2,540
Total Contractual Obligations	$ 96,345	$ 58,715	$ 29,851	$ 4,625	$ 3,154

Other Commercial Commitments	Total	Due in less than 1 year	Due in 1-3 years	Due in 3-5 years	Due after 5 years
Commercial letters of credit	$ 762	$ 762	$	$	$
Stand-by letters of credit	7,121	7,121			
Total Commercial Commitments	$ 7,883	$ 7,883	$	$	$

[a] As discussed in the Liquidity and Capital Resources section above and in Note 9 to the Consolidated Financial Statements in Part II, Item 8, the entire revolving credit facility under the Bank of America Revolving Credit Agreement is classified as a current liability on the Consolidated Balance Sheets as a result of the

combination in the Bank of America Credit Agreement of (i) lockbox agreements on Katy s depository bank accounts, and (ii) a subjective Material Adverse Effect (MAE) clause. The Revolving Credit Facility expires in April of 2009.

[b] Represents interest on the Revolving Credit Facility and Term Loan of the Bank of America Credit Agreement. Amounts assume interest accrues at the current rate in effect, including the effect of the impact of the increased margins through the end of the first quarter of 2007 pursuant to the Sixth Amendment. The amount also assumes the principal balance of the Revolving Credit Facility remains constant through its expiration date of April 20, 2009 and the

principal balance of the Term Loan amortizes in accordance with the terms of the Bank of America Credit Agreement. Due to the variable nature of the Bank of America Credit Agreement, actual interest rates could differ from the assumptions above. In addition, actual borrowing levels could differ from the assumptions above due to liquidity needs.

[c] Future non-cancelable lease rentals are included in the line entitled Operating leases, which also includes obligations associated with restructuring activities. The Consolidated Balance Sheets at December 31, 2006 and 2005, includes $1.0 million and $3.0 million, respectively, in discounted liabilities associated with non-cancelable

operating lease rentals, net of estimated sub-lease revenues, related to facilities that have been abandoned as a result of restructuring and consolidation activities.

[d] Amount owed to Montenay as a result of the SESCO partnership, discussed in Note 8 to the Consolidated Financial Statements in Part II, Item 8. This obligation is classified in the Consolidated Balance Sheets as an Accrued Expense in Current Liabilities.

[e] Benefits consisting of post-retirement medical obligations to retirees of former subsidiaries of Katy, as well as deferred compensation plan liabilities to former officers of the Company,

discussed in
Note 11 to the
Consolidated
Financial
Statements in
Part II, Item 8.

Off-balance Sheet Arrangements

See Note 8 to the Consolidated Financial Statements in Part II, Item 8 for a discussion of SESCO.

Cash Flow

Liquidity was positively impacted during 2006 as a result of positive operating cash flow along with proceeds from the sale of discontinued businesses which offset funds used for capital expenditures and reduction of debt levels. We provided $1.8 million of operating cash compared to operating cash provided during 2005 of $6.6 million. During 2006, the Company reduced debt obligations by $1.0 million primarily due to the operating cash performance noted above as well as the proceeds from the sale of discontinued businesses offsetting our capital expenditures.

Operating Activities

Cash flow from operating activities before changes in operating assets and discontinued operations was $6.1 million in 2006 versus $1.9 million in 2005. While we reported a net loss in both periods, these amounts included many non-cash items such as depreciation and amortization, impairments of long-lived assets, the write-off and amortization of debt issuance costs, non-cash stock compensation expense associated with the former CEO, the gain or loss on the sale of assets and the equity income from our equity method investment. We used $7.1 million of cash related to operating assets and liabilities in 2006 compared to $4.0 million in cash being provided in 2005. Our operating cash flow was impacted in 2006 by reduction of accounts payable offset slightly by reduced accounts receivable and inventory levels of $5.6 million. By the end of 2006, we were turning our inventory at 6.2 times per year versus 6.4 times per year in 2005. Cash of $2.4 million and $2.3 million was used in 2006 and 2005, respectively, to satisfy severance, restructuring and related obligations.

Investing Activities

Capital expenditures from continuing operations totaled $4.6 million in 2006 as compared to $8.9 million in 2005 as spending for restructuring activities and new property and equipment continued to slow down as compared to the past few years. In 2006, we sold the United Kingdom consumer plastics business and the Metal Truck Box business unit for $5.4 million excluding a $1.2 million note receivable obtained as part of the Metal Truck Box transaction. In addition, the Company sold additional assets, including our SESCO partnership interest, in 2006 and 2005 for net proceeds of $0.4 million and $1.0 million, respectively. In 2005, we acquired substantially all of the assets and assumed certain liabilities of Washington International Non-Wovens, LLC. Anticipated capital expenditures are expected to be comparable in 2007 to prior year levels, mainly due to available capacity and amended bank covenants. On March 31, 2004, Woods Canada sold its manufacturing facility for net proceeds of $3.2 million and immediately entered into a sale/leaseback arrangement to allow that business unit to occupy this property as a distribution facility. On June 28, 2004, CCP sold its vacant metals facility in Santa Fe Springs, California for net proceeds of $1.9 million.

Financing Activities

Cash flows from financing activities in 2006 reflect the reduction of our debt obligations as cash provided by operations exceeded the requirements from investing activities. In 2005, cash flows from financing activities reflect the reduction of debt obligations. Overall, debt increased $1.0 million and $1.4 million in 2006 and 2005, respectively. Direct debt costs, primarily associated with the debt modifications and refinance transactions, totaled $0.3 million and $0.2 million in 2006 and 2005, respectively. During 2006 and 2005, the Company acquired 40,800 and 3,200 shares of common stock on the open market under the cost method for approximately $0.1 million and $7.5 thousand, respectively. During 2004, 12,000 shares of common stock were repurchased on the open market for approximately $0.1 million.

TRANSACTIONS WITH RELATED AND CERTAIN OTHER PARTIES

In connection with the Contico International, L.L.C. (now CCP) acquisition on January 8, 1999, we entered into building lease agreements with Newcastle Industries, Inc. (Newcastle). Lester Miller, the former owner of CCP, and a Katy director from 1999 to 2000, is the majority owner of Newcastle. Currently, the Hazelwood, Missouri facility is the only property leased directly from Newcastle. We believe that rental expense for these properties approximates market rates. Related party rental expense was approximately $0.5 million for each of the years ended December 31, 2006, 2005 and 2004.

Kohlberg & Co., L.L.C., an affiliate of Kohlberg Investors IV, L.P., whose affiliate holds all 1,131,551 shares of our Convertible Preferred Stock, provides ongoing management oversight and advisory services to Katy. We paid $0.5 million annually for such services in 2006, 2005 and 2004. We expect to pay $0.5 million annually in future years.

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SEVERANCE, RESTRUCTURING AND RELATED CHARGES

Over the past three years, the Company has initiated several cost reduction and facility consolidation initiatives, resulting in severance, restructuring and related charges. Key initiatives were the consolidation of the St. Louis manufacturing/distribution facilities, shutdown of both Woods U.S. and Woods Canada manufacturing as well as the consolidation of the Glit facilities. These initiatives resulted from the on-going strategic reassessment of our various businesses as well as the markets in which they operate.

