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

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

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended: March 31, 2007
or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____
Commission File Number 001-05558
Katy Industries, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**75-1277589**
(State or other jurisdiction of incorporation or organization)	(I.R.S. 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

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 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 Exchange Act).
Yes o No þ

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

Class	Outstanding at April 30, 2007
Common Stock, $1 Par Value	**7,951,177 Shares**

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EXPLANATORY NOTE

Restatement of Consolidated Financial Statements

We are filing this Amended Quarterly Report on Form 10-Q/A (Amended Filing) to our Quarterly Report on Form 10-Q for the three months ended March 31, 2007 (Original Filing) to amend and restate our consolidated financial statements and the related disclosures for the three months ended March 31, 2007 and 2006, as discussed in Note 1. The Original Filing was filed with the Securities and Exchange Commission (SEC) on May 10, 2007. For further discussion, refer to the Annual Report on Form 10-K/A as of December 31, 2006 as filed on August 17, 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 the Annual Report on Form 10-K/A, and the unaudited quarterly financial information included in the Company s Quarterly Reports on Form 10-Q as of 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 of 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 $0.1 million and $0.2 million for the three months ended March 31, 2007 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 of the Company s 10-K/A. 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. For a discussion of management s consideration of the Company s disclosure controls and procedures, see Part I, Item 4 included in this Amended Filing.

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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.

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: Financial Statements;

Part I Item 2: Management s Discussion and Analysis of Financial Condition and Results of Operations;

Part I Item 4: Controls and Procedures;

Part II Item 1A: Risk Factors; and

Part I1 Item 6: Exhibits.

In accordance with applicable SEC rules, this Amended Filing 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-Q and are included for the convenience of the reader. The sections of the Form 10-Q 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-Q and has not been updated to reflect events occurring subsequent to the original filing date.

KATY INDUSTRIES, INC.
FORM 10-Q
March 31, 2007
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PART I FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS
KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Amounts in Thousands)
(Unaudited)
ASSETS

	As Restated, see Note 1 March 31, 2007	December 31, 2006
CURRENT ASSETS:		
Cash and cash equivalents	$ 2,919	$ 7,392
Accounts receivable, net	47,811	55,014
Inventories, net	60,717	54,980
Other current assets	3,592	2,991
Asset held for sale		4,483
Total current assets	115,039	124,860
OTHER ASSETS:		
Goodwill	665	665
Intangibles, net	6,358	6,435
Other	8,576	8,990
Total other assets	15,599	16,090
PROPERTY AND EQUIPMENT:		
Land and improvements	336	336
Buildings and improvements	9,710	9,669
Machinery and equipment	120,701	119,703
	130,747	129,708
Less Accumulated depreciation	(89,780)	(87,964)
Property and equipment, net	40,967	41,744
Total assets	$ 171,605	$ 182,694

See Notes to Condensed Consolidated Financial Statements.

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

	As Restated, see Note 1 March 31, 2007	December 31, 2006
CURRENT LIABILITIES:		
Accounts payable	$ 32,836	$ 33,684
Accrued compensation	3,814	3,518
Accrued expenses	33,624	38,187
Current maturities of long-term debt	1,500	1,125
Revolving credit agreement	41,491	43,879
Total current liabilities	113,265	120,393
LONG-TERM DEBT, less current maturities	11,468	11,867
OTHER LIABILITIES	9,889	8,402
Total liabilities	134,622	140,662
COMMITMENTS AND CONTINGENCIES (Note 10)		
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	27,196	27,120
Accumulated other comprehensive income	1,862	2,242
Accumulated deficit	(88,193)	(83,434)
Treasury stock, at cost, 1,871,127 shares and 1,869,827 shares, respectively	(21,960)	(21,974)
Total stockholders equity	36,983	42,032
Total liabilities and stockholders equity	$ 171,605	$ 182,694

See Notes to Condensed Consolidated Financial Statements.

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KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED MARCH 31, 2007 AND 2006
(Amounts in Thousands, Except Per Share Data)
(Unaudited)

	As Restated, see Note 1	
	2007	2006
Net sales	$ 94,803	$ 75,818
Cost of goods sold	86,346	65,553
Gross profit	8,457	10,265
Selling, general and administrative expenses	11,440	12,289
Severance, restructuring and related charges	244	782
(Gain) loss on sale of assets	(120)	102
Operating loss	(3,107)	(2,908)
Interest expense	(1,949)	(1,771)
Other, net	70	341
Loss from continuing operations before provision for income taxes	(4,986)	(4,338)
Provision for income taxes from continuing operations	(459)	(262)
Loss from continuing operations	(5,445)	(4,600)
Loss from operations of discontinued businesses (net of tax)		(389)
Gain on sale of discontinued businesses (net of tax)	1,666	
Loss before cumulative effect of a change in accounting principle	(3,779)	(4,989)
Cumulative effect of a change in accounting principle (net of tax)		(756)
Net loss	$ (3,779)	$ (5,745)
Loss per share of common stock Basic and diluted		
Loss from continuing operations	$ (0.69)	$ (0.57)
Discontinued operations	0.21	(0.05)
Cumulative effect of a change in accounting principle		(0.10)
Net loss	$ (0.48)	$ (0.72)
Weighted average common shares outstanding (thousands):		
Basic and diluted	7,951	7,971

See Notes to Condensed Consolidated Financial Statements.

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KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2007 and 2006
(Amounts in Thousands)
(Unaudited)

	As Restated, see Note 1	
	2007	2006
Cash flows from operating activities:		
Net loss	$ (3,779)	$ (5,745)
(Income) loss from discontinued operations	(1,666)	389
Loss from continuing operations	(5,445)	(5,356)
Cumulative effect of a change in accounting principle		756
Depreciation and amortization	2,072	2,241
Write-off and amortization of debt issuance costs	619	287
Stock option expense	94	191
(Gain) loss on sale of assets	(120)	102
Deferred income taxes	(94)	
	(2,874)	(1,779)
Changes in operating assets and liabilities:		
Accounts receivable	7,115	18,302
Inventories	(5,711)	(6,305)
Other assets	(708)	(76)
Accounts payable	1,301	(14,470)
Accrued expenses	(4,478)	(1,794)
Other, net	485	(1,209)
	(1,996)	(5,552)
Net cash used in continuing operations	(4,870)	(7,331)
Net cash (used in) provided by discontinued operations	(165)	389
Net cash used in operating activities	(5,035)	(6,942)
Cash flows from investing activities:		
Capital expenditures of continuing operations	(1,130)	(816)
Proceeds from sale of assets, net	120	163
Net cash used in continuing operations	(1,010)	(653)
Net cash provided by discontinued operations	6,609	
Net cash provided by (used in) investing activities	5,599	(653)

Cash flows from financing activities:		
Net (repayments) borrowings on revolving loans	(2,454)	8,578
Decrease in book overdraft	(2,153)	(5,360)
Repayments of term loans	(24)	(714)
Direct costs associated with debt facilities	(125)	(165)
Repurchases of common stock	(3)	(4)
Proceeds from the exercise of stock options		147
Net cash (used in) provided by financing activities	(4,759)	2,482
Effect of exchange rate changes on cash and cash equivalents	(278)	(307)
Net decrease in cash and cash equivalents	(4,473)	(5,420)
Cash and cash equivalents, beginning of period	7,392	8,421
Cash and cash equivalents, end of period	$ 2,919	$ 3,001

See Notes to Condensed Consolidated Financial Statements.

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KATY INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2007
(Unaudited)

(1) 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 the three months ended March 31, 2007 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 independent investigation of the physical raw material inventory counting process at Continental Commercial Products, LLC (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. For additional information on the restatement, refer to the Company s Annual Report on Form 10-K/A filed on August 17, 2007.

(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 for the three months ended March 31, 2006, and $0.1 million for the three months ended March 31, 2007.

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) Deferred compensation In conjunction with a retirement compensation program, 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 the first two quarters of 2006; therefore, the Company reduced compensation expense by the corresponding amount in 2006. The Company reduced compensation expense by $0.2 million for the three months ended March 31, 2006.

(C) 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. The Company had originally recorded the out-of-period adjustment in the first quarter of 2007; therefore, the Company reduced costs of goods sold by the corresponding amount in the first quarter of 2007.

(D) Revision of SESCO as a continuing operation For all periods presented, the Company previously inappropriately reported the results from the Savannah Energy Systems Company Partnership operation as discontinued operations, as described further in Note 5. As a result, the Company revised for the three months ended March 31, 2006 $31 thousand from loss from operations of discontinued businesses into interest expense within continuing operations.

