

KATY INDUSTRIES INC
Form 10-Q
November 13, 2012

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: September 28, 2012

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
(Address of principal executive offices)

63044
(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, 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.

Edgar Filing: KATY INDUSTRIES INC - Form 10-Q

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

Accelerated filer
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	Outstanding at October 26, 2012
Common Stock, \$1 Par Value	7,951,176 Shares

KATY INDUSTRIES, INC.
FORM 10-Q
September 28, 2012

INDEX

	Page
PART I FINANCIAL INFORMATION	
Item 1. Financial Statements:	
<u>Condensed Consolidated Balance Sheets September 28, 2012 (unaudited) and December 31, 2011</u>	3,4
<u>Condensed Consolidated Statements of Operations and Comprehensive Loss For the Three and Nine Months Ended September 28, 2012 and September 30, 2011 (unaudited)</u>	5
<u>Condensed Consolidated Statements of Cash Flows For the Nine Months Ended September 28, 2012 and September 30, 2011 (unaudited)</u>	6
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	7
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
Item 4. <u>Controls and Procedures</u>	19
PART II <u>OTHER INFORMATION</u>	21
Item 1. <u>Legal Proceedings</u>	21
Item 1A. <u>Risk Factors</u>	21
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	21
Item 3. <u>Defaults Upon Senior Securities</u>	21
Item 4. <u>Mine Safety Disclosures</u>	21
Item 5. <u>Other Information</u>	21
Item 6. <u>Exhibits</u>	21
<u>Signatures</u>	22

Index

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

KATY INDUSTRIES, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS
 AS OF SEPTEMBER 28, 2012 (UNAUDITED) AND DECEMBER 31, 2011
 (Amounts in Thousands)

ASSETS

	September 28, 2012	December 31, 2011
CURRENT ASSETS:		
Cash	\$ 937	\$ 730
Accounts receivable, net	14,010	11,759
Inventories, net	12,443	15,911
Other current assets	1,358	4,086
Assets held for sale	564	2,655
Total current assets	29,312	35,141
OTHER ASSETS:		
Goodwill	329	329
Intangibles, net	2,153	2,478
Other	2,111	2,032
Total other assets	4,593	4,839
PROPERTY AND EQUIPMENT		
Land and improvements	336	336
Buildings and improvements	8,546	8,800
Machinery and equipment	76,807	77,502
	85,689	86,638
Less - Accumulated depreciation	(69,989)	(68,805)
Property and equipment, net	15,700	17,833
Total assets	\$ 49,605	\$ 57,813

See Notes to Condensed Consolidated Financial Statements.

Index

KATY INDUSTRIES, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS
 AS OF SEPTEMBER 28, 2012 (UNAUDITED) AND DECEMBER 31, 2011
 (Amounts in Thousands, Except Share Data)

LIABILITIES AND STOCKHOLDERS' EQUITY

	September 28, 2012	December 31, 2011
CURRENT LIABILITIES:		
Accounts payable	\$8,796	\$8,928
Book overdraft	730	946
Accrued compensation	1,834	1,317
Accrued expenses	9,735	8,701
Payable to related party	2,125	1,750
Deferred revenue	688	688
Revolving credit agreement	11,271	14,359
Total current liabilities	35,179	36,689
DEFERRED REVENUE	2,064	2,605
OTHER LIABILITIES	5,740	5,904
Total liabilities	42,983	45,198
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	27,110	27,110
Accumulated other comprehensive loss	(2,300)	(2,361)
Accumulated deficit	(114,829)	(108,775)
Treasury stock, at cost, 1,871,128 shares	(21,437)	(21,437)
Total stockholders' equity	6,622	12,615
Total liabilities and stockholders' equity	\$49,605	\$57,813

See Notes to Condensed Consolidated Financial Statements.