A summary of charges by major initiative is as follows:

	2006	2005	2004
	(Amounts in Thousands)		
Consolidation of St. Louis manufacturing/distribution facilities	$ (499)	$ 39	$ 1,460
Consolidation of Glit facilities	299	724	791
Corporate office relocation	217	172	
Shutdown of Woods U.S. manufacturing	(115)		38
Shutdown of Woods Canada manufacturing	(14)	134	841
Consolidation of administrative functions for CCP		21	215
Other			160
Total severance, restructuring and related costs	$ (112)	$ 1,090	$ 3,505

The impact of actions in connection with the above initiatives on the Company s reportable segments (before tax) is as follows:

	Total Expected Cost	Total Provision to Date
Maintenance Products Group	$ 21,993	$ 20,993
Electrical Products Group	12,776	12,776
Corporate	12,323	12,073
	$ 47,092	$ 45,842

A rollforward of all restructuring and related reserves since December 31, 2004 is as follows:

	Total	One-time Termination Benefits [a]	Contract Termination Costs [b]	Other [c]
Restructuring and related liabilities at December 31, 2004	$ 4,454	$ 807	$ 3,647	$
Additions	1,170	506	516	148
Reductions	(80)	(19)	(61)	
Payments	(2,252)	(861)	(1,243)	(148)
Currency translation and other	127	(1)	128	
Restructuring and related liabilities at December 31, 2005	$ 3,419	$ 432	$ 2,987	$
Additions	516	326		190
Reductions	(628)	(19)	(609)	
Payments	(2,354)	(739)	(1,425)	(190)

Currency translation	8		8	
Restructuring and related liabilities at December 31, 2006 [d]	$ 961	$	$ 961	$

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

[b] Includes charges related to non-cancelable lease liabilities for abandoned facilities, net of estimated sub-lease revenue. Total maximum potential amount of lease loss, excluding any sublease rentals, is $1.8 million as of December 31, 2006. We have included $0.8 million as an offset for sublease rentals.

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

manufacturing and production efficiency initiatives.

[d] Katy expects to substantially complete its restructuring program in 2006. The remaining severance, restructuring and related costs for these initiatives are expected to be approximately $0.3 million.

Since 2001, the Company has been focused on a number of restructuring and cost reduction initiatives, resulting in severance, restructuring and related charges. With these changes, we anticipated cost savings from reduced headcount, higher utilized facilities and divested non-core operations. However, anticipated cost savings have been impacted from such factors as material price increases, competitive markets and inefficiencies incurred from consolidation of facilities. See Note 19 to the Consolidated Financial Statements in Part II, Item 8 for further discussion of severance, restructuring and related charges.

OUTLOOK FOR 2007

We experienced lower sales performance during 2006 from the Woods US retail electrical corded products business as well as lower volumes in our Contico and Glit business units. Price increases were passed along to our Woods US customers during 2006 as a result of the rise in copper prices in the last two years, however, pricing pressure is anticipated given current copper pricing in early 2007. We anticipate a further reduction in net sales from Woods US due to customers moving more of their purchases directly to Asian manufacturers. Given the relative stability of resin and other materials pricing for the short-term period, we anticipate pricing levels to be stable in 2007 for products within the Maintenance Products Group with sales growth being driven by volume improvement over 2006. However, in the Contico business, we face the continuing challenge of passing through price increases to offset these higher costs, and sales volumes have been and are likely to continue to be negatively impacted as a result of raising prices and our decision to exit certain unprofitable products.

We believe that the quality, shipping and production issues present at our Glit facilities in 2005 have been resolved in 2006 as the Glit business unit has improved its quality level and executed cost control in its current operations and in the consolidation of the Pineville, North Carolina operation into the Wrens, Georgia facility. We currently believe the consolidation of the Washington, Georgia facility into Wrens, Georgia will occur in 2007 and will result in improved profitability of our Glit business.

Cost of goods sold is subject to variability in the prices for certain raw materials, most significantly thermoplastic resins used in the manufacture of plastic products for the Continental and Contico businesses. Prices of plastic resins, such as polyethylene and polypropylene increased steadily from the latter half of 2002 through 2005 with prices in 2006 being relatively stable. Management has observed that the prices of plastic resins are driven to an extent by prices for crude oil and natural gas, in addition to other factors specific to the supply and demand of the resins themselves. We are equally exposed to price changes for copper at our Woods US and Woods Canada business units. Prices for copper increased in late 2003 and continued through 2006. Copper prices remain and expect to be volatile over the next few years. Prices for corrugated packaging material and other raw materials have also accelerated over the past few years. We have not employed an active hedging program related to our commodity price risk, but are employing other strategies for managing this risk, including contracting for a certain percentage of resin needs through supply agreements and opportunistic spot purchases. We have experienced cost increases in the prices of primary raw materials used in our products and inflation on other costs such as packaging materials, utilities and freight. In a climate of rising raw material costs (and especially in 2005), we experience difficulty in raising prices to shift these higher costs to our consumer customers for our plastic products. Our future earnings may be negatively impacted to the extent further increases in costs for raw materials cannot be recovered or offset through higher selling prices. We cannot predict the direction our raw material prices will take during 2007 and beyond.

Over the past few years, our management has been focused on a number of restructuring and cost reduction initiatives, including the consolidation of facilities, divestiture of non-core operations, selling general and administrative (SG&A) cost rationalization and organizational changes. In the future, we expect to benefit from various profit enhancing strategies such as process improvements (including Lean Manufacturing and Six Sigma), value engineering products, improved sourcing/purchasing and lean administration.

SG&A expenses were comparable as a percentage of sales in 2006 versus 2005 and should remain stable as a percentage of sales in 2007. We will continue to evaluate the possibility of further consolidation of administrative processes.

Interest rates rose in 2006 and we expect rates to stabilize in 2007. Ultimately, we cannot predict the future levels of interest rates. With the execution of the Seventh Amendment under the Bank of America Credit Agreement, the Company has the interest rate margins on all of our outstanding borrowings and letters of credit set at the largest

margins set forth in the Bank of America Credit Agreement. Interest rate margins, subsequent to the delivery of our financial statements for 2006 to our lenders, will be adjusted based on the Company s ratio of debt to earnings.

Given our history of operating losses, along with guidance provided by the accounting literature covering accounting for income taxes, we are unable to conclude it is more likely than not that we will be able to generate future taxable income sufficient to realize the benefits of domestic deferred tax assets carried on our books. Therefore, except for our profitable foreign subsidiaries, a full valuation allowance on the net deferred tax asset position was recorded at December 31, 2006 and 2005, and we do not expect to record the benefit of any deferred tax assets that may be generated in 2007. We will continue to record current expense associated with foreign and state income taxes.

In 2006, our financial performance benefited from favorable currency translation as the Canadian dollar and British pound strengthened throughout the year against the U.S. dollar. While we cannot predict the ultimate direction of exchange rates, we do not expect to see the same favorable impact on our financial performance in 2007.

We expect our working capital levels to remain constant as a percentage of sales. However, inventory carrying values may be impacted by higher material costs. Cash flow will be used in 2007 for capital expenditures and payments due under our term loan as well as the settlement of previously established restructuring accruals. The majority of these accruals relate to non-cancelable lease obligations for abandoned facilities. These accruals do not create incremental cash obligations in that we are obligated to make the associated payments whether we occupy the facilities or not. The amount we will ultimately pay out under these accruals is dependent on our ability to successfully sublet all or a portion of the abandoned facilities.

While the Company was in compliance with the covenants of the Bank of America Credit Agreement as of December 31, 2006, it obtained, on March 8, 2007, the Eighth Amendment. The Eighth Amendment eliminates the Fixed Charge Coverage Ratio for the remaining life of the debt agreement and requires the Company to maintain a minimum level of availability such that its eligible collateral must exceed the sum of its outstanding borrowings and letters of credit by at least $5.0 million from the effective date of the Eighth Amendment through September 29, 2007 and by $7.5 million through December 31, 2007. Thereafter, the Company is required to maintain a minimum level of availability of $5.0 million for the first three quarters of the year and $7.5 million for the fourth quarter. In addition, we reduced our Revolving Credit Facility from $90.0 million to $80.0 million.