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

Consolidated Balance Sheets
(Amounts in thousands)

	March 31, 2007	
Assets	Previously reported	Restated
CURRENT ASSETS:		
Cash and cash equivalents	$ 2,919	$ 2,919
Trade accounts receivable, net	47,811	47,811
Inventories, net (A)(C)	61,484	60,717
Other current assets	3,592	3,592
Asset held for sale		
Total current assets	115,806	115,039
OTHER ASSETS:		
Goodwill	665	665
Intangibles, net	6,358	6,358
Other	8,576	8,576
Total other assets	15,599	15,599
Property and equipment, net	40,967	40,967
Total assets	$ 172,372	$ 171,605
Liabilities and Stockholders Equity		
CURRENT LIABILITIES:		
Accounts payable	$ 32,836	$ 32,836
Accrued compensation	3,814	3,814
Accrued expenses	33,624	33,624
Current maturities, long-term debt	1,500	1,500
Revolving credit agreement	41,491	41,491
Total current liabilities	113,265	113,265
LONG-TERM DEBT, less current maturities	11,468	11,468
OTHER LIABILITIES	9,889	9,889
Total liabilities	134,622	134,622
COMMITMENTS AND CONTINGENCIES (Note 10)		
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	27,145	27,196
Accumulated other comprehensive income	1,862	1,862
Accumulated deficit	(87,375)	(88,193)
Treasury stock, at cost	(21,960)	(21,960)
Total stockholders equity	37,750	36,983
Total liabilities and stockholders equity	$ 172,372	$ 171,605

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

	For the three months ended March 31, 2007		For the three months ended March 31, 2006	
	Previously reported	Restated	Previously reported	Restated
Net sales	$ 94,803	94,803	$ 75,818	75,818
Cost of goods sold (A)(C)	86,559	86,346	65,407	65,553
Gross profit	8,244	8,457	10,411	10,265
Selling, general and administrative expenses (B)	11,440	11,440	12,481	12,289
Severance, restructuring and related charges	244	244	782	782
(Gain) loss on sale of assets	(120)	(120)	102	102
Operating loss	(3,320)	(3,107)	(2,954)	(2,908)
Interest expense (D)	(1,949)	(1,949)	(1,740)	(1,771)
Other, net	70	70	341	341
Loss from continuing operations before provision for income taxes	(5,199)	(4,986)	(4,353)	(4,338)
Provision for income taxes from continuing operations	(459)	(459)	(262)	(262)
Loss from continuing operations	(5,658)	(5,445)	(4,615)	(4,600)
Loss from operations of discontinued businesses (net of tax) (D)			(420)	(389)
Gain on sale of discontinued businesses (net of tax)	1,666	1,666		
Loss before cumulative effect of a change in accounting principle	(3,992)	(3,779)	(5,035)	(4,989)
Cumulative effect of a change in accounting principle (net of tax)			(756)	(756)
Net loss	$ (3,992)	$ (3,779)	$ (5,791)	$ (5,745)
Loss per share of common stock Basic and diluted				
Loss from continuing operations	$ (0.71)	$ (0.69)	$ (0.58)	$ (0.57)
Discontinued operations	0.21	0.21	(0.05)	(0.05)
Cumulative effect of a change in accounting principle			(0.10)	(0.10)
Net loss	$ (0.50)	$ (0.48)	$ (0.73)	$ (0.72)

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Consolidated Statements of Cash Flows
(Amounts in thousands)

	For the three months ended March 31, 2007		For the three months ended March 31, 2006	
	Previously reported	Restated	Previously reported	Restated
Cash flows from operating activities:				
Net loss	$ (3,992)	$ (3,779)	$ (5,791)	$ (5,745)
(Income) loss from discontinued operations (D)	(1,666)	(1,666)	420	389
Loss from continuing operations	(5,658)	(5,445)	(5,371)	(5,356)
Cumulative effect of a change in accounting principle			756	756
Depreciation and amortization	2,072	2,072	2,241	2,241
Write-off and amortization of debt issuance costs	619	619	287	287
Stock option expense	94	94	191	191
(Gain) loss on sale of assets	(120)	(120)	102	102
Deferred income taxes	(94)	(94)		
	(3,087)	(2,874)	(1,794)	(1,779)
Changes in operating assets and liabilities:				
Accounts receivable	7,115	7,115	18,302	18,302
Inventories (A)(C)	(5,498)	(5,711)	(6,451)	(6,305)
Other assets	(708)	(708)	(76)	(76)
Accounts payable	1,301	1,301	(14,470)	(14,470)
Accrued expenses (D)	(4,078)	(4,478)	(1,794)	(1,794)
Other, net (B)(D)	485	485	(1,048)	(1,209)
	(1,383)	(1,996)	(5,537)	(5,552)
Net cash used in continuing operations	(4,470)	(4,870)	(7,331)	(7,331)
Net cash (used in) provided by discontinued operations (D)	(565)	(165)	389	389
Net cash used in operating activities	(5,035)	(5,035)	(6,942)	(6,942)
Cash flows from investing activities:				
Capital expenditures of continuing operations	(1,130)	(1,130)	(816)	(816)
Proceeds from sale of assets, net	120	120	163	163
Net cash used in continuing operations	(1,010)	(1,010)	(653)	(653)
Net cash provided by discontinued operations	6,609	6,609		
Net cash provided by (used in) investing activities	5,599	5,599	(653)	(653)

Cash flows from financing activities:				
Net (repayments) borrowings on revolving loans	(2,454)	(2,454)	8,578	8,578
Decrease in book overdraft	(2,153)	(2,153)	(5,360)	(5,360)
Repayments of term loans	(24)	(24)	(714)	(714)
Direct costs associated with debt facilities	(125)	(125)	(165)	(165)
Repurchases of common stock	(3)	(3)	(4)	(4)
Proceeds from the exercise of stock options			147	147
Net cash (used in) provided by financing activities	(4,759)	(4,759)	2,482	2,482
Effect of exchange rate changes on cash and cash equivalents	(278)	(278)	(307)	(307)
Net decrease in cash and cash equivalents	(4,473)	(4,473)	(5,420)	(5,420)
Cash and cash equivalents, beginning of period	7,392	7,392	8,421	8,421
Cash and cash equivalents, end of period	$ 2,919	$ 2,919	$ 3,001	$ 3,001

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The comprehensive loss of approximately $4.4 million and $6.1 million for the three months ended March 31, 2007 and 2006, respectively, as previously reported was restated to a comprehensive loss of $4.2 million and $6.1 million, respectively. The change resulted from changes within our net loss attributable to common stockholders.

Financial statement footnotes affected by this restatement are as follows:

2. Significant Accounting Policies;

8. Income Taxes;

10. Industry Segments and Geographic Information; and

13. Discontinued Operations.

(2) Significant Accounting Policies

Consolidation Policy and Basis of Presentation

The condensed consolidated financial statements include the accounts of Katy Industries, Inc. and subsidiaries in which it has a greater than 50% interest, collectively Katy or the Company . All significant intercompany accounts, profits and transactions have been eliminated in consolidation. Investments in affiliates, 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. The condensed consolidated financial statements at March 31, 2007 and December 31, 2006 and for the three month periods ended March 31, 2007 and March 31, 2006 are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial condition and results of operations of the Company. Interim results may not be indicative of results to be realized for the entire year. The condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto, together with management s discussion and analysis of financial condition and results of operations, contained in the Company s Annual Report on Form 10-K for the year ended December 31, 2006. The year-end condensed balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States.

Use of Estimates and Reclassifications

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.

Certain reclassifications associated with the presentation of discontinued operations were made to the 2006 amounts in order to conform to the 2007 presentation.

Inventories

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

	As Restated, see Note 1 March 31, 2007	December 31, 2006
Raw materials	$ 15,788	$ 14,777
Work in process	1,279	613
Finished goods	54,012	47,230
Inventory reserves	(6,833)	(3,905)
LIFO reserve	(3,529)	(3,735)
	$ 60,717	$ 54,980

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At March 31, 2007 and December 31, 2006, approximately 21% and 23%, 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 $3.5 million and $3.7 million at March 31, 2007 and December 31, 2006, respectively. The primary increase in the inventory reserves relates to an adjustment for approximately $2.4 million associated with the net realizable value and potential obsolescence of inventory within the Electrical Products Group.

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 method; tooling (5 years) using the straight-line method; and leasehold improvements using the straight-line method over the remaining lease period or useful life, if shorter. Costs for repair and maintenance of machinery and equipment are expensed as incurred, unless the result significantly increases the useful life or functionality of the asset, in which case capitalization is considered. Depreciation expense from continuing operations was $1.9 million and $2.1 million for the three month periods ended March 31, 2007 and 2006, respectively.

Stock Options and Other Stock Awards

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment* (SFAS No. 123R), which sets accounting requirements for share-based compensation to employees, requires companies to recognize the grant date fair value of stock options and other equity-based compensation issued to employees and disallows the use of intrinsic value method of accounting for stock compensation. The Company has adopted SFAS No. 123R using the modified prospective method. Under this method, compensation cost recognized during the three month period ended March 31, 2007 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 and b) compensation cost for outstanding stock appreciation rights based on the March 31, 2007 fair value estimated in accordance with SFAS No. 123R. Compensation cost recognized during the three month period ended March 31, 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 outstanding stock appreciation rights as of March 31, 2006 based on the March 31, 2006 fair value estimated in accordance with SFAS No. 123R.

The following table shows total compensation (income) expense included in the Condensed Consolidated Statement of Operations for the three month periods ended March 31, 2007 and 2006:

	Three Months Ended March 31,	
	2007	2006
Selling, general and administrative expense	$ (85)	$ 489
Cumulative effect of a change in accounting principle		756
	$ (85)	$ 1,245

The fair value for stock options was estimated at the date of grant using a Black-Scholes option pricing model. The Company used the simplified method, as allowed by Staff Accounting Bulletin (SAB) No. 107, *Share-Based Payment*, for estimating the expected term by averaging the minimum and maximum lives expected for each award. In addition, the Company estimated volatility by considering its historical stock volatility over a term comparable to the remaining expected life of each award. The risk-free interest rate was the current yield available on U.S. treasury rates with issues with a remaining term equal in term to each award. The Company estimates forfeitures using historical results. Its estimates of forfeitures will be adjusted over the requisite service period based on the extent to which actual

forfeitures differ, or are expected to differ, from their estimate. The assumptions for expected term, volatility and risk-free rate are presented in the table below:

Expected term (years)	5.3 - 6.5
Volatility	53.8% - 57.6%
Risk-free rate	3.98% - 4.48%

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The fair value for stock appreciation rights, a liability award, was estimated at the effective date of SFAS No. 123R, and March 31, 2007 and 2006, using a Black-Scholes option pricing model. The Company estimated the expected term to be equal to the average between the minimum and maximum lives expected for each award. In addition, the Company estimated volatility by considering its historical stock volatility over a term comparable to the remaining expected life of each award. The risk-free interest rate was the current yield available on U.S. treasury rates with issues with a remaining term equal in term to each award. The Company estimates forfeitures using historical results. Its estimates of forfeitures will be adjusted over the requisite service period based on the extent to which actual forfeitures differ, or are expected to differ, from their estimate. The assumptions for expected term, volatility and risk-free rate are presented in the table below:

	March 31, 2007	March 31, 2006
Expected term (years)	0.1 - 5.3	3.0 - 5.3
Volatility	53.7% - 80.6%	48.2% - 55.0%
Risk-free rate	4.54% - 5.07%	4.37% - 4.83%

Derivative Financial Instruments

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

The agreement has an effective date of August 17, 2005 and a termination date of August 17, 2007 with a notional amount of $25.0 million in the first year declining to $15.0 million in the second year. The Company is hedging its variable LIBOR-based interest rate for a fixed interest rate of 4.49% for the term of the swap agreement to protect the Company from potential interest rate increases. The Company has designated its benchmark variable LIBOR-based interest rate on a portion of the Bank of America Credit Agreement as a hedged item under a cash flow hedge. In accordance with SFAS No. 133, the Company recorded an asset of $0.1 million on its balance sheet at March 31, 2007, with changes in fair market value included in other comprehensive income.