Index

KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 28, 2012 AND SEPTEMBER 30, 2011
(Amounts in Thousands, Except Per Share Data)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
Net sales	\$27,283	\$ 29,080	\$77,823	\$ 79,801
Cost of goods sold	24,395	25,480	68,882	70,893
Gross profit	2,888	3,600	8,941	8,908
Selling, general and administrative expenses	3,828	4,187	12,507	12,691
Severance, restructuring and related charges	-	393	-	393
Gain on disposal of assets	-	6	-	16
Operating loss	(940)	(986)	(3,566)	(4,192)
Interest expense	(272)	(533)	(652)	(1,234)
Other, net	46	(12)	270	224
Loss from continuing operations before income tax (expense) benefit	(1,166)	(1,531)	(3,948)	(5,202)
Income tax (expense) benefit from continuing operations	(3)	(9)	(2)	239
Loss from continuing operations	(1,169)	(1,540)	(3,950)	(4,963)
Discontinued operations:				
(Loss) income from operations of discontinued business (net of tax)	(969)	408	(1,488)	1,274
Loss on sale of discontinued businesses (net of tax)	(616)	-	(616)	-
(Loss) income from discontinued operations	(1,585)	408	(2,104)	1,274
Net loss	(2,754)	(1,132)	(6,054)	(3,689)
Other comprehensive income (loss)				
Foreign currency translation	67	(94)	61	98
Total comprehensive loss	\$(2,687)	\$ (1,226)	\$(5,993)	\$ (3,591)
Loss (income) per share of common stock - Basic and Diluted				
Loss from continuing operations	\$(0.15)	\$ (0.19)	\$(0.50)	\$ (0.62)
Discontinued operations	(0.20)	0.05	(0.26)	0.16
Net loss	\$(0.35)	\$ (0.14)	\$(0.76)	\$ (0.46)
Weighted average common shares outstanding:				
Basic and diluted	7,951	7,951	7,951	7,951
Diluted	7,951	7,951	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 NINE MONTHS ENDED SEPTEMBER 28, 2012 AND SEPTEMBER 30, 2011
(Amounts in Thousands)
(Unaudited)

	September 28, 2012	September 30, 2011
Cash flows from operating activities:		
Net loss	\$ (6,054)	\$ (3,689)
Loss (income) from discontinued operations	2,104	(1,274)
Loss from continuing operations	(3,950)	(4,963)
Depreciation	2,750	2,984
Amortization of intangible assets	326	322
Amortization of debt issuance costs	178	415
Stock-based compensation	52	(610)
(Loss) gain on sale or disposal of assets	(2)	16
	(646)	(1,836)
Changes in operating assets and liabilities:		
Accounts receivable	(2,253)	(3,637)
Inventories	2,311	(119)
Other assets	3,263	899
Accounts payable	(47)	1,031
Accrued expenses	430	4
Payable to related party	500	1,125
Deferred revenue	(541)	-
Other	96	11
	3,759	(686)
Net cash provided by (used in) continuing operations	3,113	(2,522)
Net cash provided by discontinued operations	485	1,528
Net cash provided by (used in) operating activities	3,598	(994)
Cash flows from investing activities:		
Capital expenditures	(548)	(106)
Proceeds from sale of assets	-	81
Net cash used in continuing operations	(548)	(25)
Net cash provided by (used in) discontinued operations	258	(132)
Net cash used in investing activities	(290)	(157)
Cash flows from financing activities:		
Net (repayments) borrowings	(3,126)	3,353
Decrease in book overdraft	(216)	(223)
Repayments of term loans	-	(1,081)
Direct costs associated with debt facilities	-	(272)
Net cash (used in) provided by financing activities	(3,342)	1,777
Effect of exchange rate changes on cash provided by continuing operations	388	(164)

Edgar Filing: KATY INDUSTRIES INC - Form 10-Q

Effect of exchange rate changes on cash provided by discontinued operations	(147)	296
Net Effect of exchange rate changes on cash	241		132
Net increase in cash	207		758
Cash, beginning of period	730		1,319
Cash, end of period	\$ 937		\$ 2,077

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 September 28, 2012 and the related Condensed Consolidated Statements of Operations and Comprehensive Loss for the three and nine months ended September 28, 2012 and September 30, 2011 and Cash Flows for the nine months ended September 28, 2012 and September 30, 2011 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 comprehensive loss 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, 2011. The Condensed Consolidated Balance Sheet as of December 31, 2011 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States (“GAAP”).

As discussed in Note 3, on July 24, 2012, the Company announced the closure of Container manufacturing in Norwalk California, on September 20, 2012 the Company sold certain assets related to the Gemtex division, and on October 4, 2011, the Company sold substantially all assets and certain liabilities related to the DISCO division. The Company accounted for these divisions as discontinued operations, and accordingly, has reclassified the financial results for all periods presented to reflect them as such. Unless otherwise noted, discussions in these notes pertain to the Company’s continuing operations.

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 September 28, 2012 and September 30, 2011 consisted of 63 shipping days. The nine months ended September 28, 2012 and September 30, 2011 consisted of 190 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 to the Condensed Consolidated Balance Sheets, Condensed Consolidated Statements of Operations and Comprehensive Loss and Condensed Consolidated Statements of Cash Flows were made to the 2011 amounts in order to conform to the 2012 presentation.

