

KATY INDUSTRIES INC
Form 10-Q
August 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: June 29, 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 63044
(Address of principal executive offices) (Zip Code)

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

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

Yes No

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

Yes No

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

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

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

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

| Class | Outstanding at July 27, 2012 |
|-----------------------------|------------------------------|
| Common Stock, \$1 Par Value | 7,951,176 Shares |

KATY INDUSTRIES, INC.
 FORM 10-Q
 June 29, 2012

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

KATY INDUSTRIES, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS
 AS OF JUNE 29, 2012 (UNAUDITED) AND DECEMBER 31, 2011
 (Amounts in Thousands)

ASSETS

| | June 29, 2012 | December 31, 2011 |
|---------------------------------|------------------|-------------------------|
| CURRENT ASSETS: | | |
| Cash | \$866 | \$730 |
| Accounts receivable, net | 14,748 | 11,759 |
| Inventories, net | 14,534 | 17,262 |
| Other current assets | 2,925 | 4,086 |
| Total current assets | 33,073 | 33,837 |
| OTHER ASSETS: | | |
| Goodwill | 665 | 665 |
| Intangibles, net | 2,258 | 2,478 |
| Other | 1,611 | 2,032 |
| Total other assets | 4,534 | 5,175 |
| PROPERTY AND EQUIPMENT | | |
| Land and improvements | 336 | 336 |
| Buildings and improvements | 9,101 | 9,101 |
| Machinery and equipment | 87,134 | 86,926 |
| | 96,571 | 96,363 |
| Less - Accumulated depreciation | (79,110) | (77,562) |
| Property and equipment, net | 17,461 | 18,801 |
| Total assets | \$55,068 | \$57,813 |

See Notes to Condensed Consolidated Financial Statements.

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KATY INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
AS OF JUNE 29, 2012 (UNAUDITED) AND DECEMBER 31, 2011
(Amounts in Thousands, Except Share Data)

LIABILITIES AND STOCKHOLDERS' EQUITY

| | June 29, 2012 | December 31, 2011 |
|---|------------------|-------------------------|
| CURRENT LIABILITIES: | | |
| Accounts payable | \$8,480 | \$8,928 |
| Book overdraft | 733 | 946 |
| Accrued compensation | 1,340 | 1,317 |
| Accrued expenses | 9,050 | 8,701 |
| Payable to related party | 2,000 | 1,750 |
| Deferred revenue | 688 | 688 |
| Revolving credit agreement | 15,361 | 14,359 |
| Total current liabilities | 37,652 | 36,689 |
| DEFERRED REVENUE | 2,263 | 2,605 |
| OTHER LIABILITIES | 5,846 | 5,904 |
| Total liabilities | 45,761 | 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 | (2,368) | (2,361) |
| Accumulated deficit | (112,076) | (108,775) |
| Treasury stock, at cost, 1,871,128 shares | (21,437) | (21,437) |
| Total stockholders' equity | 9,307 | 12,615 |
| Total liabilities and stockholders' equity | \$55,068 | \$57,813 |

See Notes to Condensed Consolidated Financial Statements.

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KATY INDUSTRIES, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
 FOR THE THREE AND SIX MONTHS ENDED JUNE 29, 2012 AND JULY 1, 2011

(Amounts in Thousands, Except Per Share Data)

(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-----------------|------------------|-----------------|
| | June 29, 2012 | July 1, 2011 | June 29, 2012 | July 1, 2011 |
| Net sales | \$31,673 | \$31,502 | \$59,343 | \$60,141 |
| Cost of goods sold | 27,954 | 28,906 | 53,063 | 54,788 |
| Gross profit | 3,719 | 2,596 | 6,280 | 5,353 |
| Selling, general and administrative expenses | 4,610 | 4,716 | 9,362 | 9,359 |
| Gain on disposal of assets | - | 85 | - | 10 |
| Operating loss | (891) | (2,205) | (3,082) | (4,016) |
| Interest expense | (233) | (425) | (424) | (799) |
| Other, net | 89 | 110 | 204 | 75 |
| Loss from continuing operations before income tax benefit (expense) | (1,035) | (2,520) | (3,302) | (4,740) |
| Income tax benefit (expense) from continuing operations | (6) | 257 | 1 | 248 |
| Loss from continuing operations | (1,041) | (2,263) | (3,301) | (4,492) |
| Income from operations of discontinued business (net of tax) | - | 959 | - | 1,935 |
| Net loss | \$(1,041) | \$(1,304) | \$(3,301) | \$(2,557) |
| Net loss | \$(1,041) | \$(1,304) | \$(3,301) | \$(2,557) |
| Other comprehensive income (loss) | | | | |
| Foreign currency translation | (54) | 74 | (6) | 192 |
| Total comprehensive loss | \$(1,095) | \$(1,230) | \$(3,307) | \$(2,365) |
| Income (loss) per share of common stock - Basic and Diluted: | | | | |
| Loss from continuing operations | \$(0.13) | \$(0.28) | \$(0.42) | \$(0.56) |
| Discontinued operations | - | 0.12 | - | 0.24 |
| Net loss | \$(0.13) | \$(0.16) | \$(0.42) | \$(0.32) |
| Weighted average common shares outstanding: | | | | |
| Basic and diluted | 7,951 | 7,951 | 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 SIX MONTHS ENDED JUNE 29, 2012 AND JULY 1, 2011
 (Amounts in Thousands)
 (Unaudited)