The Company reported no gain or loss for the three months ended March 31, 2007, as a result of any hedge ineffectiveness. Future changes in this swap arrangement, including termination of the agreement, may result in a reclassification of any gain or loss reported in other comprehensive income into earnings as an adjustment to interest expense.

Details regarding the swap as of March 31, 2007 are as follows (amounts in thousands):

Notional Amount	Maturity	Rate Paid	Rate Received	Fair Value (2)
$15,000	August 17, 2007	4.49%	LIBOR (1)	$ 58

(1) LIBOR rate is determined on the 23rd of each month and continues up to and including the maturity date.

(2) The fair value is the mark-to-market value.

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Comprehensive Loss

The components of comprehensive loss are as follows (amounts in thousands):

	As Restated, see Note 1 Three Months Ended March 31,	
	2007	2006
Net loss	$ (3,779)	$ (5,745)
Foreign currency translation losses	(334)	(417)
Unrealized (losses) gains on interest rate swap	(29)	93
Other	(17)	
	(380)	(324)
Comprehensive loss	$ (4,159)	$ (6,069)

(3) New Accounting Pronouncements

As discussed in Note 9, the Company adopted, effective January 1, 2007, Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes* (FIN No. 48), which describes a comprehensive model for the measurement, recognition, presentation, and disclosure of uncertain tax positions in the financial statements. Under the interpretation, the financial statements will reflect expected future tax consequences of such positions presuming the tax authorities full knowledge of the position and all relevant facts, but without considering time values.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This standard does not require any new fair value measurements but provides guidance in determining fair value measurements presently used in the preparation of financial statements. For the Company, SFAS No. 157 is effective January 1, 2008. The Company is assessing the impact this statement may have in its future financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value, with unrealized gains and losses related to these financial instruments reported in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact this statement may have in its future financial statements.

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(4) Intangible Assets

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

	March 31, 2007			December 31, 2006		
	Gross Amount	Accumulated Amortization	Net Carrying Amount	Gross Amount	Accumulated Amortization	Net Carrying Amount
Patents	$ 1,583	$ (1,093)	$ 490	$ 1,511	$ (1,065)	$ 446
Customer lists	10,454	(8,157)	2,297	10,454	(8,111)	2,343
Tradenames	5,613	(2,410)	3,203	5,612	(2,345)	3,267
Other	441	(73)	368	441	(62)	379
Total	$ 18,091	$ (11,733)	$ 6,358	$ 18,018	$ (11,583)	$ 6,435

All of Katy s intangible assets are definite long-lived intangibles. Katy recorded amortization expense on intangible assets of $0.2 million for both the three month periods ended March 31, 2007 and 2006. Estimated aggregate future amortization expense related to intangible assets is as follows (amounts in thousands):

2007 (remainder)	$ 639
2008	635
2009	600
2010	547
2011	507
2012	505
Thereafter	2,925
	$ 6,358

(5) Savannah Energy Systems Company Partnership

In 1984, Savannah Energy Systems Company (SESCO), an indirect wholly owned subsidiary of Katy, entered into a series of contracts with the Resource Recovery Development Authority of the City of Savannah, Georgia (the Authority) to construct and operate a waste-to-energy facility. The facility would be owned and operated by SESCO solely for the purpose of processing and disposing of waste from the City of Savannah.

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

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. 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.

The final payment of $0.4 million due to Montenay as of December 31, 2006 was reflected in accrued expenses in the Condensed Consolidated Balance Sheets, and was paid in January 2007.

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(6) Indebtedness

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

	March 31, 2007	December 31, 2006
Term loan payable under Bank of America Credit Agreement, interest based on LIBOR and Prime Rates (8.38% - 9.50%), due through 2009	$ 12,968	$ 12,992
Revolving loans payable under the Bank of America Credit Agreement, interest based on LIBOR and Prime Rates (8.13% - 9.25%)	41,491	43,879
Total debt	54,459	56,871
Less revolving loans, classified as current (see below)	(41,491)	(43,879)
Less current maturities	(1,500)	(1,125)
Long-term debt	$ 11,468	$ 11,867

Aggregate remaining scheduled maturities of the Term Loan as of March 31, 2007 are as follows (amounts in thousands):

2007	$ 1,125
2008	1,500
2009	10,343
	$ 12,968

On April 20, 2004, the Company completed a refinancing of its outstanding indebtedness (the Refinancing) and entered into a new agreement with Bank of America Business Capital (the Bank of America Credit Agreement). The current Bank of America Credit Agreement, as amended is a $93.0 million facility with a $13.0 million term loan (Term Loan) and a $80.0 million revolving credit facility (Revolving Credit Facility). The Bank of America Credit Agreement is an asset-based lending agreement and involves a syndicate of four banks.

The Revolving Credit Facility has an expiration date of April 20, 2009 and its borrowing base is determined by eligible inventory and accounts receivable. Unused borrowing availability on the Revolving Credit Facility was $14.2 million at March 31, 2007. All extensions of credit under the Bank of America Credit Agreement are collateralized by a first priority security interest in and lien upon the capital stock of each material domestic subsidiary (65% of the capital stock of each material foreign subsidiary), and all present and future assets and properties of Katy.

The Term Loan also has a final maturity date of April 20, 2009 with quarterly payments of $0.4 million, as amended and 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 the Company s property, plant and equipment.

The Company s 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 the Company conducts 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, the Company s largest letters of credit relate to its casualty insurance programs. At March 31, 2007, total outstanding letters of credit were $6.6 million.

On March 8, 2007 the Company obtained the Eighth Amendment to the Bank of America Credit Agreement. 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 (eligible collateral base less outstanding borrowings and letters of credit) 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 from that point through December 2007. Thereafter, the Company is required to maintain a minimum level of availability such that eligible collateral must exceed the sum of its outstanding borrowings and letters of credit by at least $5.0 million for the first three quarters of the year and $7.5 million for the fourth quarter. In addition, the Company reduced its Revolving Credit Facility from $90.0 million to $80.0 million.

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If the Company is unable to comply with the terms of the amended covenants, it could seek to obtain further amendments and pursue increased liquidity through additional debt financing and/or the sale of assets. It is possible, however, the Company may not be able to obtain further amendments from the lender or secure additional debt financing or liquidity through the sale of assets on favorable terms or at all. However, the Company believes that it will be able to comply with all covenants, as amended, throughout 2007.

Effective since April 2005, interest rate margins have been set at the largest margins set forth in the Bank of America Credit Agreement, 275 basis points over applicable LIBOR rates for Revolving Credit Facility borrowings and 300 basis points over LIBOR for borrowings under the Term Loan. In accordance with the Bank of America Credit Agreement, margins on the Term Loan will drop an additional 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 March 31, 2007.

Effective August 17, 2005, the Company entered into a two-year interest rate swap on a notional amount of $25.0 million in the first year and $15.0 million in the second year. The purpose of the swap was to limit the Company s exposure to interest rate increases on a portion of the Revolving Credit Facility over the two-year term of the swap. The fixed interest rate under the swap at March 31, 2007 and over the life of the agreement is 4.49%.

All of the debt under the Bank of America Credit Agreement is re-priced to current rates at frequent intervals. Therefore, its fair value approximates its carrying value at March 31, 2007. For the three month periods ended March 31, 2007 and 2006, the Company had amortization of debt issuance costs, included within interest expense, of $0.6 million and $0.3 million, respectively. Included in amortization of debt issuance costs is approximately $0.3 million for the three month period ended March 31, 2007 of debt issuance costs written off due to the reduction in the Revolving Credit Facility on March 8, 2007. In addition, the Company incurred $0.1 million and $0.2 million associated with amending the Bank of America Credit Agreement, as discussed above, for the three month periods ended March 31, 2007 and 2006, 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*. The Company does not expect to repay, or be required to repay, within one year, the balance of the Revolving Credit Facility classified as a current liability. The MAE clause, which is a typical requirement in commercial credit agreements, allows the lenders to require the loan to become due if they determine there has been a material adverse effect on the Company s operations, business, properties, assets, liabilities, condition, or prospects. The classification of the Revolving Credit Facility as a current liability is a result only of the combination of the lockbox agreements and MAE clause. The Revolving Credit Facility does not expire or have a maturity date within one year, but rather has a final expiration date of April 20, 2009. The lender had not notified the Company of any indication of a MAE at March 31, 2007, and the Company was not in default of any provision of the Bank of America Credit Agreement at March 31, 2007.

(7) Retirement Benefit Plans

Several subsidiaries have pension plans covering substantially all of their employees. These plans are noncontributory, defined benefit pension plans. The benefits to be paid under these plans are generally based on employees retirement age and years of service. The companies funding policies, subject to the minimum funding requirement of employee benefit and tax laws, are to contribute such amounts as determined on an actuarial basis to provide the plans with assets sufficient to meet the benefit obligations. Plan assets consist primarily of fixed income investments, corporate equities and government securities. The Company also provides certain health care and life insurance benefits for some of its retired employees. The post-retirement health plans are unfunded. Katy uses an annual measurement date of December 31 for the majority of its pension and other postretirement benefit plans for all years presented.