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

September 28,	December 31,
2012	2011

Edgar Filing: KATY INDUSTRIES INC - Form 10-Q

Raw materials	\$ 6,279	\$ 8,127
Finished goods	11,358	13,192
Inventory reserves	(804)	(909)
LIFO reserve	(4,390)	(4,499)
	\$ 12,443	\$ 15,911

7

Index

At September 28, 2012 and December 31, 2011, approximately 64% and 66%, respectively, of Katy's inventories were accounted for using the last-in, first-out ("LIFO") method of costing, while the remaining inventories were accounted for using the first-in, first-out ("FIFO") method. Current cost, as determined using the FIFO method, exceeded LIFO cost by \$4.4 million at September 28, 2012 and \$4.5 million at December 31, 2011.

Share-Based Payment – Compensation cost recognized during the three and nine months ended September 28, 2012 and September 30, 2011 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 September 28, 2012 and September 30, 2011 based on the September 28, 2012 and September 30, 2011 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.

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		Nine Months Ended	
	September	September	September	September
	28,	30,	28,	30,
	2012	2011	2012	2011
Stock option income	\$-	\$ -	\$-	\$ (274)
Stock appreciation right (income) expense	(65)	(23)	52	(336)
	\$(65)	\$ (23)	\$52	\$ (610)

For the nine months ended September 30, 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 and nine months ended September 28, 2012 and September 30, 2011.

The fair value of SARs, a liability award, is estimated at September 28, 2012 and September 30, 2011 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:

Edgar Filing: KATY INDUSTRIES INC - Form 10-Q

	September 28, 2012	September 30, 2011
Expected term (years)	0.2 - 4.8	1.2 - 5.0
Volatility	293.5% - 459.0%	187.4% - 246.2%
Risk-free interest rate	0.1% - 0.6%	0.2% - 1.0%

Accumulated Comprehensive Loss – 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 \$0.5 million and \$0.6 million at September 28, 2012 and December 31, 2011, respectively. The balance of pension and other postretirement benefits adjustments was \$1.8 million at each of September 28, 2012 and December 31, 2011.

Index

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.

Note 2. NEW ACCOUNTING PRONOUNCEMENTS

Recently Adopted Accounting Standards – In May 2011, the FASB issued further guidance which generally aligns the principles of fair value measurements with International Financial Reporting Standards. The guidance clarifies the application of existing fair value measurement requirements and expands the disclosure requirements for fair value measurements, and was effective for the nine months ended September 28, 2012. The adoption of the guidance had no effect on the Company’s consolidated financial statements.

In June 2011, the FASB issued guidance concerning the presentation of comprehensive income. The guidance gives companies the option to present total comprehensive income, components of net income, and components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance was effective for the nine months ended September 28, 2012 and was applied retrospectively. The adoption of the guidance had no effect on the Company’s consolidated financial statements.

In September 2011, the FASB issued an update to existing guidance on the assessment of goodwill impairment. This update simplifies the assessment of goodwill for impairment by allowing companies to consider qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount before performing the two step impairment review process. It also amends the examples of events or circumstances that would be considered in a goodwill impairment evaluation. This new guidance was effective for the nine months ended September 28, 2012. The adoption of the guidance had no effect on the Company’s consolidated financial statements.

In July 2012, the FASB issued guidance concerning the testing of indefinite-lived intangible assets for impairment. This guidance gives an entity the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Codification Subtopic 350-30, Intangibles--Goodwill and Other, General Intangibles Other than Goodwill. Under the guidance, an entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments in this ASU are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company does not believe the amendments in this ASU will have a material impact of the consolidated financial statements.

Note 3. DISCONTINUED OPERATIONS

On July 24, 2012, the Company announced the closure of Container manufacturing at Norwalk, California of Continental Commercial Products, LLC. The Company plans to sell certain assets related to the Container division.

On September 20, 2012, the Company sold certain assets related to the Gemtex division to 2340258 Ontario, Inc. (the “Buyer”), a corporation incorporated under the laws of the Province of Ontario, for \$1.0 million, \$0.7 million of which will be payable in 48 monthly installments subject to certain prepayment requirements in connection with the generation of excess cash by the Buyer. The company used the net proceeds from the transaction to reduce its outstanding balance under the PB Loan Agreement (as defined in Note 5 below).

On October 4, 2011, the Company sold substantially all assets and certain liabilities related to the DISCO division of Continental Commercial Products, LLC to DISCO Acquisition Corp., a Pennsylvania corporation and an affiliate of Cellucap Manufacturing Company, for \$19.0 million, subject to pre-closing and post-closing adjustments based on working capital levels, an indemnification escrow of \$475,000 and a deferred lease maintenance adjustment of \$10,000 (the “Sale Event”). The Company used net proceeds from the transaction to reduce its outstanding balance under the PNC Credit Agreement (as defined in Note 5 below).

