

KATY INDUSTRIES INC
Form 10-Q
May 16, 2011

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

FORM 10-Q

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

For the quarterly period ended: April 1, 2011

Or

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

For the transition period from _____ to _____

Commission File Number 001-05558

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

Delaware
(State or other jurisdiction of incorporation or
organization)

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

305 Rock Industrial Park Drive, Bridgeton, Missouri 63044
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (314) 656-4321

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

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer,

Edgar Filing: KATY INDUSTRIES INC - Form 10-Q

or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐

No ☒

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

Class
Common Stock, \$1 Par Value

Outstanding at April 29, 2011
7,951,176 Shares

KATY INDUSTRIES, INC.
FORM 10-Q
April 1, 2011

INDEX

	Page
<u>PART I FINANCIAL INFORMATION</u>	
<u>Item 1.</u>	
<u>Financial Statements:</u>	
<u>Condensed Consolidated Balance Sheets</u> <u>April 1, 2011 (unaudited) and December 31, 2010</u>	<u>3,4</u>
<u>Condensed Consolidated Statements of Operations</u> <u>For the Three Months Ended April 1, 2011 and April 2, 2010</u> <u>(unaudited)</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows</u> <u>For the Three Months Ended April 1, 2011 and April 2, 2010</u> <u>(unaudited)</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u> <u>(unaudited)</u>	<u>7</u>
<u>Item 2.</u>	
<u>Management's Discussion and Analysis of Financial Condition</u> <u>and</u> <u>Results of Operations</u>	<u>17</u>
<u>Item 4.</u>	
<u>Controls and Procedures</u>	<u>21</u>
<u>PART II OTHER INFORMATION</u>	<u>23</u>
<u>Item 1.</u>	
<u>Legal Proceedings</u>	<u>23</u>
<u>Item 1A.</u>	
<u>Risk Factors</u>	<u>23</u>
<u>Item 2.</u>	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>23</u>
<u>Item 3.</u>	
<u>Defaults Upon Senior Securities</u>	<u>23</u>
<u>Item 4.</u>	
<u>(REMOVED AND RESERVED)</u>	<u>23</u>
<u>Item 5.</u>	
<u>Other Information</u>	<u>23</u>
<u>Item 6.</u>	
<u>Exhibits</u>	<u>23</u>

Signatures

24

[index](#)

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

KATY INDUSTRIES, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS
 AS OF APRIL 1, 2011 (UNAUDITED) AND DECEMBER 31, 2010
 (Amounts in Thousands)

ASSETS

	April 1, 2011	December 31, 2010
CURRENT ASSETS:		
Cash	\$490	\$1,319
Accounts receivable, net	15,180	13,541
Inventories, net	16,714	16,450
Other current assets	1,721	1,512
Total current assets	34,105	32,822
OTHER ASSETS:		
Goodwill	665	665
Intangibles, net	3,416	3,530
Other	2,972	3,160
Total other assets	7,053	7,355
PROPERTY AND EQUIPMENT		
Land and improvements	336	336
Buildings and improvements	9,365	9,243
Machinery and equipment	89,860	90,945
	99,561	100,524
Less - Accumulated depreciation	(77,794)	(77,807)
Property and equipment, net	21,767	22,717
Total assets	\$62,925	\$62,894

See Notes to Condensed Consolidated Financial Statements.

[index](#)

KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
AS OF APRIL 1, 2011 (UNAUDITED) AND DECEMBER 31, 2010
(Amounts in Thousands, Except Share Data)

LIABILITIES AND STOCKHOLDERS' EQUITY

	April 1, 2011	December 31, 2010
CURRENT LIABILITIES:		
Accounts payable	\$ 12,164	\$ 11,594
Book overdraft	885	1,257
Accrued compensation	1,649	1,548
Accrued expenses	10,986	10,774
Payable to related party	1,375	500
Current maturities of long-term debt	1,325	1,275
Revolving credit agreement	15,475	15,432
Total current liabilities	43,859	42,380
LONG-TERM DEBT, less current maturities	5,719	6,169
OTHER LIABILITIES	5,696	5,306
Total liabilities	55,274	53,855
COMMITMENTS AND CONTINGENCIES (Note 9)		
STOCKHOLDERS' EQUITY		
15% Convertible preferred stock, \$100 par value; authorized 1,200,000 shares; issued and outstanding 1,131,551 shares; liquidation value \$113,155	108,256	108,256
Common stock, \$1 par value; authorized 35,000,000 shares; issued 9,822,304 shares	9,822	9,822
Additional paid-in capital	27,132	27,385
Accumulated other comprehensive loss	(1,287)	(1,405)
Accumulated deficit	(114,835)	(113,582)
Treasury stock, at cost, 1,871,128 shares	(21,437)	(21,437)
Total stockholders' equity	7,651	9,039
Total liabilities and stockholders' equity	\$ 62,925	\$ 62,894

See Notes to Condensed Consolidated Financial Statements.

[index](#)

KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED APRIL 1, 2011 AND APRIL 2, 2010
(Amounts in Thousands, Except Per Share Data)
(Unaudited)

	Three Months Ended	
	April 1, 2011	April 2, 2010
Net sales	\$32,909	\$33,839
Cost of goods sold	28,815	29,837
Gross profit	4,094	4,002
Selling, general and administrative expenses	4,976	6,033
Gain on sale or disposal of assets	(75)	-
Operating loss	(807)	(2,031)
Interest expense	(402)	(289)
Other, net	(35)	101
Loss before income tax (provision) benefit	(1,244)	(2,219)
Income tax (provision) benefit	(9)	33
Net loss	\$(1,253)	\$(2,186)
Net loss per share of common stock - Basic and diluted:	\$(0.16)	\$(0.27)
Weighted average common shares outstanding:		
Basic and diluted	7,951	7,951

See Notes to Condensed Consolidated Financial Statements.

