KATY INDUSTRIES INC
Form 10-Q
May 13, 2010

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

FORM 10-Q

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

For the quarterly period ended: April 2, 2010

Or

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

Commission File Number 001-05558

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

Delaware	75-1277589
(State or other jurisdiction of incorporation or organization)	(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 x No o

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 o No o

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.

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x

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

Class	Outstanding at April 30, 2010
Common Stock, $1 Par Value	7,951,176 Shares

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
AS OF APRIL 2, 2010 (UNAUDITED) AND DECEMBER 31, 2009
(Amounts in Thousands)

ASSETS

	April 2, 2010	December 31, 2009
CURRENT ASSETS:		
Cash	$635	$747
Accounts receivable, net	14,641	12,831
Inventories, net	16,854	16,195
Other current assets	1,217	1,144
Total current assets	33,347	30,917
OTHER ASSETS:		
Goodwill	665	665
Intangibles, net	3,878	4,010
Other	2,830	2,830
Total other assets	7,373	7,505
PROPERTY AND EQUIPMENT		
Land and improvements	336	336
Buildings and improvements	9,519	9,514
Machinery and equipment	91,768	91,585
	101,623	101,435
Less - Accumulated depreciation	(75,114)	(73,417)
Property and equipment, net	26,509	28,018
Total assets	$67,229	$66,440

See Notes to Condensed Consolidated Financial Statements.

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KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
AS OF APRIL 2, 2010 (UNAUDITED) AND DECEMBER 31, 2009
(Amounts in Thousands, Except Share Data)

LIABILITIES AND STOCKHOLDERS' EQUITY

	April 2, 2010	December 31, 2009
CURRENT LIABILITIES:		
Accounts payable	$11,794	$10,476
Book overdraft	702	1,285
Accrued compensation	2,799	2,614
Accrued expenses	14,592	14,252
Current maturities of long-term debt	6,511	6,899
Revolving credit agreement	11,451	8,856
Total current liabilities	47,849	44,382
OTHER LIABILITIES	8,172	8,739
Total liabilities	56,021	53,121
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	27,324	27,246
Accumulated other comprehensive loss	(2,056)	(2,053)
Accumulated deficit	(110,701)	(108,515)
Treasury stock, at cost, 1,871,128 shares	(21,437)	(21,437)
Total stockholders' equity	11,208	13,319
Total liabilities and stockholders' equity	$67,229	$66,440

See Notes to Condensed Consolidated Financial Statements.

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KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED APRIL 2, 2010 AND APRIL 3, 2009
(Amounts in Thousands, Except Per Share Data)
(Unaudited)

	April 2, 2010	April 3, 2009
Net sales	$33,839	$35,092
Cost of goods sold	29,837	29,955
Gross profit	4,002	5,137
Selling, general and administrative expenses	6,033	7,164
Operating loss	(2,031)	(2,027)
Interest expense	(289)	(309)
Other, net	101	(73)
Loss before income tax benefit (provision)	(2,219)	(2,409)
Income tax benefit (provision)	33	(6)
Net loss	$(2,186)	$(2,415)
Loss per share of common stock - Basic and diluted:		
Net loss	$(0.27)	$(0.30)
Weighted average common shares outstanding:		
Basic and diluted	7,951	7,951

See Notes to Condensed Consolidated Financial Statements.

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KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED APRIL 2, 2010 AND APRIL 3, 2009
(Amounts in Thousands)
(Unaudited)

	April 2, 2010	April 3, 2009
Cash flows from operating activities:		
Net loss	$(2,186)	$(2,415)
Depreciation	1,616	1,539
Amortization of intangible assets	135	117
Amortization of debt issuance costs	96	96
Stock-based compensation	59	7
	(280)	(656)
Changes in operating assets and liabilities:		
Accounts receivable	(1,780)	(1,479)
Inventories	(599)	4,032
Other assets	(177)	1,148
Accounts payable	1,293	(728)
Accrued expenses	526	(214)
Other	(566)	(749)
	(1,303)	2,010
Net cash (used in) provided by operating activities	(1,583)	1,354
Cash flows from investing activities:		
Capital expenditures	(89)	(186)
Net cash used in investing activities	(89)	(186)
Cash flows from financing activities:		
Net borrowings (repayments) on revolving loans	2,555	(131)
Decrease in book overdraft	(583)	(513)
Repayments of term loans	(388)	(375)
Net cash provided by (used in) financing activities	1,584	(1,019)
Effect of exchange rate changes on cash	(24)	23
Net (decrease) increase in cash	(112)	172
Cash, beginning of period	747	683
Cash, end of period	$635	$855

See Notes to Condensed Consolidated Financial Statements.