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Information regarding the Company s net periodic benefit cost for pension and other postretirement benefit plans for the three month periods ended March 31, 2007 and 2006 are as follows (amounts in thousands):

	Pension Benefits		Other Benefits	
	March 31, 2007	March 31, 2006	March 31, 2007	March 31, 2006
Components of net periodic benefit cost:				
Service cost	$ 2	$ 2	$	$
Interest cost	23	22	51	36
Expected return on plan assets	(24)	(22)		
Amortization of prior service cost			22	14
Amortization of net loss	13	14	4	10
Net periodic benefit cost	$ 14	$ 16	$ 77	$ 60

Required contributions to the pension plans for 2007 are $10 thousand and Katy made contributions of $35 thousand during the first quarter of 2007.

(8) Stock Incentive Plans

Stock Options

The following table summarizes stock option activity under each of the applicable Company s plans:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2006	1,718,000	$ 3.66		
Granted		$ 0.00		
Exercised		$ 0.00		
Cancelled		$ 0.00		
Outstanding at March 31, 2007	1,718,000	$ 3.66	6.45 years	$
Vested and Exercisable at March 31, 2007	1,098,000	$ 4.20	5.44 years	$

As of March 31, 2007, total unvested compensation expense associated with stock options amounted to $0.2 million and is being amortized on a straight-line basis over the respective option s vesting period. The weighted average period in which the above compensation cost will be recognized is 0.7 years as of March 31, 2007.

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Stock Appreciation Rights

The following table summarizes SARs activity under each of the applicable Company s plans:

Non-Vested at December 31, 2006	53,434
Granted	
Vested	(26,667)
Non-Vested at March 31, 2007	26,767
Total Outstanding at March 31, 2007	798,281

For the three months ended March 31, 2007 and 2006, total compensation (income) expense associated with stock appreciation rights amounted to approximately ($0.2) million and $1.0 million, respectively.

(9) Income Taxes

The Company adopted FIN No. 48 on January 1, 2007. As a result of the implementation of FIN No. 48, the Company recognized approximately a $1.1 million increase in the liability for unrecognized tax benefits, which was accounted for as an increase of $0.1 million to the January 1, 2007 balance of deferred tax assets and a reduction of $1.0 million to the January 1, 2007 balance of retained earnings.

Included in the balance at March 31, 2007 are $1.8 million of tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of the shorter deductibility period would not affect the annual effective tax rate but would have accelerated the payment of cash to the taxing authority to an earlier period.

The Company recognizes interest and penalties accrued related to the unrecognized tax benefits in the provision for income taxes. During the three months ended March 31, 2007, the Company recognized an insignificant amount in interest and penalties. The Company had approximately $0.3 million for the payment of interest and penalties accrued at March 31, 2007.

The Company believes that it is reasonably possible that the total amount of unrecognized tax benefits will change within twelve months of the date of adoption. The Company has certain tax return years subject to statutes of limitation which will close within twelve months of the date of adoption. Unless challenged by tax authorities, the closure of those statutes of limitation is expected to result in the recognition of uncertain tax positions in the amount of $0.2 million. The Company has uncertain tax positions relating to transfer pricing practices and filings in certain jurisdictions, none of which are currently under examination.

The Company and all of its subsidiaries file income tax returns in the U.S. federal jurisdiction and various states. The Company s foreign subsidiaries file income tax returns in certain foreign jurisdictions since they have operations outside the U.S. The Company and its subsidiaries are generally no longer subject to U.S. federal, state and local examinations by tax authorities for years before 2002.

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As of March 31, 2007 and December 31, 2006, the Company had deferred tax assets, net of deferred tax liabilities and valuation allowances, of $1.1 million and $1.0 million, respectively. Domestic net operating loss (NOL) carry forwards comprised $35.3 million of the deferred tax assets for both periods. Katy s history of operating losses in many of its taxing jurisdictions provides significant negative evidence with respect to the Company s ability to generate future taxable income, a requirement in order to recognize deferred tax assets on the Condensed Consolidated Balance Sheets. For this reason, the Company was unable to conclude at March 31, 2007 and December 31, 2006 that NOLs and other deferred tax assets in the United States and certain unprofitable foreign jurisdictions would be utilized in the future. As a result, valuation allowances for these entities were recorded as of such dates for the full amount of deferred tax assets, net of the amount of deferred tax liabilities.

The provision for income taxes for the three months ended March 31, 2007 and 2006 reflects current expense for state and foreign income taxes. Tax benefits were not recorded on the pre-tax net loss for the first quarter of 2007 as valuation allowances were recorded related to deferred tax assets created as a result of operating losses in the United States and certain foreign jurisdictions. As a result of accumulated operating losses in those jurisdictions, the Company has concluded that it was more likely than not that such benefits would not be realized.

(10) Commitments and Contingencies

General Environmental Claims

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

W.J. Smith Wood Preserving Company (W.J. Smith)

The W. J. Smith matter originated in the 1980s when the United States and the State of Texas, through the Texas Water Commission, initiated environmental enforcement actions against W.J. Smith alleging that certain conditions on the W.J. Smith property (the Property) violated environmental laws. In order to resolve the enforcement actions, W.J. Smith engaged in a series of cleanup activities on the Property and implemented a groundwater monitoring program.

In 1993, the EPA initiated a proceeding under Section 7003 of the Resource Conservation and Recovery Act (RCRA) against W.J. Smith and Katy. The proceeding sought certain actions at the site and at certain off-site areas, as well as development and implementation of additional cleanup activities to mitigate off-site releases. In December 1995, W.J. Smith, Katy and the EPA agreed to resolve the proceeding through an Administrative Order on Consent under Section 7003 of RCRA. While the Company has completed the cleanup activities required by the Administrative Order on Consent under Section 7003 of RCRA, the Company still has further obligations with respect to this matter in the areas of groundwater and land treatment unit monitoring and closure as well as ongoing site operation and maintenance costs.

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Since 1990, the Company has spent in excess of $7.0 million undertaking cleanup and compliance activities in connection with this matter. While ultimate liability with respect to this matter is not easy to determine, the Company has recorded and accrued amounts that it deems reasonable for prospective liabilities with respect to this matter.

Asbestos Claims

A. The Company has been named as a defendant in ten lawsuits filed in state court in Alabama by a total of approximately 324 individual plaintiffs. There are over 100 defendants named in each case. In all ten cases, the Plaintiffs claim that they were exposed to asbestos in the course of their employment at a former U.S. Steel plant in Alabama and, as a result, contracted mesothelioma, asbestosis, lung cancer or other illness. They claim that they were exposed to asbestos in products in the plant which were manufactured by each defendant. In eight of the cases, Plaintiffs also assert wrongful death claims. The Company will vigorously defend the claims against it in these matters. The liability of the Company cannot be determined at this time.

B. Sterling Fluid Systems (USA) has tendered over 2,086 cases pending in Michigan, New Jersey, New York, Illinois, Nevada, Mississippi, Wyoming, Louisiana, Georgia, Massachusetts and California to the Company for defense and indemnification. With respect to one case, Sterling has demanded that Katy indemnify it for a $200,000 settlement. Sterling bases its tender of the complaints on the provisions contained in a 1993 Purchase Agreement between the parties whereby Sterling purchased the LaBour Pump business and other assets from the Company. Sterling has not filed a lawsuit against Katy in connection with these matters.

The tendered complaints all purport to state claims against Sterling and its subsidiaries. The Company and its current subsidiaries are not named as defendants. The plaintiffs in the cases also allege that they were exposed to asbestos and products containing asbestos in the course of their employment. Each complaint names as defendants many manufacturers of products containing asbestos, apparently because plaintiffs came into contact with a variety of different products in the course of their employment. Plaintiffs claim that LaBour Pump and/or Sterling may have manufactured some of those products.

With respect to many of the tendered complaints, including the one settled by Sterling for $200,000, the Company has taken the position that Sterling has waived its right to indemnity by failing to timely request it as required under the 1993 Purchase Agreement. With respect to the balance of the tendered complaints, the Company has elected not to assume the defense of Sterling in these matters.

C. LaBour Pump Company, a former subsidiary of the Company, has been named as a defendant in over 364 similar cases in New Jersey. These cases have also been tendered by Sterling. The Company has elected to defend these cases, many of which have been dismissed or settled for nominal sums.

While the ultimate liability of the Company related to the asbestos matters above cannot be determined at this time, the Company has recorded and accrued amounts that it deems reasonable for prospective liabilities with respect to this matter.

Non-Environmental Litigation Banco del Atlantico, S.A.

Banco del Atlantico, S.A. v. Woods Industries, Inc., et al. Civil Action No. L-96-139 (now 1:03-CV-1342-LJM-VSS, *U.S. District Court, Southern District of Indiana).* The case against Woods Industries, Inc. (Woods) was dismissed by order of the District Court dated April 9, 2007. As reflected below, however, motions to reconsider and/or an appeal are likely, and certain disputes remain between Woods, Katy, and certain of Woods codefendants.

In December 1996, Banco del Atlantico (plaintiff), a bank located in Mexico, filed a lawsuit in Texas against Woods Industries, Inc., a subsidiary of Katy, and against certain past and/or then present officers, directors and owners of Woods (collectively, defendants). The plaintiff alleges that it was defrauded into making loans to a Mexican corporation controlled by certain past officers and directors of Woods based upon fraudulent representations and purported guarantees. Based on these allegations, and others, the plaintiff originally asserted claims for alleged violations of the federal Racketeer Influenced and Corrupt Organizations Act (RICO); money laundering of the proceeds of the illegal enterprise; the Indiana RICO and Crime Victims Act; common law fraud and conspiracy; and fraudulent transfer. The plaintiff also seeks recovery upon certain alleged guarantees purportedly executed by Woods Wire Products, Inc., a predecessor company from which Woods purchased certain assets in 1993 (prior to Woods s ownership by Katy, which began in December 1996). The primary legal theories under which the plaintiff seeks to hold Woods liable for its alleged damages are respondeat superior, conspiracy, successor liability, or a combination of

the three.