[index](#)

KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED APRIL 1, 2011 AND APRIL 2, 2010
(Amounts in Thousands)
(Unaudited)

	April 1, 2011	April 2, 2010
Cash flows from operating activities:		
Net loss	\$(1,253)	\$(2,186)
Depreciation	1,183	1,616
Amortization of intangible assets	132	135
Amortization of debt issuance costs	75	96
Stock-based compensation	(491)	59
Gain on sale or disposal of assets	(75)	-
	(429)	(280)
Changes in operating assets and liabilities:		
Accounts receivable	(1,610)	(1,780)
Inventories	(208)	(599)
Other assets	98	(177)
Accounts payable	550	1,168
Accrued expenses	302	526
Payable to related party	875	125
Other	257	(566)
	264	(1,303)
Net cash used in operating activities	(165)	(1,583)
Cash flows from investing activities:		
Capital expenditures	(100)	(89)
Proceeds from sale of assets	2	-
Net cash used in investing activities	(98)	(89)
Cash flows from financing activities:		
Net borrowings	269	2,555
Decrease in book overdraft	(372)	(583)
Repayments of term loans	(400)	(388)
Direct costs associated with debt facilities	(144)	-
Net cash (used in) provided by financing activities	(647)	1,584
Effect of exchange rate changes on cash	81	(24)
Net decrease in cash	(829)	(112)
Cash, beginning of period	1,319	747
Cash, end of period	\$490	\$635

See Notes to Condensed Consolidated Financial Statements.

[index](#)

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

Note 1. SIGNIFICANT ACCOUNTING POLICIES

Consolidation Policy and Basis of Presentation – The condensed consolidated financial statements include the accounts of Katy Industries, Inc. and subsidiaries in which it has a greater than 50% voting interest or significant influence, collectively “Katy” or the “Company”. All significant intercompany accounts, profits and transactions have been eliminated in consolidation. The Condensed Consolidated Balance Sheet at April 1, 2011 and the related Condensed Consolidated Statements of Operations for the three months ended April 1, 2011 and April 2, 2010 and Cash Flows for the three months ended April 1, 2011 and April 2, 2010 have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, 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, results of operations and cash flows of the Company for the interim periods. 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, 2010. The Condensed Consolidated Balance Sheet as of December 31, 2010 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States (“GAAP”).

Fiscal Year – The Company operates and reports using a 4-4-5 fiscal year which always ends on December 31. As a result, December and January do not typically consist of five and four weeks, respectively. The three months ended April 1, 2011 and April 2, 2010 both consisted of 64 shipping days.

Use of Estimates and Reclassifications – The preparation of financial statements in conformity with GAAP 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 on the Condensed Consolidated Balance Sheets and Condensed Consolidated Statements of Cash Flows were made to the 2010 amounts in order to conform to the 2011 presentation.

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

	April 1, 2011	December 31, 2010
Raw materials	\$ 8,078	\$ 8,366
Finished goods	13,709	13,146
Inventory reserves	(1,254)	(1,250)
LIFO reserve	(3,819)	(3,812)
	\$ 16,714	\$ 16,450

At April 1, 2011 and December 31, 2010, approximately 55% and 56%, 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 \$3.8 million at each of April 1, 2011 and December 31, 2010.

Share-Based Payment – Compensation cost recognized during the three months ended April 1, 2011 and April 2, 2010 includes: a) compensation cost for all stock options based on the grant date fair value amortized over the options’ vesting period and b) compensation cost for outstanding stock appreciation rights (“SARs”) as of April 1, 2011 and April 2, 2010 based on the April 1, 2011 and April 2, 2010 fair value, respectively. The Company re-measures the fair value of SARs each reporting period until the award is settled and compensation expense is recognized each reporting period for changes in fair value and vesting.

index

Compensation (income) expense is included in selling, general and administrative expense in the Condensed Consolidated Statements of Operations. The components of compensation (income) expense are as follows (amounts in thousands):

	Three Months Ended	
	April 1, 2011	April 2, 2010
Stock option (income) expense	\$ (253)	\$ 78
Stock appreciation right income	(238)	(19)
	\$ (491)	\$ 59

For the three months ended April 1, 2011, stock option income resulted from the reversal of compensation expense recognized on the cancellation of unvested stock options previously held by the Company's Chief Executive Officer, the Company's Chief Financial Officer and the Company's former Vice President-Operations.

The fair value of stock options is estimated at the date of grant using a Black-Scholes option pricing model. As the Company does not have sufficient historical exercise data to provide a basis for estimating the expected term, the Company uses the simplified method 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 is the current yield available on U.S. treasury issues with a remaining term equal 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. There were no stock options granted during the three months ended April 1, 2011 and April 2, 2010.

The fair value of SARs, a liability award, was estimated at April 1, 2011 and April 2, 2010 using a Black-Scholes option pricing model. The Company estimated 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 is the current yield available on U.S. treasury issues with a remaining term equal 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:

	April 1, 2011	April 2, 2010
Expected term (years)	0.2 - 5.5	1.2 - 6.5
Volatility	160.3%	126.9%
	-	-
	213.7%	182.2%
Risk-free interest rate	0.1% - 2.4%	0.5% - 3.2%

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

Three Months Ended

	April 1, 2011	April 2, 2010
Net loss	\$ (1,253)	\$ (2,186)
Foreign currency translation gains (losses)	118	(3)
Comprehensive loss	\$ (1,135)	\$ (2,189)

The components of accumulated other comprehensive loss are foreign currency translation adjustments and pension and other postretirement benefits adjustments. The balance of foreign currency translation adjustments was \$0.6 million and \$0.7 million at April 1, 2011 and December 31, 2010, respectively. The balance of pension and other postretirement benefits adjustments was \$0.7 million at each of April 1, 2011 and December 31, 2010.

Segment Reporting – Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief decision maker or group in deciding how to allocate resources and in assessing performance. The Company’s chief decision maker reviews the results of operations and requests for capital expenditures based on one industry segment: manufacturing, importing and distributing commercial cleaning and storage products. The Company’s entire revenue is generated through this segment.

[index](#)

Note 2. NEW ACCOUNTING PRONOUNCEMENTS

Recently Adopted Accounting Standards – In October 2009, the Financial Accounting Standards Board (“FASB”) issued guidance concerning multiple-deliverable arrangements which would enable vendors to account for products or services separately rather than as a combined unit. This guidance is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company’s adoption of this guidance had no effect on the Company’s financial position or results of operations.