If we are unable to comply with the terms of the amended covenants, we could seek to obtain further amendments and pursue increased liquidity through additional debt financing and/or the sale of assets. We believe that given our strong working capital base, additional liquidity could be obtained through additional debt financing, if necessary. However, there is no guarantee that such financing could be obtained. The Company believes that we will be able to comply with all covenants, as amended, throughout 2007. In addition, we are continually evaluating alternatives relating to the sale of excess assets and divestitures of certain of our business units. Asset sales and business divestitures present opportunities to provide additional liquidity by de-leveraging our financial position.

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

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

- Increases in the cost of, or in some cases continuation of, the current price levels of plastic resins, copper, paper board packaging, and other raw materials.
- Our inability to reduce product costs, including manufacturing, sourcing, freight, and other product costs.
- Greater reliance on third parties for our finished goods as we increase the portion of our manufacturing that is outsourced.
- Our inability to reduce administrative costs through consolidation of functions and systems improvements.
- Our inability to execute our systems integration plan.

Our inability to successfully integrate our operations as a result of the facility consolidations.
Our inability to achieve product price increases, especially as they relate to potentially higher raw material costs.

The potential impact of losing lines of business at large mass merchant retailers in the discount and do-it-yourself markets.

Competition from foreign competitors.

The potential impact of rising interest rates on our LIBOR-based Bank of America Credit Agreement.

Our inability to meet covenants associated with the Bank of America Credit Agreement.

Our failure to identify, and promptly and effectively remediate, any material weaknesses or significant deficiencies in our internal control over financial reporting.

The potential impact of rising costs for insurance for properties and various forms of liabilities.

The potential impact of changes in foreign currency exchange rates related to our foreign operations.

Labor issues, including union activities that require an increase in production costs or lead to a strike, thus impairing production and decreasing sales. We are also subject to labor relations issues at entities involved in our supply chain, including both suppliers and those involved in transportation and shipping.

Changes in significant laws and government regulations affecting environmental compliance and income taxes.

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

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are more fully described in Note 3 to the Consolidated Financial Statements of Katy included in Part II, Item 8. Certain of our accounting policies as discussed below require the application of significant judgment by management in selecting the appropriate assumptions for calculating amounts to record in our financial statements. By their nature, these judgments are subject to an inherent degree of uncertainty.

Revenue Recognition Revenue is recognized for all sales, including sales to distributors, at the time the products are shipped and title has transferred to the customer, provided that a purchase order has been received or a contract has been executed, there are no uncertainties regarding customer acceptances, the sales price is fixed and determinable and collection is deemed probable. The Company s standard shipping terms are FOB shipping point. The Company records sales discounts, returns and allowances in accordance with EITF 01-09, *Accounting for Consideration Given by a Vendor to a Customer*. Sales discounts, returns and allowances, and cooperative advertising are included in net sales, and the provision for doubtful accounts is included in selling, general and administrative expenses. These provisions are estimated at the time of sale.

Stock-based Compensation Effective January 1, 2006, the Company has adopted SFAS No. 123R, *Share-Based Payment* (SFAS No. 123R), using the modified prospective method. Under this method, compensation cost recognized during 2006 includes: a) compensation cost for all stock options granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with SFAS No. 123R amortized over the options vesting period; b) compensation cost for stock appreciation rights granted prior to, but vested as of January 1, 2006, based on the January 1, 2006 fair value estimated in accordance with SFAS No. 123R; and c) compensation cost for SARs granted prior to and vested as of December 31, 2006 based on the December 31, 2006 fair value estimated in accordance with SFAS No. 123R. Going forward into 2007 and thereafter, the Company will incur compensation expense associated with the fair value of stock options and SARs.

Accounts Receivable We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer s current creditworthiness, as determined by our review of their current credit information. We continuously monitor collections and payment from our customers and maintain a provision for estimated credit losses based upon our historical experience and any specific customer collection issues that we have identified. While such credit losses have historically been within our expectations and the provision established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. Since our accounts receivable are concentrated in a relatively few number of large sized customers, especially our consumer/retail customers, a significant change in the liquidity or financial position of any one of these customers could have a material adverse impact on our ability to collect our accounts receivable and our future operating results.

Inventories We value our inventory at the lower of the actual cost to purchase and/or manufacture the inventory or the current net realizable value of the inventory. We regularly review inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on our estimated forecast of product demand and production requirements for the next twelve months. Our accounting policies state that operating divisions are to identify, at a minimum, those inventory items that are in excess of either one year s historical or one year s forecasted usage, and to use business judgment in determining which is the more appropriate metric. Those inventory items must then be evaluated on a lower of cost or market basis for realization. A significant increase in the demand for our products could result in a short-term increase in the cost of inventory purchases while a significant decrease in demand could result in an increase in the amount of excess inventory quantities on hand. Additionally, our estimates of future product demand may prove to be inaccurate, in which case we may have understated or overstated the provision required for excess and obsolete inventory. In the future, if our inventory is determined to be overvalued, we would be required to recognize such costs in our cost of goods sold at the time of such determination.

Therefore, although we make every effort to ensure the accuracy of our forecasts of future product demand, any significant unanticipated changes in demand or product developments could have a significant impact on the value of our inventory and our reported operating results. Our reserves for excess and obsolete inventory were $3.9 million and $4.5 million, respectively, as of December 31, 2006 and 2005.

Goodwill and Impairments of Long-Lived Assets In connection with certain acquisitions, we recorded goodwill representing the cost of the acquisition in excess of the fair value of the net assets acquired. In accordance with SFAS No. 142, *Goodwill and Intangible Assets,* the fair value of each reporting unit that carries goodwill is determined annually, or as indicators of impairment are identified, and the fair value is compared to the carrying value of the reporting unit. If the fair value exceeds the carrying value, then no adjustment is necessary. If the carrying value of the reporting unit exceeds the fair value, appraisals are performed of long-lived assets and other adjustments are made to arrive at a revised fair value balance sheet. This revised fair value balance sheet (without goodwill) is compared to the fair value of the business previously determined, and a revised goodwill amount is reached. If the indicated goodwill amount meets or exceeds the current carrying value of goodwill, then no adjustment is required. However, if the result indicates a reduced level of goodwill, an impairment is recorded to state the goodwill at the revised level. Any future impairments of goodwill determined in accordance with SFAS No. 142 would be recorded as a component of income from continuing operations.