Index

The closure of Container manufacturing at Norwalk, California and the sale of the Gemtex and DISCO divisions met the criteria for classification as discontinued operations in accordance with GAAP; therefore, the Company has classified the results of the Container manufacturing, Gemtex and Disco divisions as discontinued operations for all periods presented. The assets sold as part of the Gemtex division and the assets expected to be sold of the Container division have been recorded as assets held for sale. Selected financial data for discontinued operations is summarized as follows (amounts in thousands):

	Three Months Ended September 28, 2012			Nine Months Ended September 28, 2012		
	Total	Container Manufacturing	Gemtex Division	Total	Container Manufacturing	Gemtex Division
Net sales	\$4,048	\$ 2,751	\$1,297	\$12,851	\$ 8,449	\$4,402
Operating loss - net of tax	\$(969)	\$(163)	\$(806)	\$(1,488)	\$(334)	\$(1,154)

	Three Months Ended September 30, 2011				Nine Months Ended September 30, 2011			
	Total	Container Manufacturing	Gemtex Division	Disco Division	Total	Container Manufacturing	Gemtex Division	Disco Division
Net sales	\$8,710	\$ 2,850	\$1,675	\$4,185	\$26,567	\$ 8,851	\$5,094	\$12,622
Operating income (loss) - net of tax	\$408	\$(280)	\$(229)	\$917	\$1,274	\$(537)	\$(1,041)	\$2,852

The components of assets held for sale are as follows (amounts in thousands):

	September 28, 2012			December 31, 2011		
	Total	Container Manufacturing	Gemtex Division	Total	Container Manufacturing	Gemtex Division
Assets						
Inventories, net	\$-	\$ -	\$-	\$1,351	\$ -	\$1,351
Goodwill	-	-	-	336	-	336
Property and equipment, net	564	564	-	968	766	202
	\$564	\$ 564	\$-	\$2,655	\$ 766	\$1,889

Note 4. INTANGIBLE ASSETS

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

Index

	September 28, 2012			December 31, 2011		
	Gross Amount	Accumulated Amortization	Net Carrying Amount	Gross Amount	Accumulated Amortization	Net Carrying Amount
Patents	\$1,327	\$ (1,198)	\$129	\$1,327	\$ (1,131)	\$196
Customer lists	9,391	(8,514)	877	9,391	(8,404)	987
Tradenames	4,099	(2,952)	1,147	4,099	(2,804)	1,295
Total	\$14,817	\$ (12,664)	\$2,153	\$14,817	\$ (12,339)	\$2,478

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):

2012 (remainder)	\$105
2013	398
2014	382
2015	367
2016	353
Thereafter	548
	\$2,153

Note 5. INDEBTEDNESS

On October 4, 2011, CCP, Glit/Gemtex, Ltd. and 3254018 Nova Scotia Limited (collectively, the "Borrowers"), wholly-owned subsidiaries of the Company, entered into a Loan and Security Agreement (as amended, the "PB Loan Agreement") with the PrivateBank and Trust Company ("PrivateBank"). On May 31, 2012, the PB Loan Agreement was amended (the "First Amendment") to provide additional flexibility under the financial covenants by replacing the minimum fixed charge ratio covenant for the period of April 27, 2012 to October 26, 2012, with a minimum earnings before interest, taxes, depreciation and amortization covenant and reduce the borrowing availability by \$1 million. In addition, the Company and the Lender agreed to certain specified transactions, which could include the sale or disposition of certain assets. The PB Loan Agreement was amended a second time on August 17, 2012 to modify the definition of earnings before interest, taxes, depreciation and amortization.

The PB Loan Agreement is a \$20.0 million revolving credit facility, including a \$3.0 million sub-limit for letters of credit. From October 4, 2011 to May 31, 2012 the PB Loan Agreement included a \$2.5 million sub-limit for capital expenditures ("CapEx Sublimit"). The proceeds of the Borrowers' initial borrowing under the PB Loan Agreement were used to repay the Revolving Credit, Term Loan and Security Agreement, as amended ("PNC Credit Agreement"), with PNC Bank, National Association ("PNC Bank") and pay fees and expenses associated with the negotiation and consummation of the credit facility. All extensions of credit under the PB Loan Agreement are collateralized by a first priority security interest in and lien upon substantially all present and future assets and properties of the Company and the Borrowers. The Company guarantees the obligations of the Borrowers under the PB Loan Agreement. There was \$11.3 million and \$14.4 million outstanding under the PB Loan Agreement as of September 28, 2012 and December 31, 2011, respectively.