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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% interest, collectively "Katy" or the "Company". All significant intercompany accounts, profits and transactions have been eliminated in consolidation. The Condensed Consolidated Balance Sheet at April 2, 2010 and the related Condensed Consolidated Statements of Operations for the three months ended April 2, 2010 and April 3, 2009 and Cash Flows for the three months ended April 2, 2010 and April 3, 2009 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 period. 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, 2009. The Condensed Consolidated Balance Sheet as of December 31, 2009 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 2, 2010 consisted of 64 shipping days and the three months ended April 3, 2009 consisted of 66 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 cash flows statement were made to the 2009 amounts in order to conform to the 2010 presentation.

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

	April 2, 2010	December 31, 2009
Raw materials	$ 10,014	$ 10,240
Finished goods	11,950	10,744
Inventory reserves	(1,252)	(1,315)
LIFO reserve	(3,858)	(3,474)
	$ 16,854	$ 16,195

At April 2, 2010 and December 31, 2009, 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 $3.9 million and $3.5 million at April 2, 2010 and December 31, 2009, respectively.

Share-Based Payment – Compensation cost recognized during the three months ended April 2, 2010 and April 3, 2009 includes: a) compensation cost for all stock options granted prior to, but not yet vested as of January 1, 2006, and granted subsequent to January 1, 2006, 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 2, 2010 and April 3, 2009 based on the April 2, 2010 and April 3, 2009 fair value, respectively.

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

	Three Months Ended	
	April 2, 2010	April 3, 2009
Stock option expense	$ 78	$ 161
Stock appreciation right income	(19)	(154)
	$ 59	$ 7

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 each of the three months ended April 2, 2010 and April 3, 2009.

The fair value of SARs, a liability award, was estimated at April 2, 2010 and April 3, 2009 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 2, 2010	April 3, 2009
Expected term (years)	1.2 - 6.5	0.1 - 4.6
Volatility	126.9% - 182.2%	127.5% - 203.4%
Risk-free interest rate	0.5% - 3.2%	0.2% - 1.8%

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

	Three Months Ended	
	April 2, 2010	April 3, 2009
Net loss	$ (2,186)	$ (2,415)

Foreign currency translation losses	(3)	(34)
Comprehensive loss	$ (2,189)	$ (2,449)

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 $0.8 million at each of April 2, 2010 and December 31, 2009. The balance of pension and other postretirement benefits adjustments was $1.3 million at each of April 2, 2010 and December 31, 2009.

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.

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Note 2. NEW ACCOUNTING PRONOUNCEMENTS

Recently Adopted Accounting Standards – In June 2009, the Financial Accounting Standards Board ("FASB") established the Accounting Standards Codification ("AS Codification") as the source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities. The AS Codification was not intended to change existing accounting for public companies. The AS Codification identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements. For the Company, the AS Codification was effective October 2, 2009. The Company's adoption of the AS Codification did not have a material impact on its consolidated financial statements; however, as part of the transition to the AS Codification, plain English references to the corresponding accounting principles are provided rather than specific numeric AS Codification references.

Accounting Standards Not Yet Adopted – In October 2009, the 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 is currently evaluating the impact of this guidance on its consolidated financial statements.

Note 3. INTANGIBLE ASSETS

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

	April 2, 2010			December 31, 2009		
	Gross Amount	Accumulated Amortization	Net Carrying Amount	Gross Amount	Accumulated Amortization	Net Carrying Amount
Patents	$1,205	$ (977)	$228	$1,202	$ (952)	$250
Customer lists	10,231	(8,630)	1,601	10,231	(8,582)	1,649
Tradenames	5,054	(3,005)	2,049	5,054	(2,943)	2,111
Total	$16,490	$ (12,612)	$3,878	$16,487	$ (12,477)	$4,010

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):

2010 (remainder)	$404
2011	512
2012	487
2013	466
2014	449
Thereafter	1,560
	$3,878

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Note 4. INDEBTEDNESS

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

	April 2, 2010	December 31, 2009
Term loan payable under the Bank of America Credit Agreement, interest based on LIBOR and Prime Rates (3.00% - 4.25%), due through Nov 2010	$ 6,511	$ 6,899
Revolving loans payable under the Bank of America Credit Agreement, interest based on LIBOR and Prime Rates (2.75% - 4.75%)	11,451	8,856
Total debt	17,962	15,755
Less revolving loans, classified as current	(11,451)	(8,856)
Less current maturities	(6,511)	(6,899)
Long-term debt	$ -	$ -

Aggregate remaining scheduled maturities of the Term Loan as of April 2, 2010 are as follows (amounts in thousands):

2010 (remainder)	$6,511
	$6,511

On November 30, 2007, the Company entered into the Second Amended and Restated Credit Agreement with Bank of America (the "Bank of America Credit Agreement"). The Bank of America Credit Agreement is a $50.6 million credit facility with a $10.6 million term loan ("Term Loan") and a $40.0 million revolving loan ("Revolving Credit Facility"), including a $10.0 million sub-limit for letters of credit. The Bank of America Credit Agreement is an asset-based lending agreement involving one bank.