In January 2010, the FASB issued guidance which revises two disclosure requirements concerning fair value measurements and clarifies two others. It requires separate presentation of significant transfers into and out of Levels 1 and 2 of the fair value hierarchy and disclosure of the reasons for such transfers. It also requires the presentation of purchases, sales, issuances, and settlements within Level 3 on a gross basis rather than a net basis. The amendments also clarify that disclosures should be disaggregated by class of asset or liability and that disclosures about inputs and valuation techniques should be provided for both recurring and non-recurring fair value measurements. The guidance about Level 1 and 2 transfers was effective immediately, and the guidance about gross presentation of Level 3 activity is effective for fiscal years beginning after December 15, 2010. The adoption of the guidance had no effect on the Company’s financial position or results of operations.

Note 3. INTANGIBLE ASSETS

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

	April 1, 2011			December 31, 2010		
	Gross Amount	Accumulated Amortization	Net Carrying Amount	Gross Amount	Accumulated Amortization	Net Carrying Amount
Patents	\$1,285	\$ (1,079)	\$206	\$1,267	\$ (1,057)	\$210
Customer lists	10,231	(8,821)	1,410	10,231	(8,773)	1,458
Tradenames	5,054	(3,254)	1,800	5,054	(3,192)	1,862
Total	\$16,570	\$ (13,154)	\$3,416	\$16,552	\$ (13,022)	\$3,530

All of Katy’s intangible assets are definite long-lived intangibles. Estimated aggregate future amortization expense related to intangible assets is as follows (amounts in thousands):

2011 (remainder)	\$395
2012	502
2013	482
2014	465
2015	450
Thereafter	1,122
	\$3,416

index

Note 4. INDEBTEDNESS

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

	April 1, 2011	December 31, 2010
Term loan payable under the PNC Credit Agreement, interest based on Eurodollar and Base Rates (6.51% - 8.50%)	\$7,044	\$7,444
Revolving loans payable under the PNC Credit Agreement, interest based on Eurodollar and Base Rates (3.50% - 5.50%)	15,475	15,432
Total debt	22,519	22,876
Less revolving loans, classified as current	(15,475)	(15,432)
Less current maturities	(1,325)	(1,275)
Long-term debt	\$5,719	\$6,169

Aggregate remaining scheduled maturities of the Term Loan as of April 1, 2011 are as follows (amounts in thousands):

2011 (remainder)	875
2012	1,425
2013	4,744
	\$7,044

On May 26, 2010, Continental Commercial Products, LLC (“CCP”) and Glit/Gemtex, Ltd. (collectively with CCP, the “Borrowers”), wholly owned subsidiaries of the Company, and the Company, as guarantor, entered into a Revolving Credit, Term Loan and Security Agreement (the “PNC Credit Agreement”) with PNC Bank, National Association (“PNC Bank”).

The PNC Credit Agreement is a \$33.2 million credit facility with an \$8.2 million term loan (the “Term Loan”) and a \$25.0 million revolving loan (the “Revolving Credit Facility”), including a \$3.5 million sub-limit for letters of credit. The proceeds of the Term Loan and Revolving Credit Facility were used to repay the Second Amended and Restated Credit Agreement with Bank of America (“Bank of America Credit Agreement”) and pay fees and expenses associated with the negotiation and consummation of the PNC Credit Agreement. All extensions of credit under the PNC Credit Agreement are collateralized by a first priority security interest in and lien upon substantially all present and future assets and properties of the Company. The Company guarantees the obligations of the Borrowers under the PNC Credit Agreement.

The principal balance of the Term Loan is payable in monthly installments followed by a final installment on May 26, 2013 equal to the then outstanding and unpaid principal balance of the Term Loan. Mandatory prepayments of the Term Loan will be required upon the occurrence of certain events, including sales of certain assets, and the Company must make annual prepayments of the Term Loan in an amount equal to 50% of excess cash flow (as defined in the PNC Credit Agreement).

The Revolving Credit Facility has an expiration date of May 26, 2013 and its borrowing base is determined by eligible inventory and accounts receivable, amounting to \$21.1 million at April 1, 2011. The Company’s borrowing base under the PNC Credit Agreement is reduced by the outstanding amount of standby and commercial letters of credit. Currently, the Company’s largest letters of credit relate to its casualty insurance programs. Upon

extinguishment of the Bank of America Credit Agreement, the Company was required to advance cash to Bank of America as collateral for the outstanding letters of credit in the amount of \$3.1 million. At April 1, 2011, \$0.3 million of such advance was still outstanding. The cash advance is recorded within other current assets and the revolving credit agreement in the Condensed Consolidated Balance Sheets. At April 1, 2011, total outstanding letters of credit were \$2.4 million, of which \$2.1 million are issued by PNC Bank, and \$0.3 million are issued by Bank of America under the Bank of America Credit Agreement until they are transferred to PNC Bank under the PNC Credit Agreement. The PNC Credit Agreement requires the Company to have a minimum level of availability such that its eligible collateral must exceed the sum of its outstanding borrowings and letters of credit by a certain amount. The Company amended the PNC Credit Agreement three times during the first quarter of 2011 to reduce the minimum level of required availability. The first and second amendments to the PNC Credit Agreement reduced the minimum level of required availability from \$1.5 million to \$1.1 million through February 4 and February 11, 2011, respectively. The third amendment to the PNC Credit Agreement ("Third Amendment") reduced the minimum level of required availability dollar for dollar by the aggregate amount of cash infusions into the Company (and further distributed to the Borrowers) by members of management of the Company and/or such other persons who are reasonably acceptable to PNC Bank, on the date when made. The minimum level of availability remained at the reduced amount through and including May 1, 2011, and was reinstated to \$1.5 million on May 2, 2011. This amount will be reduced to zero upon the reduction of the Term Loan by an aggregate sum of \$1.5 million, which the Company currently expects to occur in the second quarter of 2011. As a result of \$0.2 million received on February 12, 2011, the minimum level of required availability was reduced from \$1.5 million to \$1.3 million on February 12, 2011. An additional \$0.8 million was received on February 15, 2011, further reducing the minimum level of required availability to \$0.5 million on February 15, 2011.

index

The Term Loan bears interest at the Company's option at either (i) the Eurodollar Rate (as defined in the PNC Credit Agreement), plus 6.25% or (ii) the Base Rate (as defined in the PNC Credit Agreement), plus 5.25%. Borrowings under the Revolving Credit Facility bear interest at the Company's option at either (x) the Eurodollar Rate plus 3.25% or (y) the Base Rate plus 2.25%. For U.S. dollar borrowings, the Base Rate is the highest of (i) the Federal Funds Open Rate (as defined in the PNC Credit Agreement) plus one half of 1.0%, (ii) the interest rate announced by PNC Bank as its base commercial lending rate and (iii) the sum of the Daily LIBOR Rate (as defined in the PNC Credit Agreement) plus 1.0%. For Canadian dollar borrowings, the Base Rate is the higher of (x) the interest rate announced by the PNC Bank Canada Branch as its reference rate of interest for loans in Canadian dollars to Canadian borrowers and (y) the sum of the one month CDOR Rate (as defined in the PNC Credit Agreement) plus 1.75%. An unused commitment fee of 50 basis points per annum will be payable quarterly on the average unused amount of the Revolving Credit Facility.