The PB Loan Agreement has an expiration date of September 29, 2014 and its borrowing base is determined by eligible inventory and accounts receivable, amounting to \$18.9 million at September 28, 2012. The Company's borrowing base under the PB Loan Agreement is reduced by the outstanding amount of standby and commercial letters of credit and any outstanding borrowings under the CapEx Sublimit. There were \$0.2 million in outstanding

borrowings under the CapEx Sublimit as of September 28, 2012. There were no outstanding borrowings under the CapEx Sublimit as of December 31, 2011. Currently, the Company's largest letters of credit relate to its casualty insurance programs. The PB Loan Agreement requires the Company to have a minimum level of availability such that eligible collateral must exceed the sum of its outstanding borrowings and letters of credit by \$1 million. Upon extinguishment of the PNC Credit Agreement, the Company was required to advance cash to PNC Bank as collateral for the outstanding letters of credit in the amount of \$2.6 million, which is included in other current assets and the revolving credit agreement at December 31, 2011 and is no longer outstanding at September 28, 2012. Total outstanding letters of credit were \$2.1 million at September 28, 2012.

Index

Borrowings under the PB Loan Agreement bear interest at a per annum rate equal to the sum of the Prime Rate Revolving Loans Applicable Margin plus the Prime Rate (each as defined in the PB Loan Agreement), or at a per annum rate equal to the sum of the LIBOR Rate Revolving Loans Applicable Margin plus the LIBOR Rate (each as defined in the PB Loan Agreement) or an aggregate of 4.25% and 3.02% at September 28, 2012 and December 31, 2011, respectively. An unused commitment fee of 50 basis points per annum is payable monthly on the average unused amount of the PB Loan Agreement.

The PB Loan Agreement includes a financial covenant regarding minimum earnings before interest, taxes, depreciation and amortization from April 27, 2012 to October 26, 2012. The Company was in compliance with this financial covenant at September 28, 2012. Subsequent to October 26, 2012 the PB Loan agreement replaces the minimum earnings before interest, taxes, depreciation and amortization covenant with a fixed charge covenant ratio.

All of the debt under the PB Loan Agreement is re-priced to current rates at frequent intervals. Therefore, its fair value approximates its carrying value at September 28, 2012. For the three and nine months ended September 28, 2012, the Company had amortization of debt issuance costs, included within interest expense, of \$89,000 and \$178,000, respectively. For the three and nine months ended September 30, 2011, the Company had amortization of debt issuance costs, included within interest expense, of \$0.1 million and \$0.4 million, respectively.

The PB Loan 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 PB Loan 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 September 29, 2014. 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.

Note 6. 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 and nine months ended September 28, 2012 and September 30, 2011 is as follows (amounts in thousands):

Index

	Pension Benefits			
	Three Months Ended		Nine Months Ended	
	September	September	September	September
	28,	30,	28,	30,
	2012	2011	2012	2011
Components of net periodic benefit cost:				
Interest cost	\$16	\$ 18	\$50	\$ 55
Expected return on plan assets	\$(14)	\$(16)	(43)	(47)
Amortization of net loss	\$11	\$ 11	35	33
Net periodic benefit cost	\$13	\$ 13	\$42	\$ 41

	Other Benefits			
	Three Months Ended		Nine Months Ended	
	September	September	September	September
	28,	30,	28,	30,
	2012	2011	2012	2011
Components of net periodic benefit cost:				
Interest cost	\$31	\$ 26	\$93	\$ 77
Amortization of net loss	12	-	36	-
Net periodic benefit cost	\$43	\$ 26	\$129	\$ 77

During the three and nine months ended September 28, 2012, the Company made contributions to the pension plans of \$15,000 and \$45,000, respectively. The Company expects to contribute an additional \$15,000 to the pension plans throughout the remainder of 2012. 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 7. 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.

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, 2011	38,000	\$4.16		
Granted	-	\$-		

Edgar Filing: KATY INDUSTRIES INC - Form 10-Q

Exercised	-	\$-		
Expired	(6,000)	\$5.15		
Cancelled	-	\$-		
Outstanding at September 28, 2012	32,000	\$3.97	1.03 years	\$ -
Vested and Exercisable at September 28, 2012	32,000	\$3.97	1.03 years	\$ -

Index

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.

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

SARs	
Non-Vested at December 31, 2011	14,665
Granted	4,000
Vested	(7,333)
Cancelled	-
Non-Vested at September 28, 2012	11,332
Total Outstanding at September 28, 2012	244,684

At September 28, 2012 and December 31, 2011, the aggregate liability related to SARs was \$96,000 and \$44,000, respectively, and is included in accrued expenses in the Condensed Consolidated Balance Sheets.