The annual amortization on the Term Loan, paid quarterly, is $1.5 million with final payment of $5.8 million due November 30, 2010. At April 2, 2010, the balance of the Term Loan was $6.5 million and was classified as current. The Term Loan is collateralized by the Company's property, plant and equipment. The Revolving Credit Facility matures on November 30, 2010 and all extensions of credit are collateralized by a first priority security interest in and lien upon the capital stock of each material domestic subsidiary of the Company (65% of the capital stock of certain foreign subsidiaries of the Company), and all present and future assets and properties of the Company.

The Company's borrowing base under the Bank of America Credit Agreement is determined by eligible inventory and accounts receivable, amounting to $20.4 million at April 2, 2010, and is reduced by the outstanding amount of standby and commercial letters of credit. The Bank of America Credit Agreement requires the Company to maintain a minimum level of availability such that its eligible collateral must exceed the sum of its outstanding borrowings under the Revolving Credit Facility and letters of credit by at least $5.0 million. Currently, the Company's largest letters of credit relate to its casualty insurance programs. At April 2, 2010, total outstanding letters of credit were $3.2 million. In addition, the Bank of America Credit Agreement prohibits the Company from paying dividends on its securities, other than dividends paid solely in securities.

Borrowings under the Bank of America Credit Agreement bear interest, at the Company's option, at either a rate equal to the bank's base rate or LIBOR plus a margin based on levels of borrowing availability. Interest rate margins for the Revolving Credit Facility under the applicable LIBOR option range from 2.00% to 2.50%, or under the applicable prime option range from 0.25% to 0.75% on borrowing availability levels of $20.0 million to less than $10.0 million, respectively. For the Term Loan, interest rate margins under the applicable LIBOR option range from 2.25% to 2.75%, or under the applicable prime option range from 0.50% to 1.00%. Financial covenants such as minimum fixed charge coverage and leverage ratios are not included in the Bank of America Credit Agreement.

All of the debt under the Bank of America Credit Agreement is re-priced to current rates at frequent intervals. Therefore, its fair value approximates its carrying value at April 2, 2010. For each of the three months ended April 2, 2010 and April 3, 2009, the Company had amortization of debt issuance costs, included within interest expense, of $0.1 million.

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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 2, 2010 and April 3, 2009 is as follows (amounts in thousands):

	Pension Benefits Three Months Ended		Other Benefits Three Months Ended	
	April 2, 2010	April 3, 2009	April 2, 2010	April 3, 2009
Components of net periodic benefit cost:				
Interest cost	$ 18	$ 19	$ 33	$ 36
Expected return on plan assets	(15)	(13)	-	-
Amortization of net loss	11	11	8	-
Net periodic benefit cost	$ 14	$ 17	$ 41	$ 36

During the three months ended April 2, 2010, the Company made contributions to the pension plans of $10,000. The Company expects to contribute an additional $31,000 to the pension plans throughout the remainder of 2010. 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.

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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, 2009	1,501,000	$ 1.97		
Granted	-	$ -		
Exercised	-	$ -		
Expired	(8,000)	$ 9.50		
Cancelled	-	$ -		
Outstanding at April 2, 2010	1,493,000	$ 1.93	6.60 years	$ 654
Vested and Exercisable at April 2, 2010	701,334	$ 2.80	4.65 years	$ 187

As of April 2, 2010, total unvested compensation expense associated with stock options amounted to $0.2 million and is being amortized on a straight-line basis over the respective options’ vesting period. The weighted average period in which the above compensation cost will be recognized is 0.8 years as of April 2, 2010.

A summary of the status of the Company’s non-vested stock options as of April 2, 2010 is presented in the table below:

	Options	Weighted Average Grant Date Fair Value
Non-Vested at December 31, 2009	791,666	$ 0.89
Granted	-	$ -
Vested	-	$ -
Cancelled	-	$ -
Non-Vested at April 2, 2010	791,666	$ 0.89

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

	SARs	Weighted Average Fair Value
	32,000	$ 1.54

Non-Vested at December 31, 2009		
Granted	60,000	$ 1.59
Vested	-	$ -
Cancelled	-	$ -
Non-Vested at April 2, 2010	92,000	$ 1.58
Total Outstanding at April 2, 2010	555,267	$ 1.19

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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 2005.