The PNC Credit Agreement includes financial covenants regarding minimum earnings before interest, taxes, depreciation and amortization ("EBITDA," as defined in the PNC Credit Agreement) and fixed charge coverage ratio. The Third Amendment also amended these covenants and will provide the Borrowers with additional flexibility under the covenants. The Company was in compliance with these financial covenants at April 1, 2011. Additionally, the first amendment to the PNC Credit Agreement added a covenant requiring the Company to consummate a capital event no later than May 1, 2011, defined as either a capital infusion, in the form of either equity or debt or pursuant to a sale or other disposition of assets. As the Company did not consummate a capital event by May 1, 2011, which constituted an Event of Default, as defined in the PNC Credit Agreement, the Company entered into a fourth amendment to the PNC Credit Agreement ("Fourth Amendment") on May 16, 2011. The Fourth Amendment waived the default, provided the Company consummates a Sale Event, as defined in the first amendment to the PNC Credit Agreement, no later than July 6, 2011. The Fourth Amendment also further amended the EBITDA covenant and will provide the Borrowers with additional flexibility under this covenant.

If the Company is unable to comply with the terms of the amended covenants, it could seek to obtain further amendments and pursue liquidity through additional debt financing and/or the sale of assets. However, the Company believes that it will be able to comply with all covenants, as amended, throughout 2011.

All of the debt under the PNC Credit Agreement is re-priced to current rates at frequent intervals. Therefore, its fair value approximates its carrying value at April 1, 2011. For each of the three months ended April 1, 2011 and April 2, 2010, the Company had amortization of debt issuance costs, included within interest expense, of \$0.1 million. The Company incurred \$0.1 million of debt issuance costs during the three months ended April 1, 2011 associated with amending the PNC Credit Agreement.

The Revolving Credit Facility under the PNC Credit Agreement requires lockbox agreements which provide for all Company receipts to be swept daily to reduce borrowings outstanding. These agreements, combined with the existence of a material adverse effect ("MAE") clause in the PNC Credit Agreement, cause the Revolving Credit Facility to be classified as a current liability, per guidance in the Accounting Standards Codification established by the Financial Accounting Standards Board. The Company does not expect to repay, or be required to repay, within one year, the balance of the Revolving Credit Facility, which is classified as a current liability. The Revolving Credit Facility does not expire or have a maturity date within one year, but rather has a final expiration date of May 26, 2013. The MAE clause, which is a fairly typical requirement in commercial credit agreements, allows the lender to require the loan to become due if it determines there has been a material adverse effect on the Company's operations, business, properties, assets, liabilities, condition, or prospects.

In addition, CCP and the Company entered into an Export-Import Revolving Credit and Security Agreement ("Ex-Im Agreement") with PNC Bank, which provides for up to a \$1.5 million revolving advance amount on certain foreign accounts receivable as part of the Revolving Credit Facility. Concurrent with the Third Amendment, the Company

entered into a first amendment to the Ex-Im Agreement to amend the financial covenants contained in the Ex-Im Agreement to be consistent with the Third Amendment.

[index](#)

Note 5. RETIREMENT BENEFIT PLANS

Certain 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 Company's funding policies, subject to the minimum funding requirements 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 postretirement health plans are unfunded.

Information regarding the Company's net periodic benefit cost for pension and other postretirement benefit plans for the three months ended April 1, 2011 and April 2, 2010 is as follows (amounts in thousands):

	Pension Benefits		Other Benefits	
	Three Months Ended April 1, 2011	April 2, 2010	Three Months Ended April 1, 2011	April 2, 2010
Components of net periodic benefit cost:				
Interest cost	\$18	\$18	\$26	\$33
Expected return on plan assets	(16)	(15)	-	-
Amortization of net loss	11	11	-	8
Net periodic benefit cost	\$13	\$14	\$26	\$41

During the three months ended April 1, 2011, the Company made contributions to the pension plans of \$14,000. The Company expects to contribute an additional \$63,000 to the pension plans throughout the remainder of 2011. The Company uses a December 31 measurement date for its pension and other postretirement benefit plans. The fair value of plan assets was determined by using quoted prices in active markets for identical assets (Level 1 inputs per the fair value hierarchy).

Note 6. STOCK INCENTIVE PLANS

The Company has various stock incentive plans that provide for the granting of stock options, nonqualified stock options, SARs, restricted stock, performance units or shares and other incentive awards to certain employees and directors. Options have been granted at or above the market price of the Company's stock at the date of grant, typically vest over a three-year period, and are exercisable not less than twelve months or more than ten years after the date of grant. SARs have been granted at or above the market price of the Company's stock at the date of grant, typically vest over periods up to three years, and expire ten years from the date of issue. No more than 50% of the cumulative number of vested SARs held by an employee can be exercised in any one calendar year.

index

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

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2010	1,362,000	\$ 1.96		
Granted	-	\$ -		
Exercised	-	\$ -		
Expired	-	\$ -		
Cancelled	(1,000,000)	\$ 1.17		
Outstanding at April 1, 2011	362,000	\$ 4.16	0.47 years	\$ -
Vested and Exercisable at April 1, 2011	362,000	\$ 4.16	0.47 years	\$ -

A summary of the status of the Company's non-vested stock options as of April 1, 2011 is presented in the table below:

	Options	Weighted Average Grant Date Fair Value
Non-Vested at December 31, 2010	374,999	\$ 0.88
Granted	-	\$ -
Vested	-	\$ -
Cancelled	(374,999)	\$ 0.88
Non-Vested at April 1, 2011	-	\$ -

Expense of \$47,000 was reversed in the first quarter of 2011 related to 83,333 non-vested options awarded under the 2009 Vice President-Operations' Plan which were cancelled in the first quarter of 2011 as a result of the departure of the Company's Vice President-Operations. Effective March 28, 2011, the Company entered into the 2011 Change in Control Plan (the "2011 CIC Plan"). Eligible participants in the 2011 CIC Plan must surrender any and all rights in any options and/or SARs previously awarded by the Company, and acknowledge that he/she will not be entitled to receive any further options and/or SARs from the Company or any other equity-based awards. Each participant is entitled to receive in connection with a change in control an amount equal to his/her share of the aggregate fair market value of the consideration to be delivered to the shareholders of the Company with respect to the outstanding securities of the Company, net of costs or expenses, as applicable, relating to the transaction that results in the change in control, subject to the terms and conditions of the 2011 CIC Plan. As of the effective date of the 2011 CIC Plan, the Company's Chief Executive Officer and Chief Financial Officer were participants. As a result of their participation,

875,000 options were cancelled, of which 291,666 were non-vested. Expense of \$0.2 million was reversed in the first quarter of 2011 related to these non-vested options.

index

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

Non-Vested at December 31, 2010	66,332
Granted	-
Vested	(3,333)
Cancelled	(35,000)
Non-Vested at April 1, 2011	27,999
Total Outstanding at April 1, 2011	501,267

At April 1, 2011, the aggregate liability related to SARs was \$0.1 million and is included in accrued expenses in the Condensed Consolidated Balance Sheets.

Note 7. INCOME TAXES

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, various states and foreign jurisdictions. The Company and its subsidiaries are generally no longer subject to U.S. federal, state and local examinations by tax authorities for years before 2006.

As of April 1, 2011 and December 31, 2010, the Company had deferred tax assets, net of deferred tax liabilities, of \$78.2 million. Domestic net operating loss ("NOL") carry forwards comprised \$53.9 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. As a result, valuation allowances have been recorded as of such dates for the full amount of deferred tax assets, net of the amount of deferred tax liabilities.

Accounting for Uncertainty in Income Taxes

Included in the balances at each of April 1, 2011 and December 31, 2010 are \$0.4 million of liabilities for unrecognized tax benefits. Because of the impact of deferred tax accounting, other than interest and penalties, the recognition of these liabilities would not affect the annual effective tax rate. The income tax benefit for the three months ended April 2, 2010 primarily reflects current tax benefit for the recognition of uncertain tax positions of \$0.1 million due to the expiration of certain statutes of limitations. The Company anticipates reductions to the total amount of unrecognized tax benefits of an additional \$0.2 million within the next twelve months due to expiring statutes of limitations.

The Company recognizes interest and penalties accrued related to the unrecognized tax benefits in the income tax provision. The Company had approximately \$0.1 million of interest and penalties accrued at each of April 1, 2011 and December 31, 2010.

Note 8. RELATED PARTY TRANSACTIONS

Kohlberg & Co., L.L.C., whose affiliate holds all 1,131,551 shares of the Company's Convertible Preferred Stock, provides ongoing management oversight and advisory services to the Company. At April 1, 2011 and December 31, 2010, the Company owed Kohlberg \$1.4 million and \$0.5 million, respectively, for these services, which is recorded in current liabilities on the Condensed Consolidated Balance Sheets. For each of the three months ended April 1, 2011 and April 2, 2010, \$0.1 million is recorded in selling, general and administrative expenses in the Condensed Consolidated Statements of Operations for these services.

Concurrent with the Third Amendment (described above), in February 2011, loans of \$0.1 million each were received from two directors of the Company, and a loan of \$50,000 was received from the Company's Chief Executive Officer, which are recorded in other liabilities in the Condensed Consolidated Balance Sheets. In connection with these loans, the Company entered into subordinated promissory notes with these individuals. These notes mature on November 26, 2013 and accrue interest at a rate of 15% per year, to be paid in quarterly installments, which may be paid by capitalizing such interest and adding such capitalized interest to the principal amount of the subordinated notes. For the three months ended April 1, 2011, \$5,000 of interest was capitalized into the principal amount of the notes.

index

Note 9. 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 on an undiscounted basis 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 matter with W. J. Smith, a subsidiary of the Company, 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 the Company. 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, the Company 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 post-closure obligations in the areas of groundwater monitoring and ongoing site operations and maintenance costs, as well as potential contractual obligations related to real estate matters.

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 eleven lawsuits filed in state court in Alabama by a total of approximately 325 individual plaintiffs. There are over 100 defendants named in each case. In all eleven 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 while in the plant they were exposed to asbestos in products which were manufactured by each defendant. In nine 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) (“Sterling”) has tendered approximately 2,860 cases pending in Michigan, New Jersey, New York, Illinois, Nevada, Mississippi, Wyoming, Louisiana, Georgia, Massachusetts, Missouri, Kentucky, California, South Carolina and Canada to the Company for defense and indemnification. With respect to one case, Sterling has demanded that the Company 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 the Company in connection with these matters.

index

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 Company, a former division of an inactive subsidiary of the Company, 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 division of an inactive subsidiary of the Company, has been named as a defendant in approximately 430 of the New Jersey cases tendered by Sterling. The Company has elected to defend these cases, the majority of which have been dismissed or settled for nominal sums. There are approximately 90 cases which remain active as of April 1, 2011.

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 these matters.

Other Claims

There are a number of product liability and workers' compensation claims pending against the Company 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 ten 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, the Company 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, including estimated legal fees, on an undiscounted basis. 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.

Note 10. SEVERANCE, RESTRUCTURING AND RELATED CHARGES

Over the past several years, the Company has initiated several cost reduction and facility consolidation initiatives, resulting in severance, restructuring and related charges. These initiatives resulted from the on-going strategic reassessment of the Company's various businesses as well as the markets in which they operate.