| | June 29, 2012 | July 1, 2011 |
|---|------------------|-----------------|
| Cash flows from operating activities: | | |
| Net loss | \$(3,301) | \$(2,557) |
| Income from discontinued operations | - | (1,935) |
| Loss from continuing operations | (3,301) | (4,492) |
| Depreciation | 2,048 | 2,275 |
| Amortization of intangible assets | 217 | 207 |
| Amortization of debt issuance costs | 89 | 169 |
| Stock-based compensation | 117 | (587) |
| Gain on sale or disposal of assets | - | 10 |
| | (830) | (2,418) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (2,985) | (3,269) |
| Inventories | 2,731 | (2,391) |
| Other assets | 1,485 | 327 |
| Accounts payable | (865) | 3,801 |
| Accrued expenses | 501 | (349) |
| Payable to related party | 250 | 1,000 |
| Deferred revenue | (342) | - |
| Other | (177) | 60 |
| | 598 | (821) |
| Net cash used in continuing operations | (232) | (3,239) |
| Net cash provided by discontinued operations | - | 2,306 |
| Net cash used in operating activities | (232) | (933) |
| Cash flows from investing activities: | | |
| Capital expenditures | (398) | (133) |
| Proceeds from sale of assets | - | 81 |
| Net cash used in investing activities | (398) | (52) |
| Cash flows from financing activities: | | |
| Net borrowings | 1,006 | 1,680 |
| Decrease in book overdraft | (213) | (562) |
| Repayments of term loans | - | (857) |
| Direct costs associated with debt facilities | - | (264) |
| Net cash provided by (used in) financing activities | 793 | (3) |
| Effect of exchange rate changes on cash | (27) | 152 |
| Net increase (decrease) in cash | 136 | (836) |
| Cash, beginning of period | 730 | 1,319 |
| Cash, end of period | \$866 | \$483 |

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% 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 June 29, 2012 and the related Condensed Consolidated Statements of Operations and Comprehensive Loss for the three and six months ended June 29, 2012 and July 1, 2011 and Cash Flows for the six months ended June 29, 2012 and July 1, 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, in October 2011, the Company sold substantially all assets and certain liabilities related to the DISCO division of Continental Commercial Products, LLC (“CCP”), a wholly-owned subsidiary of the Company. The Company accounted for this division 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 June 29, 2012 and July 1, 2011 consisted of 63 shipping days. The six months ended June 29, 2012 and July 1, 2011 consisted of 127 shipping days.

Use of Estimates – 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.

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

| | June 29, 2012 | December 31, 2011 |
|--------------------|------------------|----------------------|
| Raw materials | \$ 7,033 | \$ 8,841 |
| Finished goods | 13,290 | 13,992 |
| Inventory reserves | (1,064) | (1,072) |
| LIFO reserve | (4,725) | (4,499) |
| | \$ 14,534 | \$ 17,262 |

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At June 29, 2012 and December 31, 2011, approximately 61% and 62%, 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 \$4.7 million and \$4.5 million at June 29, 2012 and December 31, 2011, respectively.