As of April 2, 2010 and December 31, 2009, the Company had deferred tax assets, net of deferred tax liabilities, of $75.7 million. Domestic net operating loss ("NOL") carry forwards comprised $48.6 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, and tax benefits were not recorded on the pre-tax net loss for the three months ended April 2, 2010.

Accounting for Uncertainty in Income Taxes

Included in the balances at April 2, 2010 and December 31, 2009 are $0.8 million and $0.9 million, respectively, 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 $0.3 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 $0.3 million of interest and penalties accrued at each of April 2, 2010 and December 31, 2009, respectively.

Note 8. RELATED PARTY TRANSACTIONS

Kohlberg & Co., L.L.C. ("Kohlberg"), 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 2, 2010, the Company owed Kohlberg $0.1 million for these services. This amount is recorded in accounts payable in the Condensed Consolidated Balance Sheets and selling, general and administrative expenses in the Condensed Consolidated Statements of Operations.

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.

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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 2,750 cases pending in Michigan, New Jersey, New York, Illinois, Nevada, Mississippi, Wyoming, Louisiana, Georgia, Massachusetts, Missouri, Kentucky, California 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.

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 400 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 80 cases which remain active as of April 2, 2010.

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

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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

In 2002, the Company committed to a plan to consolidate the manufacturing and distribution of the four Continental Commercial Products, LLC ("CCP") facilities in the St. Louis, Missouri area. Management believed that in order to implement a more competitive cost structure, 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, 2009	$ 415
Additions	-
Payments	(27)
Restructuring liabilities at April 2, 2010	$ 388

These amounts relate 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 $0.9 million as of April 2, 2010. The Company has included $0.5 million as an offset for sub-lease rentals. As of April 2, 2010, the Company does not anticipate any further significant severance, restructuring and other related charges in the upcoming year related to the plans discussed above.

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

2010 (remainder)	$171
2011	217

$388

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, 2009. Words and phrases such as "anticipates," "believes," "estimates," "expects," "intends," "plans," "projects," "may," "should," "will," "continue," "is subje 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:

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- Increases in the cost of, or in some cases continuation of, the current price levels of thermoplastic resins, paper board packaging, 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 control our raw materials costs.
- 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 Bank of America Credit Agreement.
- Our inability to meet covenants associated with the Bank of America 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.

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RESULTS OF OPERATIONS

Three Months Ended April 2, 2010 versus Three Months Ended April 3, 2009

Net sales decreased 3.6% from $35.1 million during the three months ended April 3, 2009 to $33.8 million during the three months ended April 2, 2010. Overall, this decline was a result of two fewer shipping days in the quarter (64 days in the three months ended April 2, 2010 versus 66 days in the three months ended April 3, 2009). Gross margin was 11.8% for the three months ended April 2, 2010, a decrease of 2.8 percentage points from the same period a year ago. Gross margin was impacted by an unfavorable variance in our LIFO adjustment of $1.6 million resulting from an increase in resin prices. Excluding the LIFO adjustment, gross margin increased 1.7 percentage points from the first quarter of 2009. The increase was a result of improvements in productivity, including the related impact on material costs and scrap reduction, as well as better sourcing results from lower cost countries.

Selling, general and administrative expenses were $6.0 million for the three months ended April 2, 2010, a $1.1 million reduction from the same period a year ago. The decrease was primarily due to prior year expenses associated with the transition and hiring of executive level personnel and a decrease in self-insurance accruals.

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 $2.2 million, or $0.27 per share, for the first quarter of 2010, as compared to a net loss of $2.4 million, or $0.30 per share, for the first quarter of 2009.

LIQUIDITY AND CAPITAL RESOURCES

We require funding for working capital needs and capital expenditures. We believe that our cash flow from operations and the use of available borrowings under the Bank of America Credit Agreement (as defined below) provide sufficient liquidity for our operations going forward. As of April 2, 2010, we had cash of $0.6 million as compared to cash of $0.7 million at December 31, 2009. As of April 2, 2010, we had outstanding borrowings of $18.0 million (62% of total capitalization) under the Bank of America Credit Agreement (as defined below), which matures on November 30, 2010. Our unused borrowing availability at April 2, 2010 on the Revolving Credit Facility (as defined below) was $0.7 million after the $5.0 million minimum availability requirement discussed below. As of December 31, 2009, we had outstanding borrowings of $15.8 million (54% of total capitalization) with unused borrowing availability of $1.3 million after the $5.0 million minimum availability requirement.