We review our long-lived assets for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* whenever triggering events indicate that an impairment may have occurred. We monitor our operations to look for triggering events that may cause us to perform an impairment analysis. These events include, among others, loss of product lines, poor operating performance and abandonment of facilities. We determine the lowest level at which cash flows are separately identifiable to perform the future cash flows tests, and apply the results to the assets related to those separately identifiable cash flows. In some cases, this may be at the individual asset level, but in other cases, it is more appropriate to perform this testing at a business unit level (especially when poor operating performance was the triggering event). For assets that are to be held and used, we compare undiscounted future cash flows associated with the asset (or asset group) and determine if the carrying value of the asset (asset group) will be recovered by those cash flows over the remaining useful life of the asset (or of the primary asset of an asset group). If the future undiscounted cash flows indicate that the carrying value of the asset (asset group) will not be recovered, then the asset is marked to fair value. For assets that are to be disposed of by sale

or by a means other than by sale, the identified asset (or disposal group if a group of assets or entire business unit) is marked to fair value less costs to sell. In the case of the planned sale of a business unit, SFAS No. 144 indicates that disposal groups should be reported as discontinued operations on the consolidated financial statements if cash flows of the disposal group are separately identifiable. SFAS No. 144 has had an impact on the application of accounting for discontinued operations, making it in general much easier to classify a business unit (disposal group) held for sale as a discontinued operation. The rules covering discontinued operations prior to SFAS No. 144 generally required that an entire segment of a business be planned for disposal in order to classify it as a discontinued operation. We recorded impairments of long-lived assets during 2005 and 2004 in accordance with SFAS No. 144, which are discussed in Notes 4 and 5 to the Consolidated Financial Statements in Part II, Item 8.

Deferred Income Taxes We recognize deferred income tax assets and liabilities based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities. Deferred income tax assets also include federal, state and foreign net operating loss carry forwards, primarily due to the significant operating losses incurred during recent years, as well as various tax credits. We regularly review our deferred income tax assets for recoverability taking into consideration historical net income (losses), projected future income (losses) and the expected timing of the reversals of existing temporary differences. We establish a valuation allowance when it is more likely than not that these assets will not be recovered. As of December 31, 2006, we had a valuation allowance of $67.0 million. During the year ended December 31, 2006, we increased the valuation allowance by $2.2 million primarily to provide a full reserve against our net deferred tax asset position. Except for certain of our foreign subsidiaries, given the negative evidence provided by our history of operating losses, and considering guidance provided by SFAS No. 109, *Accounting for Income Taxes*, we were unable to conclude that it is more likely that not that our deferred tax assets would be recoverable through the generation of future taxable income. We will continue to evaluate our valuation allowance requirements based on future operating results and business acquisitions and dispositions, and we may adjust our deferred tax asset valuation allowance. Such changes in our deferred tax asset valuation allowance will be reflected in current operations through our income tax provision.

Workers Compensation and Product Liabilities We make payments for workers compensation and product liability claims generally through the use of a third party claims administrator. We have purchased insurance coverage for large claims over our self-insured retention levels. Our workers compensation liabilities are developed using actuarial methods based upon historical data for payment patterns, cost trends, and other relevant factors. In order to consider a range of possible outcomes, we have based our estimates of liabilities in this area on several different sources of loss development factors, including those from the insurance industry, the manufacturing industry, and factors developed in-house. Our general approach is to identify a reasonable, logical conclusion, typically in the middle range of the possible outcomes. While we believe that our liabilities for workers compensation and product liability claims as of December 31, 2006 are adequate and that the judgment applied is appropriate, such estimated liabilities could differ materially from what will actually transpire in the future.

Environmental and Other Contingencies We and certain of our current and former direct and indirect corporate predecessors, subsidiaries and divisions are involved in remedial activities at certain present and former locations and have been identified by the United States Environmental Protection Agency, 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 our estimate of allocation of liability among PRPs, the probability that other PRPs, many of whom are large, solvent, public companies, will fully pay the costs apportioned to them, currently available information concerning the scope of contamination, estimated remediation costs, estimated legal fees and other factors, we have recorded and accrued for environmental liabilities in amounts that we deem reasonable. The ultimate costs will depend on a number of factors and the amount currently accrued represents our best current estimate of the total costs to be incurred. We expect this amount to be substantially paid over the next one to four years. See Note 18 to the Consolidated Financial Statements in Part II, Item 8.

Severance, Restructuring and Related Charges Since the Recapitalization in mid-2001, we have initiated several cost reduction and facility consolidation initiatives including, (1) the closure or consolidation of manufacturing, distribution and office facilities, (2) the centralization of business units, and (3) the outsourcing of our Electrical Products manufacturing to Asia. These initiatives have resulted in significant severance, restructuring and related charges. Included in these charges are one-time termination benefits including severance, benefits and other employee-related costs associated with employee terminations; contract termination costs mostly related to non-cancelable lease liabilities for abandoned facilities, net of sublease revenue; and other costs associated with the consolidation of administrative and operational functions and consultants working on sourcing and other manufacturing and production efficiency initiatives. Our current restructuring programs were substantially completed

in 2006. In accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, we recognize costs (including costs for one-time termination benefits) associated with exit or disposal activities as they are incurred. However, charges related to non-cancelable leases require estimates of sublease income and adjustments to these liabilities are possible in the future depending on the accuracy of the sublease assumptions made.

NEW ACCOUNTING PRONOUNCEMENTS

See Note 3 of the Notes to the Consolidated Financial Statements in Part II, Item 8 for a discussion of new accounting pronouncements and the potential impact to the Company s consolidated results of operations and financial position.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

Our exposure to market risk associated with changes in interest rates relates primarily to our debt obligations. Accordingly, effective August 17, 2005, we entered into a two-year interest rate swap agreement on a notional amount of $25.0 million in the first year and $15.0 million in the second year. The fixed interest rate under the swap at December 31, 2006 and over the life of the agreement is 4.49%. Our interest obligations on outstanding debt at December 31, 2006 were indexed from short-term LIBOR. As a result of the current rising interest rate environment and the increase in the interest rate margins on our borrowings as a result of the amendments to the Bank of America Credit Agreement, our exposures to interest rate risks on the non-capped debt could be material to our financial position or results of operations. See Note 9 to the Consolidated Financial Statements in Part II, Item 8.

The following table presents as of December 31, 2006, our financial instruments, rates of interest and indications of fair value:

Expected Maturity Dates
(Amounts in Thousands)

ASSETS	2007	2008	2009	2010	2011	Thereafter	Total	Fair Value
Temporary cash investments								
Fixed rate	$	$	$	$	$	$	$	$
Average interest rate								
INDEBTEDNESS								
Fixed rate debt	$	$	$	$	$	$	$	$
Average interest rate								
Variable rate debt	$ 1,125	$ 1,500	$ 54,246	$	$	$	$ 56,871	$ 56,871
Average interest rate	8.38%	8.38%	8.18%					

Foreign Exchange Risk

We are exposed to fluctuations in the Euro, British pound, Canadian dollar and various Asian currencies such as the Chinese Renminbi. Some of our subsidiaries make significant U.S. dollar purchases from Asian suppliers, particularly in China, Taiwan and the Philippines. An adverse change in foreign currency exchange rates of Asian countries could result in an increase in the cost of purchases. We do not currently hedge foreign currency transaction or translation exposures. Our net investment in foreign subsidiaries translated into U.S. dollars at December 31, 2006 is $23.1 million. A 10% change in foreign currency exchange rates would amount to $2.3 million change in our net investment in foreign subsidiaries at December 31, 2006.

Commodity Price Risk

We have not employed an active hedging program related to our commodity price risk, but are employing other strategies for managing this risk, including contracting for a certain percentage of resin needs through supply agreements and opportunistic spot purchases. See Part I Item 1 - Raw Materials and Part II Item 7 Outlook for 2007 for a further discussion of our raw materials.

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Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Katy Industries, Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders equity and cash flows present fairly, in all material respects, the financial position of Katy Industries, Inc. and its subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 11 to the consolidated financial statements, the Company changed the manner in which it accounts for pensions and post-retirement plans in fiscal 2006.

As discussed in Note 13 to the consolidated financial statements, the Company changed the manner in which it accounts for share-based compensation in fiscal 2006.

As discussed in Note 2 to the consolidated financial statements, the Company has restated its 2006 and 2005 consolidated financial statements.