Note 8. 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 September 28, 2012 and December 31, 2011, the Company had deferred tax assets, net of deferred tax liabilities, of \$76.3 million. Domestic net operating loss ("NOL") carry forwards comprised \$54.0 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 September 28, 2012 and December 31, 2011 are \$0.1 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 Company recognizes interest and penalties accrued related to the unrecognized tax benefits in the income tax provision. The Company had approximately \$25,000 of interest and penalties accrued at each of September 28, 2012 and December 31, 2011.

Note 9. 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 September 28, 2012 and December 31, 2011, the Company owed Kohlberg \$2.1 million and \$1.8 million, respectively, for these services, which is recorded in current liabilities on the Condensed Consolidated Balance Sheets. For each of the three and nine months ended September 28, 2012 and September 30, 2011, \$0.1 million and \$0.4 million, respectively, is recorded in selling, general and administrative expenses in the Condensed Consolidated Statements of Operations for these services.

Index

Note 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 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.

Other Claims

There are a number of product liability, asbestos 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.

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, 2011. Words and phrases such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “projects,” “may,” “should,” “will,” “continue,” “is subject to” 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 PB Loan Agreement.
 - Our inability to meet covenants associated with the PB Loan 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.
- 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 health-care costs, 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 September 28, 2012 versus Three Months Ended September 30, 2011

Net sales decreased 6.2% from \$29.1 million during the three months ended September 30, 2011 to \$27.3 million during the three months ended September 28, 2012. The majority of the decrease was a result of volume shortfall in

our Continental and Glit business units. Gross margin was 10.6% for the three months ended September 28, 2012, a decrease of 1.8 percentage point from the same period a year ago. Gross margin was impacted by an unfavorable LIFO adjustment of \$0.3 million resulting from inventory fluctuations in the three months ended September 28, 2012 as compared to a \$0.2 million unfavorable adjustment for the three months ended September 30, 2011. Excluding the LIFO adjustment in both periods, gross margin was 11.7% for the three months ended September 28, 2012 as compared to 13.1% for the three months ended September 30, 2011, respectively.

Index

Selling, general and administrative ("SG&A") expenses decreased to \$3.8 million for the three months ended September 28, 2012 from \$4.2 million for the same period a year ago. The decrease in SG&A expenses was primarily due to favorable quarter over quarter experience in group insurance and legal costs.

Operating loss was \$0.9 million for the three months ended September 28, 2012, compared to \$1.0 million for the same period a year ago primarily due to the decrease in gross margins as described above, which were offset by the decrease in SG&A expense as described above and the one-time severance, restructuring and related charges of \$0.4 million associated with the Company's noncancellable lease liability for an abandoned facility and the related sub-lease rental for the three months ended September 30, 2011.

Interest expense of \$0.3 million for the three months ended September 28, 2012 compared favorably to \$0.5 million for the same time period a year ago as a result of lower average borrowings under the PB Loan agreement (as defined below) than under the PNC Credit Agreement (as defined below).

With the sale of the Gemtex division and the closure of Container manufacturing at Norwalk, California during the three months ended September 28, 2012, all activity associated with these divisions has been classified as discontinued operations. Loss from operations for these divisions was \$1.0 million for the three months ended September 28, 2012, compared to a loss from these operations of \$0.5 million for the three months ended September 28, 2011. During the three months ended September 28, 2012 we recorded a loss of \$0.6 million on the sale of the Gemtex division. As a result of the sale of the DISCO division on October 4, 2011, all activity associated with the division was classified as discontinued operations. Income for the division was \$0.9 million for the three months ended September 30, 2011.

Overall, we reported a net loss of \$2.8 million, or \$0.35 per share, for the third quarter of 2012, as compared to net loss of \$1.1 million, or \$0.14 per share, for the third quarter of 2011.

Nine Months Ended September 28, 2012 versus Nine Months Ended September 30, 2011

Net sales decreased 2.5% from \$79.8 million during the nine months ended September 30, 2011 to \$77.8 million during the nine months ended September 28, 2012. The majority of the decrease was a result of volume shortfall in our Wilen and Glit business units. Changes in net sales resulting from pricing and currency translation were nominal and not sufficient to offset raw material cost increases. Gross margin was 11.5% for the nine months ended September 28, 2012, an increase of 0.3 percentage point from the same period a year ago. Gross margin was impacted by an unfavorable LIFO adjustment of \$0.7 for the nine months ended September 28, 2012 and nine months ending September 30, 2011 resulting from inventory fluctuations. Excluding the LIFO adjustment, gross margin increased by 0.3 percentage points from the first nine months of 2011.