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The case was transferred from Texas to the Southern District of Indiana in 2003. In September 2004, the plaintiff and HSBC Mexico, S.A. (collectively, plaintiffs), who intervened in the litigation as an additional alleged owner of the claims against the defendants, filed a Second Amended Complaint.

On August 11, 2005, the Court dismissed *with prejudice* all of the federal and Indiana RICO claims asserted in the Second Amended Complaint against Woods. During subsequent discovery, Defendants moved for sanctions for the Plaintiffs asserted failures to abide by the rules of discovery and produce certain documents and witnesses, including the sanction of dismissal of the case *with prejudice*. Defendants also moved for summary judgment on the remaining claims on January 16, 2007. Plaintiffs also cross-moved for summary judgment in their favor on their claims under the alleged guarantees purportedly executed by old Woods Wire Products, Inc.

On April 9, 2007, while the parties summary judgment motions were still being briefed, the Court granted Defendants motion for sanctions and dismissed all of Plaintiffs claims *with prejudice*. The Court s dismissal order dismisses all remaining claims against Woods.

Katy expects Plaintiffs to request a reconsideration of and/or appeal the Court s dismissal orders, although no such request or notice of appeal has yet been filed. Plaintiffs claims as originally pled sought damages in excess of $24.0 million, requested that the Court void certain asset sales as purported fraudulent transfers (including the 1993 Woods Wire Products, Inc./Woods asset sale), and treble damages for some or all of their claims. Katy may have recourse against the former owners of Woods and others for, among other things, violations of covenants, representations and warranties under the purchase agreement through which Katy acquired Woods, and under state, federal and common law. Woods may also have indemnity claims against the former officers and directors. In addition, there is a dispute with the former owners of Woods regarding the final disposition of amounts withheld from the purchase price, which may be subject to further adjustment as a result of the claims by Plaintiffs. The extent or limit of any such adjustment cannot be predicted at this time.

While the ultimate liability of the Company related to this matter cannot be determined at this time, the Company has recorded and accrued amounts that it deems reasonable for prospective liabilities with respect to this matter.

Other Claims

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

Although management believes that the actions specified above in this section individually and in the aggregate are not likely to have outcomes that will have a material adverse effect on the Company s financial position, results of operations or cash flow, further costs could be significant and will be recorded as a charge to operations when, and if, current information dictates a change in management s estimates.

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(11) Industry Segment Information

The Company is organized into two operating segments: Maintenance Products and Electrical Products. The activities of the Maintenance Products Group include the manufacture and distribution of a variety of commercial cleaning supplies and consumer home products. The Electrical Products Group is a marketer and distributor of consumer electrical corded products. For all periods presented, information for the Maintenance Products Group excludes amounts related to the United Kingdom consumer plastics and Metal Truck Box business units as the units are classified as discontinued operations as discussed further in Note 13. The following table sets forth information by segment (amounts in thousands):

		As Restated, see Note 1 Three months ended March 31,	
		2007	2006
Maintenance Products Group			
Net external sales		$ 50,308	$ 49,973
Operating income		907	800
Operating margin		1.8%	1.6%
Depreciation and amortization		1,873	1,968
Capital expenditures		1,017	653
Electrical Products Group			
Net external sales		$ 44,495	$ 25,845
Operating (loss) income		(1,224)	59
Operating (deficit) margin		(2.8%)	0.2%
Depreciation and amortization		165	239
Capital expenditures		113	163
Total			
Net external sales	Operating segments	$ 94,803	$ 75,818
	Total	$ 94,803	$ 75,818
Operating loss	Operating segments	$ (317)	$ 859
	Unallocated corporate	(2,666)	(2,883)
	Severance, restructuring and related charges	(244)	(782)
	Gain (loss) on sale of assets	120	(102)
	Total	$ (3,107)	$ (2,908)
Depreciation and amortization	Operating segments	$ 2,038	$ 2,207
	Unallocated corporate	34	34
	Total	$ 2,072	$ 2,241
Capital expenditures	Operating segments	$ 1,130	$ 816

	Total	$ 1,130	$ 816

		March 31, 2007	December 31, 2006
Total assets	Maintenance Products Group	$ 98,454	$ 95,119
	Electrical Products Group	66,253	74,025
	Other [a]	2,217	6,700
	Unallocated corporate	4,681	6,850
	Total	$ 171,605	$ 182,694

[a] Amounts shown as Other represent items associated with Sahlman Holding Company, Inc., the Company s equity method investment in both periods. For December 31, 2006, amount also includes the real assets of the United Kingdom consumer plastics business unit, which is classified as an asset held for sale at December 31, 2006.

(12) 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, Missouri 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 the Company s various businesses as well as the markets in which they operate.

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A summary of charges by major initiative is as follows (amounts in thousands):

	Three Months Ended March 31,	
	2007	2006
Consolidation of St. Louis manufacturing/distribution facilities	$ 189	$ 699
Consolidation of Glit facilities	19	
Shutdown of Woods Canada manufacturing	36	
Corporate office relocation		83
Total severance, restructuring and related charges	$ 244	$ 782

Consolidation of St. Louis manufacturing/distribution facilities In 2002, the Company committed to a plan to consolidate the manufacturing and distribution of the four Continental Commercial Products, LLC (CCP) facilities in the St. Louis, Missouri area. Management believed that in order to implement a more competitive cost structure and combat competitive pricing pressure, the excess capacity at the Company s four plastic molding facilities in this area would need to be eliminated. This plan was expected to be completed by the end of 2003; however, charges have been incurred past 2003 due to changes in assumptions in non-cancelable lease accruals. Charges in 2007 were for an adjustment to the non-cancelable lease accrual at the Hazelwood, Missouri facility due to changes on the estimates for insurance and maintenance costs. Charges in 2006 were for an adjustment to the non-cancelable lease accrual at the Hazelwood, Missouri facility due to the execution of a sublease on the property. Management believes that no further charges will be incurred for this activity, except for potential adjustments to non-cancelable lease liabilities. Following is a rollforward of restructuring liabilities by type for the consolidation of St. Louis manufacturing/distribution facilities (amounts in thousands):

	Contract Termination Costs [b]
Restructuring liabilities at December 31, 2006	$ 465
Additions	189
Payments	(223)
Restructuring liabilities at March 31, 2007	$ 431

Consolidation of Glit facilities In 2002, the Company approved a plan to consolidate the manufacturing facilities of its Glit business unit in order to implement a more competitive cost structure. It was anticipated that this activity would begin in early 2003 and be completed by the end of the second quarter of 2004. Due to numerous operational issues, including management turnover and a small fire at the Wrens, Georgia facility, the completion of this consolidation was delayed. In 2007, the Company began the process of closing the Washington, Georgia facility. Charges were incurred in 2007 associated with severance for terminations at the Washington, Georgia facility. Management believes that no further charges will be incurred for this activity. Following is a rollforward of restructuring liabilities by type for the consolidation of Glit facilities (amounts in thousands):

	Total	One-time Termination Benefits [a]	Contract Termination Costs [b]
Restructuring liabilities at December 31, 2006	$ 5	$	$ 5
Additions	19	19	
Payments	(24)	(19)	(5)

Restructuring liabilities at March 31, 2007	$	$	$

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Shutdown of Woods Canada manufacturing In 2003, the Company approved a plan to shut down the manufacturing operation in Toronto, Ontario and source substantially all of its products from Asia. Management believed that this action was necessary in order to implement a more competitive cost structure to combat pricing pressure by producers in Asia. In connection with this shutdown, the Company also anticipated the sale and leaseback of this facility, which would provide additional liquidity. In December 2003, Woods Canada closed this manufacturing facility in Toronto, Ontario, but was unable to complete the sale/leaseback transaction at that time. Accordingly, the charge for the non-cancelable lease accrual was recorded in the first quarter of 2004, upon the completion of the sale/leaseback transaction. The idle capacity was a direct result of the elimination of the manufacturing function from this facility. A portion of the facility was available for sublease at the time the accrual was established. Charges in 2007 were for an adjustment to the non-cancelable lease accruals. Management believes that no more costs will be incurred for this activity, except for potential adjustments to non-cancelable lease liabilities. Following is a rollforward of restructuring liabilities by type for the shutdown of Woods Canada manufacturing (amounts in thousands):

	Contract Termination Costs [b]
Restructuring liabilities at December 31, 2006	$ 491
Additions	36
Payments	(67)
Restructuring liabilities at March 31, 2007	$ 460

Corporate office relocation In November 2005, the Company announced the closing of its corporate office in Middlebury, Connecticut, and the relocation of certain corporate functions to the CCP location in Bridgeton, Missouri, the outsourcing of other functions, and the move of the remaining functions to a new location in Arlington, Virginia. The amounts recorded in 2006 primarily relate to severance for employees at the Middlebury office. There was no activity for this initiative during the first quarter of 2007.
The table below details activity in restructuring reserves since December 31, 2006 (amounts in thousands):

	Total	One-time Termination Benefits [a]	Contract Termination Costs [b]
Restructuring liabilities at December 31, 2006	$ 961	$	$ 961
Additions	244	19	225
Payments	(314)	(19)	(295)
Restructuring liabilities at March 31, 2007 [c]	$ 891	$	$ 891

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

[b] Includes charges related to

non-cancelable lease liabilities for abandoned facilities, net of potential sub-lease revenue. Total maximum potential amount of lease loss, excluding any sublease rentals, is $1.7 million as of March 31, 2007. The Company has included $0.8 million as an offset for sublease rentals.