/s/ PricewaterhouseCoopers LLP

St. Louis, Missouri

March 16, 2007, except for the restatement discussed in Note 2 to the consolidated financial statements, as to which the date is August 17, 2007.

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KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2006 and 2005
(Amounts in Thousands)
ASSETS

	As Restated, see Note 2 2006	2005
CURRENT ASSETS:		
Cash and cash equivalents	$ 7,392	$ 8,421
Trade accounts receivable, net of allowances of $2,213 and $2,445	55,014	63,612
Inventories, net	54,980	62,593
Other current assets	2,991	3,600
Asset held for sale	4,483	
Total current assets	124,860	138,226
OTHER ASSETS:		
Goodwill	665	665
Intangibles, net	6,435	6,946
Other	8,990	8,260
Total other assets	16,090	15,871
PROPERTY AND EQUIPMENT		
Land and improvements	336	1,732
Buildings and improvements	9,669	14,011
Machinery and equipment	119,703	140,514
	129,708	156,257
Less Accumulated depreciation	(87,964)	(98,260)
Property and equipment, net	41,744	57,997
Total assets	$ 182,694	$ 212,094

See Notes to Consolidated Financial Statements.

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KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2006 and 2005
(Amounts in Thousands, Except Share Data)
LIABILITIES AND STOCKHOLDERS EQUITY

	2006	As Restated, see Note 2 2005
CURRENT LIABILITIES:		
Accounts payable	$ 33,684	$ 47,449
Accrued compensation	3,518	4,071
Accrued expenses	38,187	37,713
Current maturities, long-term debt	1,125	2,857
Revolving credit agreement	43,879	41,946
Total current liabilities	120,393	134,036
LONG-TERM DEBT, less current maturities	11,867	12,857
OTHER LIABILITIES	8,402	10,497
Total liabilities	140,662	157,390
COMMITMENTS AND CONTINGENCIES (Notes 18 and 21)		
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 9,822,304 shares	9,822	9,822
Additional paid-in capital	27,120	27,067
Accumulated other comprehensive income	2,242	3,158
Accumulated deficit	(83,434)	(71,055)
Treasury stock, at cost, 1,869,827 shares and 1,874,027 shares, respectively	(21,974)	(22,544)
Total stockholders equity	42,032	54,704
Total liabilities and stockholders equity	$ 182,694	$ 212,094

See Notes to Consolidated Financial Statements.

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KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 and 2004
(Amounts in Thousands, Except Per Share Data)

	As Restated, see Note 2		
	2006	2005	2004
Net sales	$ 396,166	$ 423,390	$ 416,681
Cost of goods sold	345,469	372,921	361,660
Gross profit	50,697	50,469	55,021
Selling, general and administrative expenses	46,556	52,749	52,668
Impairments of goodwill		1,574	7,976
Impairments of other long-lived assets		538	22,080
Severance, restructuring and related charges	(112)	1,090	3,505
Loss (gain) on sale of assets	467	(377)	(288)
Operating income (loss)	3,786	(5,105)	(30,920)
Equity in income of equity method investment		600	
Gain on SESCO joint venture transaction	563		
Interest expense	(7,114)	(5,713)	(3,968)
Other, net	302	207	(998)
Loss from continuing operations before provision for income taxes	(2,463)	(10,011)	(35,886)
Provision for income taxes from continuing operations	(2,326)	(1,608)	(642)
Loss from continuing operations	(4,789)	(11,619)	(36,528)
(Loss) income from operations of discontinued businesses (net of tax)	(1,429)	(2,178)	1,182
Loss on sale of discontinued businesses (net of tax)	(5,405)		(775)
Loss before cumulative effect of a change in accounting principle	(11,623)	(13,797)	(36,121)
Cumulative effect of a change in accounting principle (net of tax)	(756)		
Net loss	(12,379)	(13,797)	(36,121)
Payment-in-kind of dividends on convertible preferred stock			(14,749)
Net loss attributable to common stockholders	$ (12,379)	$ (13,797)	$ (50,870)
Loss per share of common stock Basic and diluted			
Loss from continuing operations attributable to common stockholders	$ (0.60)	$ (1.47)	$ (6.50)
Discontinued operations (net of tax)	(0.86)	(0.27)	0.05
Cumulative effect of a change in accounting principle	(0.09)		
Net loss attributable to common stockholders	$ (1.55)	$ (1.74)	$ (6.45)

See Notes to Consolidated Financial Statements.

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KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 and 2004
(Amounts in Thousands, Except Share Data)

	Convertible Preferred Stock		Common Stock			Accumulated Other				
	Number of Shares	Par Value	Number of Shares	Par Value	Additional Paid-in Capital	Comprehensive Income	Accumulated Deficit	Treasury Stock	Comprehensive Loss	Total Stockholders Equity
Balance, January 1, 2004	925,750	$ 93,507	9,822,204	$ 9,822	$ 40,441	$ 2,387	$ (21,137)	$ (22,728)		$ 102,292
Net loss							(36,121)		$ (36,121)	(36,121)
Foreign currency translation adjustment						2,065			2,065	2,065
Pension minimum liability adjustment						112			112	112
Comprehensive loss									$ (33,944)	
Purchase of treasury stock								(75)		(75)
Issuance of convertible preferred stock related to PIK dividends accrued	205,801									
Payment in kind dividends accrued		14,749			(14,749)					
Stock option exercise					(571)			875		304
Other					(10)			18		8
Balance, December 31, 2004	1,131,551	$ 108,256	9,822,204	$ 9,822	$ 25,111	$ 4,564	$ (57,258)	$ (21,910)		$ 68,585
Net loss, As Restated, see Note 2							(13,797)		$ (13,797)	(13,797)
Foreign currency						(1,352)			(1,352)	(1,352)

translation adjustment										
Pension minimum liability adjustment						(109)			(109)	(109)
Interest rate swap						55			55	55
Comprehensive loss, As Restated, see Note 2									$ (15,203)	
Purchase of treasury stock								(7)		(7)
Stock compensation, As Restated, see Note 2					2,004					2,004
Other					(48)			(627)		(675)
Balance, December 31, 2005, As Restated, see Note 2	1,131,551	$ 108,256	9,822,204	$ 9,822	$ 27,067	$ 3,158	$ (71,055)	$ (22,544)		$ 54,704
Net loss, As Restated, see Note 2							(12,379)		$ (12,379)	(12,379)
Foreign currency translation adjustment						686			686	686
Interest rate swap						22			22	22
Comprehensive loss, As Restated, see Note 2									$ (11,671)	
Adoption of SFAS 158						(1,624)				(1,624)
Purchase of treasury stock								(111)		(111)
Stock option exercise					(378)			525		147
Stock compensation					587					587
Other			100		(156)			156		

Balance, December 31, 2006, As Restated, see Note 2	1,131,551	$ 108,256	9,822,304	$ 9,822	$ 27,120	$ 2,242	$ (83,434)	$ (21,974)		$ 42,032

See Notes to Consolidated Financial Statements.

KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 and 2004
(Amounts in Thousands)

	As Restated, see Note 2		
	2006	2005	2004
Cash flows from operating activities:			
Net loss	$ (12,379)	$ (13,797)	$ (36,121)
Loss (income) from discontinued operations	6,834	2,178	(407)
Loss from continuing operations	(5,545)	(11,619)	(36,528)
Cumulative effect of a change in accounting principle	756		
Depreciation and amortization	8,640	8,968	12,145
Impairments of goodwill		1,574	7,976
Impairments of other long-lived assets		538	22,080
Write-off and amortization of debt issuance costs	1,178	1,122	1,076
Stock option expense	587	2,004	
Loss (gain) on sale of assets	467	(377)	(288)
Equity in income of equity method investment		(600)	
Deferred income taxes	14	240	(1,228)
	6,097	1,850	5,233
Changes in operating assets and liabilities:			
Accounts receivable	2,743	(16)	(215)
Inventories	2,830	2,260	(8,649)
Other assets	600	(1,045)	307
Accounts payable	(8,000)	7,503	200
Accrued expenses	(78)	(3,952)	(1,595)
Other, net	(5,206)	(804)	(3,508)
	(7,111)	3,946	(13,460)
Net cash (used in) provided by continuing operations	(1,014)	5,796	(8,227)
Net cash provided by discontinued operations	2,837	766	256
Net cash provided by (used in) operating activities	1,823	6,562	(7,971)
Cash flows from investing activities:			
Capital expenditures of continuing operations	(4,614)	(8,925)	(10,782)
Acquisition of subsidiary, net of cash acquired		(1,115)	
Proceeds from sale of assets, net	367	981	5,778
Net cash used in continuing operations	(4,247)	(9,059)	(5,004)
Net cash provided by (used in) discontinued operations	5,292	(335)	(3,051)

Net cash provided by (used in) investing activities	1,045	(9,394)	(8,055)
Cash flows from financing activities:			
Net borrowings of revolving loans	1,761	1,450	4,037
(Decrease) increase in book overdraft	(2,322)	4,028	
Proceeds of term loans	1,364		18,152
Repayments of term loans	(4,086)	(2,857)	(3,244)
Direct costs associated with debt facilities	(312)	(151)	(1,485)
Repurchases of common stock	(111)	(7)	(75)
Proceeds from the exercise of stock options	147		304
Net cash (used in) provided by financing activities	(3,559)	2,463	17,689
Effect of exchange rate changes on cash and cash equivalents	(338)	265	114
Net (decrease) increase in cash and cash equivalents	(1,029)	(104)	1,777
Cash and cash equivalents, beginning of period	8,421	8,525	6,748
Cash and cash equivalents, end of period	$ 7,392	$ 8,421	$ 8,525
Supplemental disclosure of non-cash investing activities:			
Note receivable from sale of discontinued operations	$ 1,200	$	$

See Notes to Consolidated Financial Statements.

KATY INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of December 31, 2006 and 2005
(Amounts in Thousands, Except Per Share Data)

Note 1. ORGANIZATION OF THE BUSINESS

The Company is organized into two operating segments: the Maintenance Products Group and the Electrical Products Group. The activities of the Maintenance Products Group include the manufacture and distribution of a variety of commercial cleaning supplies and consumer home storage products. The Electrical Products Group is a distributor of consumer electrical corded products. Principal geographic markets are in the United States, Canada, and Europe and include the sanitary maintenance, foodservice, mass merchant retail and home improvement markets.

Note 2. RESTATEMENT OF PRIOR FINANCIAL INFORMATION

Restatement As a result of accounting errors in the raw material inventory records, management and the Company s Audit Committee determined on August 6, 2007 that the Company s consolidated financial statements for fiscal 2005 and 2006 should no longer be relied upon. The Company s decision to restate its consolidated financial statements is based on facts obtained by management and the results of an internal investigation of the physical raw material inventory counting process at CCP. These procedures resulted in the identification of an intentional overstatement of raw material inventory when completing the physical inventory. At the time of the physical inventories, the Company did not have sufficient controls in place to ensure that the accurate physical raw material inventory on hand was properly accounted for and reported in the proper period.

(A) Impact of error on previously filed financial statements The impact of the raw material inventory error on loss from continuing operations and net loss is approximately ($0.2) million and ($0.6) million for the years ended December 31, 2005 and 2006, respectively.

Other Out-of-Period Adjustments and Revisions Due to the adjustments discussed above that required a restatement of our previously filed consolidated financial statements, we are also correcting these out-of-period adjustments and revisions by recording them in the proper periods.

The out-of-period adjustments and revisions in the table include the following as referenced:

(B) Accelerated vesting of stock options The Company recorded non-cash compensation expense in 2005 of approximately $0.1 million related to stock options which would not have otherwise vested but for an accelerated vesting as further described in Note 12.

(C) Deferred compensation In conjunction with a retirement compensation program as further described in Note 11, the Company made an adjustment for approximately $0.4 million in 2005 associated with the accounting for related compensation expense. The Company had originally recorded the out-of-period adjustment in 2006; therefore, the Company reduced compensation expense by the corresponding amount in 2006.

(D) Inventory reserves The Company recorded an adjustment of approximately $0.1 million to increase inventory reserves and cost of goods sold in 2006 associated with our lower of cost or market evaluation.

(E) Revision of SESCO as a continuing operation For all years presented, the Company previously inappropriately reported the results from the Savannah Energy Systems Company Partnership operation as discontinued operations, as described further in Note 8. As a result, the Company revised in 2006 $0.4 million from loss from operations of discontinued businesses and $0.1 million from loss on sale of discontinued businesses. Accordingly, the Company recorded in 2006 within continuing operations a $0.6 million gain on SESCO joint venture transaction offset by $0.1 million in interest expense. For 2005, the Company revised $0.1 million from loss from operations of discontinued businesses to interest expense within continuing operations.

All affected amounts described in these Notes to Consolidated Financial Statements have been restated. As a result of this restatement, the Company s fiscal 2005 and 2006 financial results are adjusted as follows:

Consolidated Balance Sheets
(Amounts in thousands)

Assets	December 31, 2006 Previously reported	December 31, 2006 Restated	December 31, 2005 Previously reported	December 31, 2005 Restated
CURRENT ASSETS:				
Cash and cash equivalents	$ 7,392	$ 7,392	$ 8,421	$ 8,421
Trade accounts receivable, net	55,014	55,014	63,612	63,612
Inventories, net (A)(D)	55,960	54,980	62,799	62,593
Other current assets	2,991	2,991	3,600	3,600
Asset held for sale	4,483	4,483		
Total current assets	125,840	124,860	138,432	138,226
OTHER ASSETS:				
Goodwill	665	665	665	665
Intangibles, net	6,435	6,435	6,946	6,946
Other (C)	8,990	8,990	8,643	8,260
Total other assets	16,090	16,090	16,254	15,871
Property and equipment, net	41,744	41,744	57,997	57,997
Total assets	$ 183,674	$ 182,694	$ 212,683	$ 212,094
Liabilities and Stockholders Equity				
CURRENT LIABILITIES:				
Accounts payable	$ 33,684	33,684	$ 47,449	47,449
Accrued compensation	3,518	3,518	4,071	4,071
Accrued expenses	38,187	38,187	37,713	37,713
Current maturities, long-term debt	1,125	1,125	2,857	2,857
Revolving credit agreement	43,879	43,879	41,946	41,946
Total current liabilities	120,393	120,393	134,036	134,036
LONG-TERM DEBT, less current maturities	11,867	11,867	12,857	12,857
OTHER LIABILITIES	8,402	8,402	10,497	10,497
Total liabilities	140,662	140,662	157,390	157,390
COMMITMENTS AND CONTINGENCIES (Notes 18 and 21)				
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	108,256	108,256
Common stock, $1 par value; authorized 35,000,000 shares; issued 9,822,304 shares	9,822	9,822	9,822	9,822
Additional paid-in capital (B)	27,069	27,120	27,016	27,067
Accumulated other comprehensive income	2,242	2,242	3,158	3,158
Accumulated deficit	(82,403)	(83,434)	(70,415)	(71,055)
Treasury stock, at cost	(21,974)	(21,974)	(22,544)	(22,544)
Total stockholders equity	43,012	42,032	55,293	54,704
Total liabilities and stockholders equity	$ 183,674	$ 182,694	$ 212,683	$ 212,094