Share-Based Payment – Compensation cost recognized during the three and six months ended June 29, 2012 and July 1, 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 June 29, 2012 and July 1, 2011 based on the June 29, 2012 and June 1, 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 expense (income) is included in selling, general and administrative expense in the Condensed Consolidated Statements of Operations and Comprehensive Loss. The components of compensation expense (income) are as follows (amounts in thousands):

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------------|------------------|-----------------|
| | June 29, 2012 | July 1, 2011 | June 29, 2012 | July 1, 2011 |
| Stock option income | \$ - | \$ (21) | \$ - | \$ (274) |
| Stock appreciation right expense (income) | 4 | (75) | 117 | (313) |
| | \$ 4 | \$ (96) | \$ 117 | \$ (587) |

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

The fair value of stock options is estimated at the date of grant using a Black-Scholes option pricing model. As the Company does not have sufficient historical exercise data to provide a basis for estimating the expected term, the Company uses the simplified method for estimating the expected term by averaging the minimum and maximum lives expected for each award. In addition, the Company estimated volatility by considering its historical stock volatility over a term comparable to the remaining expected life of each award. The risk-free interest rate is the current yield available on U.S. treasury issues with a remaining term equal to each award. The Company estimates forfeitures using historical results. Its estimates of forfeitures will be adjusted over the requisite service period based on the extent to which actual forfeitures differ, or are expected to differ, from their estimate. There were no stock options granted during the three and six months ended June 29, 2012 and July 1, 2011.

The fair value of SARs, a liability award, was estimated at June 29, 2012 and July 1, 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:

June 29, July 1,

| | 2012 | 2011 |
|-------------------------|-----------|-----------|
| Expected term (years) | 0.4 - 5.0 | 1.4 - 5.2 |
| | 284.8% - | 171.5% - |
| Volatility | 559.0% | 218.2% |
| | 0.1% - | 0.3% - |
| Risk-free interest rate | 0.7% | 1.9% |

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 \$0.6 million at June 29, 2012 and December 31, 2011. The balance of pension and other postretirement benefits adjustments was \$1.8 million at each of June 29, 2012 and December 31, 2011.

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 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 six months ended June 29, 2012. The adoption of the guidance had no effect on the Company's financial position or results of operations.

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 six months ended June 29, 2012 and was applied retrospectively. The adoption of the guidance had no effect on the Company's financial position or results of operations.

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 six months ended June 29, 2012. The adoption of the guidance had no effect on the Company's financial position or results of operations.

In July 2012, the FASB has 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 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.

Note 3. DISCONTINUED OPERATIONS

On October 4, 2011, the Company sold substantially all assets and certain liabilities related to the DISCO division of CCP 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 \$0.5 million 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). The sale of the DISCO division met the criteria for classification as a discontinued operation in accordance with GAAP; therefore, the Company has classified the results of the DISCO division as discontinued operations for all periods presented. Selected financial data for discontinued operations is summarized as follows (amounts in thousands):

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| | Three Months Ended June 29, 2012 | Six Months Ended June 29, 2012 |
|--------------------------|---|---|
| Net sales | \$ 4,167 | \$ 8,437 |
| Pre-tax operating income | \$ 959 | \$ 1,935 |

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Note 4.INTANGIBLE ASSETS

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

| | June 29, 2012 | | | December 31, 2011 | | |
|----------------|------------------|-----------------------------|---------------------------|----------------------|-----------------------------|---------------------------|
| | Gross Amount | Accumulated Amortization | Net Carrying Amount | Gross Amount | Accumulated Amortization | Net Carrying Amount |
| Patents | \$1,324 | \$ (1,176) | \$148 | \$1,327 | \$ (1,131) | \$196 |
| Customer lists | 9,391 | (8,478) | 913 | 9,391 | (8,404) | 987 |
| Tradenames | 4,099 | (2,902) | 1,197 | 4,099 | (2,804) | 1,295 |
| Total | \$14,814 | \$ (12,556) | \$2,258 | \$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) | \$210 |
| 2013 | 398 |
| 2014 | 382 |
| 2015 | 367 |
| 2016 | 353 |
| Thereafter | 548 |
| | \$2,258 |

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 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 \$15.4 million and \$14.4 million outstanding under the PB Loan Agreement as of June 29, 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 \$20.0 million at June 29, 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 June 29, 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, of which \$1.5 million was still outstanding at June 29, 2012. The cash advance is recorded within other current assets and the revolving credit agreement in the Consolidated Balance Sheets. At June 29, 2012, total outstanding letters of credit were \$2.5 million, of which \$1.5 million is issued by PNC Bank under the PNC Credit Agreement until they are transferred to PrivateBank under the PB Loan Agreement.

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 June 29, 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.