[c] Katy expects to substantially complete its current restructuring programs in 2007. The remaining severance, restructuring and related costs for these initiatives are expected to be approximately $0.3 million.

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The table below details activity in restructuring reserves by operating segment since December 31, 2006 (amounts in thousands):

	Total	Maintenance Products Group	Electrical Products Group
Restructuring liabilities at December 31, 2006	$ 961	$ 470	$ 491
Additions	244	208	36
Payments	(314)	(247)	(67)
Restructuring liabilities at March 31, 2007	$ 891	$ 431	$ 460

The table below summarizes the future payments for severance, restructuring and other related charges by operating segment detailed above (amounts in thousands):

	Total	Maintenance Products Group	Electrical Products Group
2007	$ 325	$ 148	$ 177
2008	341	99	242
2009	98	57	41
2010	61	61	
2011	66	66	
Thereafter			
Total Payments	$ 891	$ 431	$ 460

(13) Discontinued Operations

Two of Katy s operations have been classified as discontinued operations for the quarters ended March 31, 2007 and 2006 in accordance with SFAS No. 144, *Accounting for the Impairments or Disposal of Long Lived Assets* (SFAS No. 144).

On June 2, 2006, the Company sold certain assets of the Metal Truck Box business unit within the Maintenance Products Group for gross proceeds of $3.6 million, including a $1.2 million note receivable. These proceeds were used to pay off related portions of the Term Loan and the Revolving Credit Facility. The Company recorded a loss of $50 thousand in 2006 in connection with this sale. Management and the board of directors determined that this business is not a core component of the Company s long-term business strategy.

On November 27, 2006, the Company sold its United Kingdom consumer plastics business unit (excluding the related real estate holdings) for gross proceeds of approximately $3.0 million. These proceeds were used to pay off related portions of the Term Loan and the Revolving Credit Facility. The Company recorded a loss of $5.4 million in the third and fourth quarters of 2006 in connection with this sale. During the first quarter of 2007, the Company incurred an additional $0.2 million loss as a result of finalizing the working capital adjustment. Management and the board of directors determined that this business is not a core component of the Company s long-term business strategy.

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The Company did not separately identify the related assets and liabilities of the Metal Truck Box business unit and the United Kingdom consumer plastics business unit on the Condensed Consolidated Balance Sheets, except for the Asset Held for Sale. Following is a summary of the major asset and liability categories for these discontinued operations:

	As Restated, see Note 1 March 31, 2007	December 31, 2006
Current assets:		
Accounts receivable, net	$	$ 83
	$	$ 83
Current liabilities:		
Accrued expenses	492	743
	$ 492	$ 743

As of December 31, 2006, the Company was in the process of selling the related real estate holdings of the United Kingdom consumer plastics business unit. As a result, the real estate holdings were classified as an asset held for sale on the Condensed Consolidated Balance Sheets in accordance with SFAS No. 144. Accordingly, the carrying value of the business unit s net assets was adjusted to the lower of its costs or its fair value less costs to sell, amounting to $4.5 million. Costs to sell include the incremental direct costs to complete the sale and represent costs such as broker commissions, legal and other closing costs. The transaction on the sale of the real estate holdings was completed on January 9, 2007 and resulted in a gain of approximately $1.9 million.

The historical operating results of the United Kingdom consumer plastics business unit and the Metal Truck Box business unit have been segregated as discontinued operations on the Condensed Consolidated Statements of Operations. Selected financial data for discontinued operations is summarized as follows (in thousands):

	As Restated, see Note 1 Three months ended March 31, 2007	2006
Net sales	$	$ 8,078
Pre-tax operating loss	$	$ (399)
Pre-tax gain on sale of discontinued businesses	$ 1,666	$

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Item 2. 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 the three months ended March 31, 2007 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. For additional information on the restatement, refer to the Company s Annual Report on Form 10-K/A filed on August 17, 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 $0.1 million and $0.2 million for the three months ended March 31, 2007 and 2006, respectively, which is allocated entirely to loss from continuing operations.

Refer to Note 1 of the Consolidated Financial Statements for additional discussion related to the effects of the restatement.

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RESULTS OF OPERATIONS
Three Months Ended March 31, 2007 versus Three Months Ended March 31, 2006

	As Restated, see Note 1			
	2007		2006	
	(Amounts in Millions, Except Per Share Data)			
	$	% to Sales	$	% to Sales
Net sales	$ 94.8	100.0	$ 75.8	100.0
Cost of goods sold	86.4	91.1	65.5	86.5
Gross profit	8.4	8.9	10.3	13.5
Selling, general and administrative expenses	11.4	12.1	12.3	16.2
Severance, restructuring and related charges	0.2	0.2	0.8	1.0
(Gain) loss on sale of assets	(0.1)	(0.1)	0.1	0.1
Operating loss	(3.1)	(3.3)	(2.9)	(3.8)
Interest expense	(2.0)		(1.8)	
Other, net	0.1		0.3	
Loss from continuing operations before provision for income taxes	(5.0)		(4.4)	
Provision for income taxes from continuing operations	(0.5)		(0.2)	
Loss from continuing operations	(5.5)		(4.6)	
Loss from operations of discontinued businesses (net of tax)			(0.3)	
Gain on sale of discontinued businesses (net of tax)	1.7			
Loss before cumulative effect of a change in accounting principle	(3.8)		(4.9)	
Cumulative effect of a change in accounting principle (net of tax)			(0.8)	
Net loss	$ (3.8)		$ (5.7)	
Loss per share of common stock basic and diluted:				
Loss from continuing operations	$ (0.69)		$ (0.57)	
Discontinued operations	0.21		(0.05)	
Cumulative effect of a change in accounting principle			(0.10)	

Net loss	$ (0.48)	$ (0.72)

Overview

Our consolidated net sales for the three month period ending March 31, 2007 increased $19.0 million compared to the three month period ending March 31, 2006. The increase in net sales of 25% was comprised of higher volumes of 16%, higher pricing of 8% and favorable foreign currency translation of 1%. Gross margins were 8.9% for the three month period ending March 31, 2007, a decrease of 4.6 percentage points compared to the three month period ending March 31, 2006. In 2007, higher raw material costs and our inability to recover these costs from customers within our Electrical Products Group even though major price increases were implemented adversely impacted gross margin levels. Selling, general and administrative expense (SG&A) as a percentage of sales decreased to 12.1% for the first quarter of 2007 from 16.2% in the first quarter of 2006, primarily due to the cost improvements implemented throughout 2006 and the fixed nature of these expenses as a percentage of net sales. The operating loss of ($3.1) million was comparable to the operating loss of ($2.9) million in 2006 due to the factors noted above.

Results within both periods presented reflect the activity of our discontinued businesses units: United Kingdom consumer plastics and Metal Truck Box as discontinued operations. During the three month period ending March 31, 2006, we reported a cumulative effect of a change in accounting principle of ($0.8) million [($0.10) per share] associated with the adoption, effective January 1, 2006, of SFAS No. 123R. Overall, we reported a net loss of ($3.8) million [($0.48) per share] for the three month period ending March 31, 2007, versus a net loss of ($5.7) million [($0.72) per share] in the same period of 2006.

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Net Sales

Maintenance Products Group

Net sales from the Maintenance Products Group of $50.3 million during the three month period ending March 31, 2007 were comparable to net sales of $50.0 million during the three month period ending March 31, 2006. Overall, this increase of 1% was due to lower volumes of 2% offset by higher pricing of 2% and foreign currency translation of 1%. Sales activity for the Contico business unit continues to be impacted by reduced volumes. In addition, lower sales volume present for the other business units selling into the janitorial markets were offset by improved volume at our Glit business unit.

Higher pricing resulted from the implementation of selling price increases across the Maintenance Products Group, most of which took effect 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 increased from $25.8 million for the three month period ending March 31, 2006 to $44.5 million for the three month period ending March 31, 2007. The increase in sales of 72% was a result of higher volume of 52% and higher pricing of 20%. Volume in the first quarter of 2007 in the U.S. was positively impacted by activity with its major customers. Sales in 2006 were adversely impacted by the absence of activity given the inventory positions of certain customers and the related reduced orders. Multiple selling price increases were implemented throughout 2006 to try to offset the rising cost of copper and polyvinyl chloride.

Operating Income (Loss)

As Restated, see Note 1
Three months ended March 31,
(Amounts in Millions)

	2007		2006		Change	
	$	% Margin	$	% Margin	$	% Margin
Maintenance Products Group	$ 0.9	1.8	$ 0.8	1.6	$ 0.1	0.2
Electrical Products Group	(1.2)	(2.8)	0.1	0.2	(1.3)	(3.0)
Unallocated corporate expense	(2.7)		(2.9)		0.2	
	(3.0)	(3.1)	(2.0)	(2.7)	(1.0)	(0.4)
Severance, restructuring and related charges	(0.2)		(0.8)		0.6	
Gain (loss) on sale of assets	0.1		(0.1)		0.2	
Operating loss	$ (3.1)	(3.3)	$ (2.9)	(3.8)	$ (0.2)	0.5

Maintenance Products Group

The Maintenance Products Group s operating income for the three month period ending March 31, 2007 was $0.9 million (1.8% of net sales) compared to operating income of $0.8 million (1.6% of net sales) for the three month period ending March 31, 2006. Overall performance of the group was comparable to prior year given the relatively stable sales activity.

Electrical Products Group

The Electrical Products Group s operating income decreased from $0.1 million (0.2% of net sales) for the three month period ending March 31, 2006 to an operating loss of ($1.2) million ((2.8)% of net sales) for the three month period ending March 31, 2007. The decrease in profitability was primarily due to the increased costs of copper, our primary raw material, and our inability to recover all of these cost increases from customers. The three months ended March 31, 2007 operating loss includes an adjustment of approximately $2.4 million associated with the net realizable

value and potential obsolescence of inventory. The adjustment was made due to the on-going volatility of copper costs.