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Consolidated Statements of Operations
(Amounts in thousands, except per share data)

	For the years ended			
	December 31, 2006		December 31, 2005	
	Previously reported	Restated	Previously reported	Restated
Net sales	$ 396,166	396,166	$ 423,390	423,390
Cost of goods sold (A)(D)	344,695	345,469	372,715	372,921
Gross profit	51,471	50,697	50,675	50,469
Selling, general and administrative expenses (B)(C)	46,939	46,556	52,315	52,749
Impairments of goodwill			1,574	1,574
Impairments of other long-lived assets			538	538
Severance, restructuring and related charges	(112)	(112)	1,090	1,090
Loss (gain) on sale of assets	467	467	(377)	(377)
Operating income (loss)	4,177	3,786	(4,465)	(5,105)
Equity in income of equity method investment			600	600
Gain on SESCO joint venture transaction (E)		563		
Interest expense (E)	(7,037)	(7,114)	(5,570)	(5,713)
Other, net	302	302	207	207
Loss from continuing operations before provision for income taxes	(2,558)	(2,463)	(9,228)	(10,011)
Provision for income taxes from continuing operations	(2,326)	(2,326)	(1,608)	(1,608)
Loss from continuing operations	(4,884)	(4,789)	(10,836)	(11,619)
(Loss) income from operations of discontinued businesses (net of tax) (E)	(1,043)	(1,429)	(2,321)	(2,178)
Loss on sale of discontinued businesses (net of tax) (E)	(5,305)	(5,405)		
Loss before cumulative effect of a change in accounting principle	(11,232)	(11,623)	(13,157)	(13,797)
Cumulative effect of a change in accounting principle (net of tax)	(756)	(756)		
Net loss	(11,988)	(12,379)	(13,157)	(13,797)
Payment-in-kind of dividends on convertible preferred stock				
Net loss attributable to common stockholders	$ (11,988)	$ (12,379)	$ (13,157)	$ (13,797)
Loss per share of common stock Basic and diluted				
Loss from continuing operations attributable to common stockholders	$ (0.61)	$ (0.60)	$ (1.37)	$ (1.47)

Discontinued operations (net of tax)		(0.80)		(0.86)		(0.29)		(0.27)
Cumulative effect of a change in accounting principle		(0.09)		(0.09)				
Net loss attributable to common stockholders	$	(1.50)	$	(1.55)	$	(1.66)	$	(1.74)

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Consolidated Statements of Cash Flows
(Amounts in thousands)

	For the years ended			
	December 31, 2006		December 31, 2005	
	Previously reported	Restated	Previously reported	Restated
Cash flows from operating activities:				
Net loss	$ (11,988)	$ (12,379)	$ (13,157)	$ (13,797)
Loss (income) from discontinued operations (E)	6,348	6,834	2,321	2,178
Loss from continuing operations	(5,640)	(5,545)	(10,836)	(11,619)
Cumulative effect of a change in accounting principle	756	756		
Depreciation and amortization	8,640	8,640	8,968	8,968
Impairments of goodwill			1,574	1,574
Impairments of other long-lived assets			538	538
Write-off and amortization of debt issuance costs	1,178	1,178	1,122	1,122
Stock option expense (B)	587	587	1,953	2,004
Loss (gain) on sale of assets	467	467	(377)	(377)
Equity in income of equity method investment			(600)	(600)
Deferred income taxes	14	14	240	240
	6,002	6,097	2,582	1,850
Changes in operating assets and liabilities:				
Accounts receivable	2,743	2,743	(16)	(16)
Inventories (A)(D)	2,056	2,830	2,054	2,260
Other assets	600	600	(1,045)	(1,045)
Accounts payable	(8,000)	(8,000)	7,503	7,503
Accrued expenses (E)	622	(78)	(3,047)	(3,952)
Other, net (C)(E)	(3,237)	(5,206)	(1,187)	(804)
	(5,216)	(7,111)	4,262	3,946
Net cash (used in) provided by continuing operations	786	(1,014)	6,844	5,796
Net cash provided by discontinued operations (E)	1,037	2,837	(282)	766
Net cash provided by (used in) operating activities	1,823	1,823	6,562	6,562
Cash flows from investing activities:				
Capital expenditures of continuing operations	(4,614)	(4,614)	(8,925)	(8,925)
Acquisition of subsidiary, net of cash acquired			(1,115)	(1,115)
Proceeds from sale of assets, net (E)	267	367	981	981

Net cash used in continuing operations	(4,347)	(4,247)	(9,059)	(9,059)
Net cash provided by (used in) discontinued operations (E)	5,392	5,292	(335)	(335)
Net cash provided by (used in) investing activities	1,045	1,045	(9,394)	(9,394)
Cash flows from financing activities:				
Net borrowings on revolving loans	1,761	1,761	1,450	1,450
(Decrease) increase in book overdraft	(2,322)	(2,322)	4,028	4,028
Proceeds of term loans	1,364	1,364		
Repayments of term loans	(4,086)	(4,086)	(2,857)	(2,857)
Direct costs associated with debt facilities	(312)	(312)	(151)	(151)
Repurchases of common stock	(111)	(111)	(7)	(7)
Proceeds from the exercise of stock options	147	147		
Net cash (used in) provided by financing activities	(3,559)	(3,559)	2,463	2,463
Effect of exchange rate changes on cash and cash equivalents	(338)	(338)	265	265
Net (decrease) increase in cash and cash equivalents	(1,029)	(1,029)	(104)	(104)
Cash and cash equivalents, beginning of period	8,421	8,421	8,525	8,525
Cash and cash equivalents, end of period	$ 7,392	$ 7,392	$ 8,421	$ 8,421
Supplemental disclosure of non-cash investing activities:				
Note receivable from sale of discontinued operations	$ 1,200	$ 1,200	$	$

The comprehensive loss of approximately $12.9 million and $14.6 million for the years ended December 31, 2006 and 2005, respectively as previously reported was restated to a comprehensive loss of $11.7 million and $15.2 million, respectively. The change resulted from changes within our net loss attributable to common stockholders. Refer to Note 21 for restated unaudited quarterly results of operations.
Financial statement footnotes affected by this restatement are as follows:

3. Significant Accounting Policies;

7. Discontinued Operations;

8. Savannah Energy Systems Company Partnership;

10. Earnings Per Share;

14. Income Taxes;

17. Industry Segments and Geographic Information; and

21. Quarterly Results of Operations (Unaudited).

Note 3. 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 50% voting interest or significant influence, collectively Katy or the Company . All significant intercompany accounts, profits and transactions have been eliminated in consolidation. Investments in affiliates, which do not meet the criteria of a variable interest entity and are not majority owned or where the Company exercises significant influence, are reported using the equity method.

As part of the continuous evaluation of its operations, Katy has acquired and disposed of certain of its operating units in recent years. Those which affected the Consolidated Financial Statements for the year ended December 31, 2006 are discussed in Note 6.

At December 31, 2006, the Company owns 30,000 shares of common stock, a 45% interest, in Sahlman Holding Company, Inc. (Sahlman) that is accounted for under the equity method. The Company does not have significant influence over the operation. Sahlman is engaged in the business of shrimp farming in Nicaragua. As of December 31, 2006 and 2005, the investment balance was $2.2 million.