Wilco facility relocation – In the second quarter of 2010, the Company informed employees of its intent to close the Wilco facility in Atlanta, Georgia and relocate the manufacturing and distribution functions to the CCP location in Bridgeton, Missouri. The relocation was completed by the end of 2010. Management believes that no further

material charges will be incurred for this activity. Following is a rollforward of restructuring liabilities by type for the Wilen facility relocation (amounts in thousands):

	One-time Termination Benefits
Restructuring liabilities at December 31, 2010	\$ 125
Additions	-
Payments	(86)
Restructuring liabilities at April 1, 2011	\$ 39

index

This amount includes severance, benefits and other employee-related costs associated with employee terminations and the balance is expected to be paid in the second quarter of 2011.

Consolidation of St. Louis manufacturing/distribution facilities – In 2002, the Company committed to a plan to consolidate the manufacturing and distribution of the four CCP facilities in the St. Louis, Missouri area. Management believed that in order to implement a more competitive cost structure, the excess capacity at the four plastic molding facilities in this area would need to be eliminated. This plan was completed by the end of 2003. Management believes that no further charges will be incurred for this activity, except for potential adjustments to non-cancelable lease liabilities as actual activity compares to assumptions made. Following is a rollforward of restructuring liabilities for the consolidation of St. Louis manufacturing/distribution facilities (amounts in thousands):

	Contract Termination Costs
Restructuring liabilities at December 31, 2010	\$ 314
Additions	-
Payments	(20)
Restructuring liabilities at April 1, 2011	\$ 294

This amount relates to non-cancelable lease liabilities for abandoned facilities, net of potential sub-lease revenue. Total maximum potential amount of lease loss, excluding any sub-lease rentals, is \$0.6 million as of April 1, 2011. The Company has included \$0.3 million as an offset for sub-lease rentals. This amount is expected to be paid in 2011. As of April 1, 2011, the Company does not anticipate any further significant severance, restructuring and other related charges in the upcoming year related to the plan discussed above.

A rollforward of all restructuring liabilities is as follows (amounts in thousands):

	Total	One-time Termination Benefits	Contract Termination Costs
Restructuring liabilities at December 31, 2010	\$439	\$ 125	\$ 314
Additions	-	-	-
Payments	(106)	(86)	(20)
Restructuring liabilities at April 1, 2011	\$333	\$ 39	\$ 294

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

Forward-Looking Statements

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. Additional information concerning these and other risks and uncertainties is included in Item 1A under the caption “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2010. Words and phrases such as

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

index

- Increases in the cost of, or in some cases continuation of, the current price levels of thermoplastic resins, paper board packaging, latex binders, cotton and other raw materials.
 - Our inability to reduce product costs, including manufacturing, sourcing, freight, and other product costs.
 - Our inability to protect our intellectual property rights adequately.
 - Our inability to expand our customer base and increase corresponding revenues.
- Our inability to achieve product price increases, especially as they relate to potentially higher raw material costs.
- Unfavorable economic or business conditions, as well as our exposure to the credit risks of our customers and distributors, which may reduce our sales or make it difficult to collect accounts receivable.
 - Competition from foreign and domestic competitors.
- The potential impact of rising interest rates on our debt outstanding under the PNC Credit Agreement.
 - Our inability to meet covenants associated with the PNC Credit Agreement.
- Our inability to access funds under our current loan agreements or refinance our loan agreements given the current instability in the credit markets.
- 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 Canadian operations.
- Labor issues, including union activities that require an increase in production costs or lead to a strike, thus impairing production and decreasing sales, and 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.

OVERVIEW

We are a manufacturer, importer and distributor of commercial cleaning and storage products. Our commercial cleaning products are sold primarily to janitorial/sanitary and foodservice distributors that supply end users such as restaurants, hotels, healthcare facilities and schools. Our storage products are primarily sold through major home improvement and mass market retail outlets.

RESULTS OF OPERATIONS

Three Months Ended April 1, 2011 versus Three Months Ended April 2, 2010

Net sales decreased 2.7% from \$33.8 million during the three months ended April 2, 2010 to \$32.9 million during the three months ended April 1, 2011. The majority of the decrease was a result of volume shortfall in our Continental

and Glit business units, primarily due to three less shipping days in the first quarter of 2011 than in the first quarter of 2010 due to inclement weather shutdowns. Changes in net sales resulting from pricing and currency translation were nominal. Gross margin was 12.4% for the three months ended April 1, 2011, an increase of 0.6 percentage points from the same period a year ago. Gross margin was impacted by a favorable variance in our LIFO adjustment of \$0.4 million resulting from inventory fluctuations. Excluding the LIFO adjustment, gross margin decreased 0.5 percentage points from the first quarter of 2010. The decrease was primarily a result of increased raw material costs.

Selling, general and administrative (“SG&A”) expenses were \$5.0 million for the three months ended April 1, 2011, a \$1.1 million reduction from the same period a year ago. The decrease was a result of cost-cutting efforts including, but not limited to, supervisor salary expenses and management bonus accruals, as well as decreases in stock-based compensation expense due to our lower stock price and the reversal of prior years’ compensation expense as a result of cancelled unvested stock options during the three months ended April 1, 2011.

index

Operating loss decreased from \$2.0 million during the three months ended April 2, 2010 to \$0.8 million during the three months ended April 1, 2011 primarily due to the decrease in SG&A expenses described above as well as a \$0.1 million gain on sale or disposal of assets during the three months ended April 1, 2011.

Interest expense increased by \$0.1 million during the three months ended April 1, 2011 as compared to the three months ended April 2, 2010 as a result of higher interest rates and average borrowings under the PNC Credit Agreement.

The income tax benefit for the three months ended April 2, 2010 includes a benefit for the recognition of uncertain tax positions of \$0.1 million as the statutes of limitations on certain tax years expired.

Overall, we reported a net loss of \$1.3 million, or \$0.16 per share, for the first quarter of 2011, as compared to a net loss of \$2.2 million, or \$0.27 per share, for the first quarter of 2010.

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 PNC Credit Agreement (as defined below) provide sufficient liquidity for our operations going forward. As of April 1, 2011, we had cash of \$0.5 million and outstanding checks of \$0.9 million as compared to cash of \$1.3 million and outstanding checks of \$1.3 million at December 31, 2010. As of April 1, 2011, we had outstanding borrowings of \$22.5 million (75% of total capitalization) under the PNC Credit Agreement. Our unused borrowing availability at April 1, 2011 on the Revolving Credit Facility (as defined below) was \$3.0 million after the \$0.5 million minimum availability requirement discussed below. As of December 31, 2010, we had outstanding borrowings of \$22.9 million (72% of total capitalization) with unused borrowing availability of \$0.5 million after the \$1.1 million minimum availability requirement discussed below.