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Corporate

Corporate operating expenses decreased from $2.9 million in the three month period ending March 31, 2006 to $2.7 million in the three month period ending March 31, 2007 principally due to variation of compensation expense recognized for stock options and SARs. During the first quarter of 2006, the Company recognized $0.3 million in compensation expense associated with SARs. In 2007, we recognized income associated with SARs of $0.2 million as a result of Katy s reduced stock price impacting the valuation of SARs.

Severance, Restructuring and Related Charges

Operating results for the Company during the three months ended March 31, 2007 and 2006 were impacted by severance, restructuring and related charges of $0.2 million and $0.8 million, respectively. Charges in 2007 related to changes in lease assumptions for abandoned facilities. Charges in 2006 related to changes in lease assumptions for an abandoned facility upon the execution of a sublease ($0.7 million) with the remaining charges primarily related to the relocation of the corporate headquarters.

Other Items

Interest expense increased by $0.2 million in the first quarter of 2007 versus the same period of 2006, primarily from the write-off of debt issuance costs as a result of reducing the Revolving Credit Facility under the Bank of America Credit Agreement from $90.0 million to $80.0 million. Overall, average borrowing levels were lower in 2007 compared to 2006; however, this impact was offset by higher interest rates. Other, net for the three months ended March 31, 2006 included gain on foreign currency transactions.

The provision for income taxes for the three months ended March 31, 2007 and 2006 reflects current expense for state and foreign income taxes. Tax benefits were not recorded on the pre-tax net loss for the first quarter of 2007 and 2006 as valuation allowances were recorded related to deferred tax assets created as a result of operating losses in the United States and certain foreign jurisdictions.

Gain on sale of discontinued businesses in the first quarter of 2007 reflects the sale of our real estate holdings of the United Kingdom consumer plastics business unit. We recorded a $1.9 million gain on this sale which was offset by a $0.2 million loss resulting from the final working capital adjustment for the United Kingdom consumer plastics business unit. For the first quarter of 2006, loss from operations of discontinued businesses reflects the activity for the United Kingdom consumer plastics business unit and the Metal Truck Box business unit, which were sold in 2006.

Effective January 1, 2006, the Company adopted SFAS No. 123R. As a result, a cumulative effect of this adoption of $0.8 million was recognized associated with the fair value of all vested SARs. See Note 1 to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for a discussion of the cumulative effect of a change in accounting principle.

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 March 31, 2007, we had cash and cash equivalents of $2.9 million versus cash and cash equivalents of $7.4 million at December 31, 2006. Also as of March 31, 2007, we had outstanding borrowings of $54.5 million [60% of total capitalization], under the Bank of America Credit Agreement, as defined below, with unused borrowing availability on the Revolving Credit Facility, as defined below, of $14.2 million. As of December 31, 2006, we had outstanding borrowings of $56.9 million [58% of total capitalization]. We used $5.0 million of cash in operations during the quarter ended March 31, 2007 versus using $6.9 million of cash in operations during the quarter ended March 31, 2006. Cash flow use in 2007 was lower than in 2006 primarily due to the improvement in working capital levels.

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We have a number of obligations and commitments, which are listed on the schedule later in this section entitled Contractual 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. However, the Company may not be able to secure liquidity through the sale of assets on favorable terms or at all.

Bank of America Credit Agreement

On April 20, 2004, the Company completed a refinancing of its outstanding indebtedness (the Refinancing) and entered into a new agreement with Bank of America Business Capital (the Bank of America Credit Agreement). The current Bank of America Credit Agreement, as amended is a $93.0 million facility with a $13.0 million term loan (Term Loan) and a $80.0 million revolving credit facility (Revolving Credit Facility). The Bank of America Credit Agreement is an asset-based lending agreement and involves a syndicate of four banks.

The Revolving Credit Facility has an expiration date of April 20, 2009 and its borrowing base is determined by eligible inventory and accounts receivable. Unused borrowing availability on the Revolving Credit Facility was $14.2 million at March 31, 2007. All extensions of credit under the Bank of America Credit Agreement are collateralized by a first priority security interest in and lien upon the capital stock of each material domestic subsidiary (65% of the capital stock of each material foreign subsidiary), and all present and future assets and properties of Katy. The Term Loan also has a final maturity date of April 20, 2009 with quarterly payments of $0.4 million, as amended and 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 the Company s property, plant and equipment.

The Company s 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 the Company conducts 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, the Company s largest letters of credit relate to its casualty insurance programs. At March 31, 2007, total outstanding letters of credit were $6.6 million.

On March 8, 2007 the Company obtained the Eighth Amendment to the Bank of America Credit Agreement. 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 (eligible collateral base less outstanding borrowings and letters of credit) 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 from that point through December 2007. Thereafter, the Company is required to maintain a minimum level of availability such that eligible collateral must exceed the sum of its outstanding borrowings and letters of credit by at least $5.0 million for the first three quarters of the year and $7.5 million for the fourth quarter. In addition, the Company reduced its Revolving Credit Facility from $90.0 million to $80.0 million.

If the Company is unable to comply with the terms of the amended covenants, it could seek to obtain further amendments and pursue increased liquidity through additional debt financing and/or the sale of assets. It is possible, however, the Company may not be able to obtain further amendments from the lender or secure additional debt financing or liquidity through the sale of assets on favorable terms or at all. However, the Company believes that it will be able to comply with all covenants, as amended, throughout 2007.

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Effective since April 2005, interest rate margins have been set at the largest margins set forth in the Bank of America Credit Agreement, 275 basis points over applicable LIBOR rates for Revolving Credit Facility borrowings and 300 basis points over LIBOR for borrowings under the Term Loan. In accordance with the Bank of America Credit Agreement, margins on the Term Loan will drop an additional 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 March 31, 2007.

Effective August 17, 2005, the Company entered into a two-year interest rate swap on a notional amount of $25.0 million in the first year and $15.0 million in the second year. The purpose of the swap was to limit the Company s exposure to interest rate increases on a portion of the Revolving Credit Facility over the two-year term of the swap. The fixed interest rate under the swap at March 31, 2007 and over the life of the agreement is 4.49%.

All of the debt under the Bank of America Credit Agreement is re-priced to current rates at frequent intervals. Therefore, its fair value approximates its carrying value at March 31, 2007. In each of the three months ended March 31, 2007 and 2006, the Company had amortization of debt issuance costs, included within interest expense, of $0.6 million and $0.3 million, respectively. Included in amortization of debt issuance costs is approximately $0.3 million in the three months ended March 31, 2007 of debt issuance costs written off due to the reduction in the Revolving Credit Facility on March 8, 2007. In addition, the Company incurred $0.1 million and $0.2 million associated with amending the Bank of America Credit Agreement, as discussed above, in the three months ended March 31, 2007 and 2006, 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*. The Company does not expect to repay, or be required to repay, within one year, the balance of the Revolving Credit Facility classified as a current liability. The MAE clause, which is a fairly typical requirement in commercial credit agreements, allows the lenders to require the loan to become due if they determine there has been a material adverse effect on the Company s operations, business, properties, assets, liabilities, condition, or prospects. The classification of the Revolving Credit Facility as a current liability is a result only of the combination of the lockbox agreements and MAE clause. The Revolving Credit Facility does not expire or have a maturity date within one year, but rather has a final expiration date of April 20, 2009. The lender had not notified the Company of any indication of a MAE at March 31, 2007, and the Company was not in default of any provision of the Bank of America Credit Agreement at March 31, 2007.

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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 March 31, 2007, are summarized below (in thousands of dollars):

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]	$ 41,491	$ 41,491	$	$	$
Term Loan	12,968	1,500	11,468		
Interest on debt [b]	8,861	4,379	4,482		
Operating leases [c]	20,366	7,751	9,423	2,668	524
Severance and restructuring [c]	521	148	265	108	
Postretirement benefits [d]	5,807	694	1,498	1,194	2,421
Total Contractual Obligations	$ 90,014	$ 55,963	$ 27,136	$ 3,970	$ 2,945

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	$ 664	$ 664	$	$	$
Stand-by letters of credit	5,949	5,949			
Total Commercial Commitments	$ 6,613	$ 6,613	$	$	$

[a] As discussed in the Liquidity and Capital Resources section above and in Note 6 to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q, the entire Revolving Credit Facility under the Bank of America Credit Agreement is classified as a current liability on the Condensed 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 Condensed Consolidated Balance Sheets at March 31, 2007 includes $0.9 million in discounted liabilities associated with non-cancelable operating lease

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

[d] Benefits consist 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.

Off-balance Sheet Arrangements

Not applicable.

Cash Flow

Liquidity was positively impacted during the first quarter of 2007 as a result of the sale of the real estate holdings of the United Kingdom consumer plastics business unit for approximately $6.6 million. We used $5.0 million of operating cash compared to using $6.9 million of operating cash during the first quarter of 2006. Debt obligations at March 31, 2007 decreased $2.4 million from December 31, 2006, primarily the result of the above proceeds from the sale of real estate offsetting any seasonal working capital requirements.

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Operating Activities

Cash flow used in operating activities before changes in operating assets was $2.9 million in the first quarter of 2007 versus $1.8 million in the first quarter of 2006. While we had net losses in both periods, these amounts included non-cash items such as depreciation, amortization and amortization of debt issuance costs. We used $2.0 million of cash related to operating assets and liabilities during the three months ended March 31, 2007 versus $5.6 million during the three months ended March 31, 2006. Our operating cash flow was positively impacted in the first quarter of 2007 by improvements in working capital performance. During the first quarter of 2007, we were turning our inventory at 6.0 times per year versus 4.4 times per year during the first quarter of 2006.