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.

Revenue Recognition Revenue is recognized for all sales, including sales to agents and distributors, at the time the products are shipped and title has transferred to the customer, provided that a purchase order has been received or a contract has been executed, there are no uncertainties regarding customer acceptances, the sales price is fixed and determinable and collectibility is deemed probable. The Company s standard shipping terms are FOB shipping point. The Company records sales discounts, returns and allowances in accordance with Emerging Issues Task Force (EITF) Issue No. 01-09, *Accounting for Consideration Given by a Vendor to a Customer*. Sales discounts, returns and allowances, and cooperative advertising are included in net sales, and the provision for doubtful accounts is included in selling, general and administrative expenses. These provisions are estimated at the time of sale.

Cash and Cash Equivalents Cash equivalents consist of highly liquid investments with original maturities of three months or less.

Advertising Costs Advertising costs are expensed as incurred. Advertising costs within continuing operations expensed in 2006, 2005 and 2004 were $3.1 million, $3.3 million and $3.4 million, respectively.

Accounts Receivable and Allowance for Doubtful Accounts Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company s best estimate of the amount of probable credit losses in its existing accounts receivable. The Company determines the allowance based on its historical write-off experience. The Company reviews its allowance for doubtful accounts quarterly, which includes a review of past due balances over 90 days and over a specified amount for collectibility. All other balances are reviewed on a pooled basis by market distribution channels. Account balances are charged off against the allowance when the Company determines it is probable the receivable will not be recovered. The Company does not have any off-balance-sheet credit exposure related to its customers. Charges within continuing operations to expense for probable credit losses and allowances were $3.1 million, $3.3 million and $3.1 million in 2006, 2005 and 2004, respectively.

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Inventories Inventories are stated at the lower of cost or market value, and reserves are established for excess and obsolete inventory in order to ensure proper valuation of inventories. Cost includes materials, labor and overhead. At December 31, 2006 and 2005, approximately 23% 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 $3.7 million and $6.6 million at December 31, 2006 and 2005, respectively. The reduction in the LIFO reserve primarily resulted from the reduction in quantity levels as well as the sales of the Metal Truck Box and United Kingdom consumer plastics business units. The components of inventories are:

	As Restated, see Note 2 December 31,	
	2006	2005
	(Amounts in Thousands)	
Raw materials	$ 14,777	$ 22,997
Work in process	613	1,766
Finished goods	47,230	48,949
Inventory reserves	(3,905)	(4,548)
LIFO reserve	(3,735)	(6,571)
	$ 54,980	$ 62,593

In November 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 151, *Inventory Costs, an amendment of ARB No. 43, Chapter 4* (SFAS No. 151). SFAS No. 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and spoilage. In addition, SFAS No. 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 No. 151 are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Effective January 1, 2006, the Company adopted SFAS No. 151 which did not have a material impact on the results of operations and financial position.

Goodwill In connection with certain acquisitions, the Company recorded goodwill representing the cost of the acquisition in excess of the fair value of the net assets acquired. Beginning in 2002, goodwill is not amortized in accordance with SFAS No. 142, *Goodwill and Intangible Assets* (SFAS No. 142). The fair value of each reporting unit that carries goodwill is determined annually, or as indicators of impairment are identified, and the fair value is compared to the carrying value of the reporting unit. If the fair value exceeds the carrying value, then no adjustment is necessary. If the carrying value of the reporting unit exceeds the fair value, appraisals are performed of long-lived assets and other adjustments are made to arrive at a revised fair value balance sheet. This revised fair value balance sheet (without goodwill) is compared to the fair value of the business previously determined, and a revised goodwill amount is reached. If the indicated goodwill amount meets or exceeds the current carrying value of goodwill, then no adjustment is required. However, if the result indicates a reduced level of goodwill, an impairment is recorded to state the goodwill at the revised level. Any impairments of goodwill determined in accordance with SFAS No. 142 are recorded as a component of income from continuing operations. See Note 4.

Property 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 for 2006, 2005 and 2004 was $8.0 million, $8.3 million, and $10.4 million, respectively.

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Katy adopted SFAS No. 143, *Accounting for Asset Retirement Obligations* (SFAS No. 143), 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 December 31, 2006 an asset of $0.4 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
Accretion expense		49
Additions		330
Changes in estimates, including timing		32
Payments		(580)
SFAS No. 143 Obligation at December 31, 2005	$	1,068
Accretion expense		49
SFAS No. 143 Obligation at December 31, 2006	$	1,117

Impairment of Long-lived Assets Long-lived assets, other than goodwill which is discussed above, are reviewed for impairment if events or circumstances indicate the carrying amount of these assets may not be recoverable through future undiscounted cash flows. If this review indicates that the carrying value of these assets will not be recoverable, based on future undiscounted net cash flows from the use or disposition of the asset, the carrying value is reduced to fair value. See Note 5.

Income Taxes Income taxes are accounted for using a balance sheet approach known as the liability method. The liability method accounts for deferred income taxes by applying the statutory tax rates in effect at the date of the balance sheet to the differences between the book basis and tax basis of the assets and liabilities. The Company records a valuation allowance when it is more likely than not that some portion or all of the deferred income tax asset will not be realizable. See Note 14.

Foreign Currency Translation The results of the Company s 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 component of accumulated other comprehensive income (loss). Katy recorded gains on foreign exchange transactions (included in other, net in the Consolidated Statements of Operations) of $0.2 million, $2.0 thousand, and $0.3 million, in 2006, 2005 and 2004, respectively.

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 the 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.

Stock Options and Other Stock Awards Prior to January 1, 2006, the Company accounted for stock options and other stock awards under the provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25), as allowed by SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123), as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (SFAS No. 148). APB No. 25 dictated a measurement date concept in the determination of compensation expense related to stock awards including stock options, restricted stock, and stock appreciation rights (SARs).

Katy s outstanding stock options all had established measurement dates and therefore, fixed plan accounting was applied, generally resulting in no compensation expense for stock option awards. However, the Company issued stock appreciation rights, stock awards and restricted stock awards which were accounted for as variable stock compensation awards for which compensation income (expense) was recorded. Compensation income associated with stock appreciation rights was $0.9 million and $0.1 million in 2005 and 2004, respectively. Compensation expense relative to stock awards was $22.1 thousand and $8.9 thousand in 2005 and 2004, respectively. No compensation expense relative to restricted stock awards was recognized in 2005 or 2004. Compensation income (expense) for stock awards and stock appreciation rights is recorded in selling, general and administrative expenses in the Consolidated Statements of Operations.

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Effective January 1, 2006, the Company has adopted SFAS No. 123R, *Share-Based Payment* (SFAS No. 123R), using the modified prospective method. Under this method, compensation cost recognized during 2006 includes: a) compensation cost for all stock options granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with SFAS No. 123R amortized over the options vesting period; b) compensation cost for stock appreciation rights granted prior to, but vested as of January 1, 2006, based on the January 1, 2006 fair value estimated in accordance with SFAS No. 123R; and c) compensation cost for stock appreciation rights granted prior to and vested as of December 31, 2006 based on the December 31, 2006 fair value estimated in accordance with SFAS No. 123R.
The following table shows total compensation expense (see Note 12 for descriptions of Stock Incentive Plans) included in the Consolidated Statements of Operations for the year ended December 31, 2006:

	Year Ended December 31, 2006
Selling, general and administrative expense	$ 398