PNC Credit Agreement

On May 26, 2010, Continental Commercial Products, LLC (“CCP”) and Glit/Gemtex, Ltd. (collectively with CCP, the “Borrowers”), wholly owned subsidiaries of the Company, and the Company, as guarantor, entered into a Revolving Credit, Term Loan and Security Agreement (the “PNC Credit Agreement”) with PNC Bank, National Association (“PNC Bank”).

The PNC Credit Agreement is a \$33.2 million credit facility with an \$8.2 million term loan (the “Term Loan”) and a \$25.0 million revolving loan (the “Revolving Credit Facility”), including a \$3.5 million sub-limit for letters of credit. The proceeds of the Term Loan and Revolving Credit Facility were used to repay the Second Amended and Restated Credit Agreement with Bank of America (“Bank of America Credit Agreement”) and pay fees and expenses associated with the negotiation and consummation of the PNC Credit Agreement. The PNC Credit Agreement resulted in two important benefits related to our long-term strategy: (1) the reduction of the availability block under the Revolving Credit Facility from \$5.0 million to \$1.5 million, as compared to the revolver under the Bank of America Credit Agreement, allows for additional borrowing capacity and increased working capital flexibility and (2) the additional \$1.7 million availability under the Term Loan, as compared to the term loan under the Bank of America Credit Agreement, allowed us to negotiate a settlement of an existing obligation due to Pentland USA, Inc. (“Pentland”), whereby we accelerated all amounts due to Pentland in 2010 of \$1.9 million and paid an additional \$0.1 million in satisfaction of a liability of \$4.1 million. This settlement eliminates cash requirements of \$1.8 million in 2011 and \$0.4 million in 2012.

All extensions of credit under the PNC Credit Agreement are collateralized by a first priority security interest in and lien upon substantially all present and future assets and properties of the Company. The Company guarantees the

obligations of the Borrowers under the PNC Credit Agreement.

The principal balance of the Term Loan is payable in monthly installments followed by a final installment on May 26, 2013 equal to the then outstanding and unpaid principal balance of the Term Loan. Mandatory prepayments of the Term Loan will be required upon the occurrence of certain events, including sales of certain assets, and the Company must make annual prepayments of the Term Loan in an amount equal to 50% of excess cash flow (as defined in the PNC Credit Agreement).

index

The Revolving Credit Facility has an expiration date of May 26, 2013 and its borrowing base is determined by eligible inventory and accounts receivable, amounting to \$21.1 million at April 1, 2011. The Company's borrowing base under the PNC Credit Agreement is reduced by the outstanding amount of standby and commercial letters of credit. Currently, the Company's largest letters of credit relate to its casualty insurance programs. Upon extinguishment of the Bank of America Credit Agreement, the Company was required to advance cash to Bank of America as collateral for the outstanding letters of credit in the amount of \$3.1 million. At April 1, 2011, \$0.3 million of such advance was still outstanding. The cash advance is recorded within other current assets and the revolving credit agreement in the Condensed Consolidated Balance Sheets. At April 1, 2011, total outstanding letters of credit were \$2.4 million, of which \$2.1 million are issued by PNC Bank, and \$0.3 million are issued by Bank of America under the Bank of America Credit Agreement until they are transferred to PNC Bank under the PNC Credit Agreement. The PNC Credit Agreement requires the Company to have a minimum level of availability such that its eligible collateral must exceed the sum of its outstanding borrowings and letters of credit by a certain amount. The Company amended the PNC Credit Agreement three times during the first quarter of 2011 to reduce the minimum level of required availability. The first and second amendments to the PNC Credit Agreement reduced the minimum level of required availability from \$1.5 million to \$1.1 million through February 4 and February 11, 2011, respectively. The third amendment to the PNC Credit Agreement ("Third Amendment") reduced the minimum level of required availability dollar for dollar by the aggregate amount of cash infusions into the Company (and further distributed to the Borrowers) by members of management of the Company and/or such other persons who are reasonably acceptable to PNC Bank, on the date when made. The minimum level of availability remained at the reduced amount through and including May 1, 2011, and was reinstated to \$1.5 million on May 2, 2011. This amount will be reduced to zero upon the reduction of the Term Loan by an aggregate sum of \$1.5 million, which the Company currently expects to occur in the second quarter of 2011. As a result of \$0.2 million received on February 12, 2011, the minimum level of required availability was reduced from \$1.5 million to \$1.3 million on February 12, 2011. An additional \$0.8 million was received on February 15, 2011, further reducing the minimum level of required availability to \$0.5 million on February 15, 2011.

The Term Loan bears interest at the Company's option at either (i) the Eurodollar Rate (as defined in the PNC Credit Agreement), plus 6.25% or (ii) the Base Rate (as defined in the PNC Credit Agreement), plus 5.25%. Borrowings under the Revolving Credit Facility bear interest at the Company's option at either (x) the Eurodollar Rate plus 3.25% or (y) the Base Rate plus 2.25%. For U.S. dollar borrowings, the Base Rate is the highest of (i) the Federal Funds Open Rate (as defined in the PNC Credit Agreement) plus one half of 1.0%, (ii) the interest rate announced by PNC Bank as its base commercial lending rate and (iii) the sum of the Daily LIBOR Rate (as defined in the PNC Credit Agreement) plus 1.0%. For Canadian dollar borrowings, the Base Rate is the higher of (x) the interest rate announced by the PNC Bank Canada Branch as its reference rate of interest for loans in Canadian dollars to Canadian borrowers and (y) the sum of the one month CDOR Rate (as defined in the PNC Credit Agreement) plus 1.75%. An unused commitment fee of 50 basis points per annum will be payable quarterly on the average unused amount of the Revolving Credit Facility.