SG&A expenses were stable at \$12.5 million for the nine months ended September 28, 2012, compared to \$12.7 million from the same period a year ago.

Operating loss decreased from \$4.2 million during the nine months ended September 30, 2011 to \$3.6 million during the nine months ended September 28, 2012 primarily due to the increase in gross margin as described above and the nine months ended September 30, 2011 was negatively impacted by one -time severance, restructuring and related charges of \$0.4 million associated with the Company's noncancellable lease liability for an abandoned facility and the related sub-lease rental.

Interest expense decreased by \$0.6 million for the nine months ended September 28, 2012 as compared to the nine months ended September 30, 2011 as a result of lower average borrowings under the PB Loan agreement (as defined

below) than under the PNC Credit Agreement (as defined below).

The income tax benefit for the nine months ended September 30, 2011 includes a benefit for the recognition of uncertain tax positions of \$0.3 million as the statutes of limitations on certain tax years expired.

With the sale of the Gemtex division and the closure of Container manufacturing at Norwalk California during the nine months ended September 28, 2012, all activity associated with these divisions has been classified as discontinued operations. Loss from operations for these divisions was \$1.5 million for the nine months ended September 28, 2012 compared to \$1.6 million for the nine months ended September 30, 2011. During the nine months ended September 28, 2012 we recorded a loss of \$0.6 million on the sale of the Gemtex division. As a result of the sale of the DISCO division on October 4, 2011, all activity associated with the division was classified as discontinued operations. Income for the division was \$2.8 million for the nine months ended September 30, 2011.

Index

Overall, we reported a net loss of \$6.1 million, or \$0.76 per share, for the nine months ended September 28, 2012, as compared to a net loss of \$3.7 million, or \$0.46 per share, for the same period a year ago.

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 PB Loan Agreement (as defined below) provide sufficient liquidity for our operations going forward. As of September 28, 2012, we had cash of \$0.9 million and outstanding checks of \$0.7 million as compared to cash of \$0.7 million and outstanding checks of \$0.9 million at December 31, 2011. As of September 28, 2012, we had outstanding borrowings of \$11.3 million (64% of total capitalization) under the PB Loan Agreement. Our unused borrowing availability at September 28, 2012 on the Revolving Credit Facility (as defined below) was \$4.5 million after the \$1.0 million minimum availability requirement discussed below. As of December 31, 2011, we had outstanding borrowings of \$14.4 million (53% of total capitalization) with unused borrowing availability of \$4.9 million.

PB Loan Agreement

On October 4, 2011, CCP, Glit/Gemtex, Ltd. and 3254018 Nova Scotia Limited (collectively, the “Borrowers”), wholly-owned subsidiaries of the Company, entered into a Loan and Security Agreement (as amended, the “PB Loan Agreement”) with the PrivateBank and Trust Company (“PrivateBank”). On May 31, 2012, the PB Loan Agreement was amended (the “First Amendment”) to provide additional flexibility under the financial covenants by replacing the minimum fixed charge ratio covenant for the period of April 27, 2012 to October 26, 2012, with a minimum earnings before interest, taxes, depreciation and amortization covenant and reduce the borrowing availability by \$1 million. In addition, the Company and the Lender agreed to certain specified transactions, which could include the sale or disposition of certain assets. The PB Loan Agreement was amended a second time on August 17, 2012 to modify the definition of earnings before interest, taxes, depreciation and amortization.

The PB Loan Agreement is a \$20.0 million revolving credit facility, including a \$3.0 million sub-limit for letters of credit. From October 4, 2011 to May 31, 2012 the PB Loan Agreement included a \$2.5 million sub-limit for capital expenditures (“CapEx Sublimit”). The proceeds of the Borrowers’ initial borrowing under the PB Loan Agreement were used to repay the Revolving Credit, Term Loan and Security Agreement, as amended (“PNC Credit Agreement”), with PNC Bank, National Association (“PNC Bank”) and pay fees and expenses associated with the negotiation and consummation of the credit facility. All extensions of credit under the PB Loan Agreement are collateralized by a first priority security interest in and lien upon substantially all present and future assets and properties of the Company and the Borrowers. The Company guarantees the obligations of the Borrowers under the PB Loan Agreement. There was \$11.3 million and \$14.4 million outstanding under the PB Loan Agreement as of September 28, 2012 and December 31, 2011, respectively.