Investing Activities

Capital expenditures totaled $1.1 million during the three months ended March 31, 2007 as compared to $0.8 million during the three months ended March 31, 2006. Anticipated capital expenditures in 2007 are expected to be comparable to 2006. In addition, cash flows from investing activities reflect proceeds from the sale of a discontinued business for $6.6 million.

Financing Activities

Overall, debt decreased $2.4 million during the three months ended March 31, 2007 versus an increase of $7.8 million during the three months ended March 31, 2006, primarily relating to the levels of accounts payable during these time periods. Direct debt costs totaling $0.1 million and $0.2 million in the first quarter of 2007 and 2006, respectively, represents a fee paid to our lenders in connection with the amendments made to the Bank of America Credit Agreement.

STOCK EXCHANGE LISTING

On April 9, 2007, the Company announced that the New York Stock Exchange (NYSE) would suspend trading of the Company s shares of common stock due to noncompliance with the continuing listing standards of the NYSE. The Company did not meet the required market capitalization level of $75.0 million over a consecutive thirty day trading period or the required total stockholders equity of not less than $75.0 million. The shares of Katy were suspended from trading on the NYSE at the close of business on April 12, 2007. With the expectation that the NYSE would delist the Company s shares, the Company pursued conducting the trading of its shares on another exchange or quotation system. On April 16, 2007, the Company announced that its shares of common stock began trading on the OTC Bulletin Board, effective immediately, under the ticker symbol KATY.

SEVERANCE, RESTRUCTURING AND RELATED CHARGES

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.

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A summary of charges by major initiative is as follows (amounts in thousands):

	Three Months Ended March 31,	
	2007	2006
Consolidation of St. Louis manufacturing/distribution facilities	$ 189	$ 699
Consolidation of Glit facilities	19	
Shutdown of Woods Canada manufacturing	36	
Corporate office relocation		83
Total severance, restructuring and related charges	$ 244	$ 782

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

	Total Expected Cost	Total Provision to Date
Maintenance Products Group	$ 21,301	$ 21,001
Electrical Products Group	12,683	12,683
Corporate	12,290	12,290
	$ 46,274	$ 45,974

A rollforward of all restructuring and related reserves since December 31, 2006 is as follows (amounts in thousands):

	Total	One-time Termination Benefits [a]	Contract Termination Costs [b]
Restructuring liabilities at December 31, 2006	$ 961	$	$ 961
Additions	244	19	225
Payments	(314)	(19)	(295)
Restructuring liabilities at March 31, 2007 [c]	$ 891	$	$ 891

[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 $1.7 million as of March 31, 2007. We have included $0.8 million as an offset for sublease rentals.

[c] Katy expects to substantially complete its current restructuring programs in 2007. 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 12 to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for a discussion of severance, restructuring and related charges.

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OUTLOOK FOR 2007

We experienced lower sales performance during 2006 from the Electrical Products Group as well as lower volumes in our Contico and Glit business units. Price increases were passed along to our Electrical Products Group customers during 2006 as a result of the rise in copper prices in the last two years; however, pricing pressure is anticipated given the volatility in copper pricing over the last twelve months. Despite the net sales increase in the first quarter, we anticipate a further reduction in net sales from the Electrical Products Group 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 has executed 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 mid-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 within our Electrical Products Group. Prices for copper increased in late 2003 and continued through 2006. Copper prices remain and expect to be volatile over the remainder of 2007. 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 in other costs such as packaging materials, utilities and freight. In a climate of rising raw material costs, 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. We have and expect to continue 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. Under the Bank of America Credit Agreement, as amended, the Company s interest rate margins on all of our outstanding borrowings and letters of credit are at the highest levels set forth in the Bank of America Credit Agreement.

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.

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Our financial performance benefited from favorable currency translation as the Canadian dollar and British pound strengthened throughout 2006 and first quarter of 2007 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 for the remainder of 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.

The Company was in compliance with the covenants of the Bank of America Credit Agreement as of December 31, 2006. Nevertheless, on March 8, 2007, the Company obtained the Eighth Amendment to the Bank of America Credit Agreement. 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 (eligible collateral base less outstanding borrowings and letters of credit) 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 from that point 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. However, the Company may not be able to secure liquidity through the sale of assets on favorable terms or at all.

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.

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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.

ENVIRONMENTAL AND OTHER CONTINGENCIES

See Note 10 to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for a discussion of environmental and other contingencies.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

See Note 3 to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for a discussion of recently issued accounting pronouncements.

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CRITICAL ACCOUNTING POLICIES

We disclosed details regarding certain of our critical accounting policies in the Management s Discussion and Analysis section of our Annual Report on Form 10-K for the year ended December 31, 2006 (Part II, Item 7). There have been no changes to policies as of March 31, 2007, except for the adoption of FIN 48.

The Company adopted FIN No. 48 on January 1, 2007. As a result of the implementation of FIN No. 48, the Company recognized approximately a $1.1 million increase in the liability for unrecognized tax benefits, which was accounted for as an increase of $0.1 million to the January 1, 2007 balance of deferred tax assets and a reduction of $1.0 million to the January 1, 2007 balance of retained earnings.

Item 3. 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 March 31, 2007 and over the life of the agreement is 4.49%. Our interest obligations on outstanding debt at March 31, 2007 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 Sixth Amendment to the Bank of America Credit Agreement, our exposures to interest rate risks could be material to our financial position or results of operations. For example, a 1% increase in the interest rate of the Bank of America Credit Agreement would increase our annual interest expense by approximately $0.4 million.

Foreign Exchange Risk

We are exposed to fluctuations in the Euro, British pound, Canadian dollar and Chinese Renminbi. Some of our subsidiaries make significant U.S. dollar purchases from Asian suppliers, particularly in China. 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 March 31, 2007 is $9.1 million. A 10% change in foreign currency exchange rates would amount to $0.9 million change in our net investment in foreign subsidiaries at March 31, 2007.

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 Management s Discussion and Analysis of Financial Condition and Results of Operations Outlook for 2007 in Part I, Item 2 of this Quarterly Report on Form 10-Q, for further discussion of our exposure to increasing raw material costs.

Item 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our filings with the Securities and Exchange Commission (SEC) is reported within the time periods specified in the SEC s rules, and that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

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Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, Katy carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period of our report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective at the reasonable assurance level because of the identification of material weaknesses in our internal control over financial reporting described further below.

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 one of the Company s wholly-owned subsidiaries.

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 quantity of 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.

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. 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.

The Company believes the above errors resulted from the following material weaknesses in internal control over financial reporting:

- The Company did not maintain a proper level of segregation of duties, specifically the verification process of physical raw material inventory on hand and the operational handling of this inventory; and

- The Company did not maintain sufficient oversight of the raw material inventory counting and reconciliation process.

As discussed below, 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 inventory and cost of goods sold, which could result in a material misstatement to the annual or interim consolidated financial statements that could not be prevented or detected. Accordingly, management determined that these control deficiencies represented material weaknesses in internal control over financial reporting.

Remediation of Material Weaknesses

The Company has undertaken the following steps during the second and third quarters of 2007 to address the above material weaknesses within our internal controls over physical counting of inventory:

- Completed a full resin physical inventory by independent employees not involved in the operational handling and reporting of resin inventory;

- Completed a full comparison of the physical resin inventory to the general ledger and recorded the appropriate adjustment;

- Verified the automated measurement systems with third parties as well as the physical observation of the resin inventory by independent employees;

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Initiated weekly physical counts of resin inventory and completed a comparison to the perpetual inventory system for any differences with any significant differences investigated by management. We will continue to perform these weekly physical counts until management believes the process and related controls are operating as designed; and

Reviewed and adjusted, as necessary, procedures and personnel involved in the physical inventory counting of resin.

Management and the Board of Directors are committed to the remediation and continued improvement of our internal control over financial reporting. We have dedicated and will continue to dedicate significant resources to this remediation effort and believe that we have made significant progress in reestablishing effective internal controls over financial reporting associated with the above raw material inventory counting process.

(b) Change in Internal Controls

There have been no changes in Katy s internal control over financial reporting during the quarter ended March 31, 2007 that has materially affected, or is reasonably likely to materially affect Katy s internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Except as otherwise noted in Note 10 to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q, during the quarter for which this report is filed, there have been no material developments in previously reported legal proceedings, and no other cases or legal proceedings, other than ordinary routine litigation incidental to the Company s business and other nonmaterial proceedings, were brought against the Company.

Item 1A. RISK FACTORS

We are affected by risks specific to us as well as factors that affect all businesses operating in a global market. The significant factors known to us that could materially adversely affect our business, financial condition, or operating results are described in our most recently filed Annual Report on Form 10-K (Item 1A of Part I). There has been no material change in those risk factors, other than the following additional risk factor:

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.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On April 20, 2003, the Company announced a plan to spend up to $5.0 million to repurchase shares of its common stock. The Company suspended purchases under the plan on May 10, 2004. On December 5, 2005, we announced the resumption of the plan. During the three months ended March 31, 2007 and 2006, the Company purchased 1,300 shares and 1,200 shares, respectively, of common stock on the open market for less than $0.1 million.

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Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

The Company has filed a Proxy Statement pursuant to Section 14(a) of the Securities Exchange Act of 1934 in advance of our Annual Meeting of Shareholders to be held on Thursday, May 31, 2007.

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS

31.1 CEO Certification pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 CFO Certification pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 CEO Certification required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 CFO Certification required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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Signatures

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

KATY INDUSTRIES, INC.
Registrant

DATE: August 17, 2007

By: /s/ Anthony T. Castor III
Anthony T. Castor III
President and Chief Executive Officer

By: /s/ Amir Rosenthal
Amir Rosenthal
Vice President, Chief Financial Officer,
General Counsel and Secretary

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Exhibit Index

Exhibit No.	Description
31.1	CEO Certification pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	CFO Certification pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	CEO Certification required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	CFO Certification required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.