The PNC Credit Agreement includes financial covenants regarding minimum earnings before interest, taxes, depreciation and amortization ("EBITDA," as defined in the PNC Credit Agreement) and fixed charge coverage ratio. The Third Amendment also amended these covenants and will provide the Borrowers with additional flexibility under the covenants. The Company was in compliance with these financial covenants at April 1, 2011. Additionally, the first amendment to the PNC Credit Agreement added a covenant requiring the Company to consummate a capital event no later than May 1, 2011, defined as either a capital infusion, in the form of either equity or debt or pursuant to a sale or other disposition of assets. As the Company did not consummate a capital event by May 1, 2011, which constituted an Event of Default, as defined in the PNC Credit Agreement, the Company entered into a fourth amendment to the PNC Credit Agreement ("Fourth Amendment") on May 16, 2011. The Fourth Amendment waived the default, provided the Company consummates a Sale Event, as defined in the first amendment to the PNC Credit Agreement, no later than July 6, 2011. The Fourth Amendment also further amended the EBITDA covenant and will

provide the Borrowers with additional flexibility under this covenant.

If the Company is unable to comply with the terms of the amended covenants, it could seek to obtain further amendments and pursue liquidity through additional debt financing and/or the sale of assets. However, the Company believes that it will be able to comply with all covenants, as amended, throughout 2011.

All of the debt under the PNC Credit Agreement is re-priced to current rates at frequent intervals. Therefore, its fair value approximates its carrying value at April 1, 2011. For each of the three months ended April 1, 2011 and April 2, 2010, the Company had amortization of debt issuance costs, included within interest expense, of \$0.1 million. The Company incurred \$0.1 million of debt issuance costs during the three months ended April 1, 2011 associated with amending the PNC Credit Agreement.

index

The Revolving Credit Facility under the PNC Credit Agreement requires lockbox agreements which provide for all Company receipts to be swept daily to reduce borrowings outstanding. These agreements, combined with the existence of a material adverse effect (“MAE”) clause in the PNC Credit Agreement, cause the Revolving Credit Facility to be classified as a current liability, per guidance in the Accounting Standards Codification established by the Financial Accounting Standards Board. The Company does not expect to repay, or be required to repay, within one year, the balance of the Revolving Credit Facility, which is classified as a current liability. The Revolving Credit Facility does not expire or have a maturity date within one year, but rather has a final expiration date of May 26, 2013. The MAE clause, which is a fairly typical requirement in commercial credit agreements, allows the lender to require the loan to become due if it determines there has been a material adverse effect on the Company’s operations, business, properties, assets, liabilities, condition, or prospects.

In addition, CCP and the Company entered into an Export-Import Revolving Credit and Security Agreement (“Ex-Im Agreement”) with PNC Bank, which provides for up to a \$1.5 million revolving advance amount on certain foreign accounts receivable as part of the Revolving Credit Facility. Concurrent with the Third Amendment, the Company entered into a first amendment to the Ex-Im Agreement to amend the financial covenants contained in the Ex-Im Agreement to be consistent with the Third Amendment.

Cash Flows

Cash used in operating activities before changes in operating assets and liabilities was \$0.4 million in the first quarter of 2011 as compared to \$0.3 million in the same period of 2010. Changes in operating assets and liabilities provided \$0.3 million in the first quarter of 2011 as compared to using \$1.3 million in the same period of 2010. This variance was primarily a result of cash provided by amounts payable to a related party and other liabilities, partially offset by cash used in accounts payable. As of April 1, 2011 we were turning our inventory at 4.4 times per year as compared to 4.0 times per year as of December 31, 2010 and 4.2 times per year as of April 2, 2010.

Cash flows used in financing activities in the first quarter of 2011 reflect a \$0.4 million decrease in our debt levels and a \$0.4 million decrease in our book overdraft since December 31, 2010, as well as \$0.1 million of cash used associated with debt facilities, offset by \$0.3 million in cash provided by notes payable to related parties.

OFF-BALANCE SHEET ARRANGEMENTS

As of April 1, 2011, the Company had no off-balance sheet arrangements.

SEVERANCE, RESTRUCTURING AND RELATED CHARGES

See Note 10 to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for further discussion of severance, restructuring and related charges.

ENVIRONMENTAL AND OTHER CONTINGENCIES

See Note 9 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.

R E C E N T L Y I S S U E D A C C O U N T I N G
PRONOUNCEMENTS

See Note 2 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.

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, 2010 (Part II, Item 7). There have been no changes to these policies as of April 1, 2011.

Item 4. CONTROLS AND PROCEDURES

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, regulations and related forms, and that such information is accumulated and communicated to our management, including the principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

index

Katy carried out an evaluation, under the supervision and with the participation of our management, including the principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (pursuant to Rule 13a-15(e) under the Exchange Act) as of the end of the period of our report. Based upon that evaluation, the principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective as of the end of the period covered by this report.

Changes in Internal Control over Financial Reporting

There have been no changes in Katy's internal control over financial reporting during the quarter ended April 1, 2011 that have materially affected, or are reasonably likely to materially affect, Katy's internal control over financial reporting.

[index](#)

PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Except as otherwise noted in Note 9 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 Part I, Item 1A of our Annual Report on Form 10-K, filed on March 31, 2011. There has been no material change in those risk factors.

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

None.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

Item 4. (REMOVED AND RESERVED)

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS

Exhibit Number	Exhibit Title	
<u>10.1</u>	<u>Fourth Amendment and Waiver to Revolving Credit, Term Loan and Security Agreement dated May 16, 2011, among Continental Commercial Products, LLC, Glit/Gemtex, Ltd., Katy Industries, Inc. and PNC Bank, National Association.</u>	<u>*</u>
<u>31.1</u>	<u>CEO Certification pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>	<u>*</u>
<u>31.2</u>	<u>CFO Certification pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>	<u>*</u>
<u>32.1</u>	<u>CEO Certification required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>	<u>*#</u>
<u>32.2</u>	<u>CFO Certification required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>	<u>*#</u>

* Indicates filed herewith.

These certifications are being furnished solely to accompany this report pursuant to 18 U.S.C. Section 1350, and are not being filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and are not to be incorporated by reference into any filing of Katy Industries, Inc. whether made before or after the date hereof, regardless of any general incorporation language in such filing.

[index](#)

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: May 16, 2011
David J. Feldman
President and Chief Executive Officer

By /s/ David J. Feldman

By /s/ James W. Shaffer
James W. Shaffer
Vice President, Treasurer and Chief Financial Officer