The PB Loan Agreement has an expiration date of September 29, 2014 and its borrowing base is determined by eligible inventory and accounts receivable, amounting to \$18.9 million at September 28, 2012. The Company’s borrowing base under the PB Loan Agreement is reduced by the outstanding amount of standby and commercial letters of credit and any outstanding borrowings under the CapEx Sublimit. There were \$0.2 million in outstanding borrowings under the CapEx Sublimit as of September 28, 2012. There were no outstanding borrowings under the CapEx Sublimit as of December 31, 2011. Currently, the Company’s largest letters of credit relate to its casualty insurance programs. The PB Loan Agreement requires the Company to have a minimum level of availability such that eligible collateral must exceed the sum of its outstanding borrowings and letters of credit by \$1 million. Upon extinguishment of the PNC Credit Agreement, the Company was required to advance cash to PNC Bank as collateral for the outstanding letters of credit in the amount of \$2.6 million, which is included in other current assets and the

revolving credit agreement at December 31, 2011 and is no longer outstanding at September 28, 2012. Total outstanding letters of credit were \$2.1 million at September 28, 2012.

Borrowings under the PB Loan Agreement bear interest at a per annum rate equal to the sum of the Prime Rate Revolving Loans Applicable Margin plus the Prime Rate (each as defined in the PB Loan Agreement), or at a per annum rate equal to the sum of the LIBOR Rate Revolving Loans Applicable Margin plus the LIBOR Rate (each as defined in the PB Loan Agreement) or an aggregate of 4.25% and 3.02% at September 28, 2012 and December 31, 2011, respectively. An unused commitment fee of 50 basis points per annum is payable monthly on the average unused amount of the PB Loan Agreement.

The PB Loan Agreement includes a financial covenant regarding minimum earnings before interest, taxes, depreciation and amortization from April 27, 2012 to October 26, 2012. The Company was in compliance with this financial covenant at September 28, 2012. Subsequent to October 26, 2012 the PB Loan agreement replaces the minimum earnings before interest, taxes, depreciation and amortization covenant with a fixed charge covenant ratio.

Index

All of the debt under the PB Loan Agreement is re-priced to current rates at frequent intervals. Therefore, its fair value approximates its carrying value at September 28, 2012. For the three and nine months ended September 28, 2012, the Company had amortization of debt issuance costs, included within interest expense, of \$89,000 and \$178,000, respectively. For the three and nine months ended September 30, 2011, the Company had amortization of debt issuance costs, included within interest expense, of \$0.1 million and \$0.4 million, respectively.

The PB Loan 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 PB Loan 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 September 29, 2014. 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.

Cash Flows

Cash used in operating activities before changes in operating assets and liabilities was \$0.6 million in the first nine months of 2012 as compared to \$1.8 million of cash used in the same period of 2011. Changes in operating assets and liabilities from continuing operations provided \$3.1 million in the first nine months of 2012 as compared to use of \$2.5 million in the same period of 2011. This variance was primarily a result of a decrease in inventory as we continue to manage inventory levels, the refund of \$2.5 million in cash collateralization of letters of credit in connection with the termination of the PNC credit agreement and an increase in accounts receivable. As of September 28, 2012 we had day’s sales outstanding in accounts receivable of 39 days compared to 42 days as of December 31, 2011 and 41 days as of September 30, 2011.

Cash flows used from, financing activities in the nine months ended September 28, 2012 reflect a \$3.1 million decrease in our debt levels and a \$0.2 million decrease in our book overdraft since December 31, 2011. The decrease in debt levels is a result of \$0.3 million received in connection of the sale of Gemtex and the refund of \$2.5 million in cash collateralization of letters of credit in connection with the termination of the PNC credit agreement.

OFF-BALANCE SHEET ARRANGEMENTS

As of September 28, 2012, the Company had no off-balance sheet arrangements.

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 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, 2011 (Part II, Item 7). There have been no changes to these policies as of September 28, 2012.

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 September 28, 2012 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 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 Part I, Item 1A of our Annual Report on Form 10-K, filed on March 26, 2012. 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. MINE SAFETY DISCLOSURES

None.

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS

Exhibit Number	Exhibit Title	Page
3.1	The Amended and Restated By-Laws of the Company (incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K filed March 30, 2012).	
10.1	Consent and First Amendment to Loan and Security Agreement dated May 31, 2012, among Continental Commercial Products, LLC, Glit/Gemtex, Ltd., Katy Industries, Inc. and The PrivateBank and Trust Company (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed June 6, 2012).	
<u>31.1</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>31.2</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>32.1</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>32.2</u>	CFO Certification required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of # the Sarbanes-Oxley Act of 2002.
101	* Interactive data files pursuant to Rule 405 of Regulation S-5: (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Cash Flows and (iv) the Notes to Condensed Consolidated Financial Statements.

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: November 13, 2012

By /s/ David J. Feldman
David J. Feldman
President and Chief Executive Officer

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