Bank of America Credit Agreement

On November 30, 2007, the Company entered into the Second Amended and Restated Credit Agreement with Bank of America (the “Bank of America Credit Agreement”). The Bank of America Credit Agreement is a $50.6 million credit facility with a $10.6 million term loan (“Term Loan”) and a $40.0 million revolving loan (“Revolving Credit Facility”), including a $10.0 million sub-limit for letters of credit. The Bank of America Credit Agreement is an asset-based lending agreement involving one bank.

The annual amortization on the Term Loan, paid quarterly, is $1.5 million with final payment of $5.8 million due November 30, 2010. At April 2, 2010, the balance of the Term Loan was $6.5 million and was classified as current. The Term Loan is collateralized by the Company’s property, plant and equipment. The Revolving Credit Facility matures on November 30, 2010 and all extensions of credit are collateralized by a first priority security interest in and lien upon the capital stock of each material domestic subsidiary of the Company (65% of the capital stock of certain foreign subsidiaries of the Company), and all present and future assets and properties of the Company.

The Company's borrowing base under the Bank of America Credit Agreement is determined by eligible inventory and accounts receivable, amounting to $20.4 million at April 2, 2010, and is reduced by the outstanding amount of standby and commercial letters of credit. The Bank of America Credit Agreement requires the Company to maintain a minimum level of availability such that its eligible collateral must exceed the sum of its outstanding borrowings under the Revolving Credit Facility and letters of credit by at least $5.0 million. Currently, the Company's largest letters of credit relate to its casualty insurance programs. At April 2, 2010, total outstanding letters of credit were $3.2 million. In addition, the Bank of America Credit Agreement prohibits the Company from paying dividends on its securities, other than dividends paid solely in securities.

Borrowings under the Bank of America Credit Agreement bear interest, at the Company's option, at either a rate equal to the bank's base rate or LIBOR plus a margin based on levels of borrowing availability. Interest rate margins for the Revolving Credit Facility under the applicable LIBOR option range from 2.00% to 2.50%, or under the applicable prime option range from 0.25% to 0.75% on borrowing availability levels of $20.0 million to less than $10.0 million, respectively. For the Term Loan, interest rate margins under the applicable LIBOR option range from 2.25% to 2.75%, or under the applicable prime option range from 0.50% to 1.00%. Financial covenants such as minimum fixed charge coverage and leverage ratios are not included in the Bank of America Credit Agreement.

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All of the debt under the Bank of America Credit Agreement is re-priced to current rates at frequent intervals. Therefore, its fair value approximates its carrying value at April 2, 2010. For each of the three months ended April 2, 2010 and April 3, 2009, the Company had amortization of debt issuance costs, included within interest expense, of $0.1 million.

Cash Flows

Cash used in operating activities before changes in operating assets and liabilities was $0.3 million in the first quarter of 2010 as compared to $0.7 million in the same period of 2009. This variance was primarily a result of a $0.2 million reduction in net loss from operations quarter over quarter. Changes in operating assets and liabilities used $1.3 million in the first quarter of 2010 as compared to providing $2.0 million in the same period of 2009. This variance was a result of an increase in accounts receivable and inventories, partially offset by an increase in accounts payable. The change in accounts receivable was due to increased sales from the fourth quarter of 2009 to the first quarter of 2010, and the increase in inventory was due to the timing of mop purchases. The increase in accounts payable was primarily a result of improved payment terms with certain vendors and the timing of mop and resin purchases. As of April 2, 2010 we were turning our inventory at 4.2 times per year as compared to 3.9 times per year as of December 31, 2009 and 4.5 times per year as of April 3, 2009.

Cash flows used in financing activities in the first quarter of 2010 reflect a $2.2 million increase in our debt levels since December 31, 2009.

OFF-BALANCE SHEET ARRANGEMENTS

As of April 2, 2010, 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.

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, 2009 (Part II, Item 7). There have been no changes to these policies as of April 2, 2010.

Item 4T. 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.

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.

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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 2, 2010 that have materially affected, or are reasonably likely to materially affect, Katy's internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Except as otherwise noted in Note 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 25, 2010. 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	
31.1	CEO Certification pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	
31.2	CFO Certification pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	
32.1	CEO Certification required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	#
32.2	CFO Certification required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	#

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.

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Signatures

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

KATY INDUSTRIES, INC.
Registrant

DATE: May 13, 2010 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