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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 June 29, 2012. Subsequent to October 26, 2012 the PB Loan agreement will replace 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 June 29, 2012. For the three and six months ended June 29, 2012, the Company had amortization of debt issuance costs, included within interest expense, of \$49,000 and \$89,000, respectively. For the three and six months ended July 1, 2011, the Company had amortization of debt issuance costs, included within interest expense, of \$0.1 million and \$0.3 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 six months ended June 29, 2012 and July 1, 2011 is as follows (amounts in thousands):

| | Pension Benefits | | | |
|--|--------------------|-----------------|------------------|-----------------|
| | Three Months Ended | | Six Months Ended | |
| | June 29, 2012 | July 1, 2011 | June 29, 2012 | July 1, 2011 |
| Components of net periodic benefit cost: | | | | |
| Interest cost | \$ 17 | \$ 19 | \$ 34 | \$ 37 |
| Expected return on plan assets | (13) | (15) | (29) | (31) |
| Amortization of net loss | 12 | 11 | 24 | 22 |
| Net periodic benefit cost | \$ 16 | \$ 15 | \$ 29 | \$ 28 |

| | Other Benefits | | | |
|--|--------------------|-----------------|------------------|-----------------|
| | Three Months Ended | | Six Months Ended | |
| | June 29, 2012 | July 1, 2011 | June 29, 2012 | July 1, 2011 |
| | | | | |

Components of net periodic benefit

cost:

| | | | | |
|---------------------------|-------|-------|-------|-------|
| Interest cost | \$ 30 | \$ 25 | \$ 62 | \$ 51 |
| Net periodic benefit cost | \$ 30 | \$ 25 | \$ 62 | \$ 51 |

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During the three and six months ended June 29, 2012, the Company made contributions to the pension plans of \$15,000 and \$30,000, respectively. The Company expects to contribute an additional \$30,000 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 | - | \$ - | | |
| Exercised | - | \$ - | | |
| Expired | (6,000) | \$ 5.15 | | |
| Cancelled | - | \$ - | | |
| Outstanding at June 29, 2012 | 32,000 | \$ 3.97 | 1.3 years | \$ - |
| Vested and Exercisable at June 29, 2012 | 32,000 | \$ 3.97 | 1.3 years | \$ - |

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.

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

| | |
|------------------------------------|----------|
| Non-Vested at December 31, 2011 | 14,665 |
| Granted | 4,000 |
| Vested | (7,333) |
| Cancelled | - |
| Non-Vested at June 29, 2012 | 11,332 |
| Total Outstanding at June 29, 2012 | 264,934 |

At June 29, 2012 and December 31, 2011, the aggregate liability related to SARs was \$0.2 million 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 June 29, 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 June 29, 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 June 29, 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 June 29, 2012 and December 31, 2011, the Company owed Kohlberg \$2.0 million and \$1.9 million, respectively, for these services, which is recorded in current liabilities on the Condensed Consolidated Balance Sheets. For each of the three and six months ended June 29, 2012 and July 1, 2011, \$0.1 million and \$0.3 million, respectively, is recorded in selling, general and administrative expenses in the Condensed Consolidated Statements of Operations for these services.

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.

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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:

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.

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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.

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

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

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

OVERVIEW

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

RESULTS OF OPERATIONS

Three Months Ended June 29, 2012 versus Three Months Ended July 1, 2011

Net sales increased from \$31.5 million during the three months ended July 1, 2011 to \$31.7 million during the three months ended June 29, 2012. Gross margin was 11.7% for the three months ended June 29, 2012, an increase of 3.5 percentage points from the same period a year ago. The increase in gross margin was primarily due to sales mix changes in our Continental operations and decreased inefficiencies experienced in our Wilen operation after the relocation from Atlanta, Georgia to Bridgeton, Missouri in 2010. As a result, our gross profit increased \$0.9 million from \$2.6 million to \$3.7 million.

Selling, general and administrative (“SG&A”) expenses decreased slightly to \$4.6 million for the three months ended June 29, 2012 compared to \$4.7 million for the same period a year ago.

Operating loss was \$0.9 million for the three months ended June 29, 2012, compared to \$2.2 million for the same period a year ago. The decrease in operating loss was primarily the result of the increase in gross margin.

Interest expense decreased by \$0.2 million during the three months ended June 29, 2012 as compared to the three months ended July 1, 2011 as a result of lower interest rates and 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 three months ended July 1, 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.

Loss from continuing operations decreased from \$2.3 million for the three months ended July 1, 2011 to \$1.0 million for the three months ended June 29, 2012 primarily due to the increase in gross margin and lower interest expense.

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With the sale of the DISCO division on October 4, 2011, all activity associated with this division has been classified as discontinued operations. Income from operations for this division was \$1.0 million for the three months ended July 1, 2011.

Overall, we reported a net loss of \$1.0 million, or \$0.13 per share, and \$1.3 million, or \$0.16 per share, for the three months ended June 29 and July 1, 2011, respectively.

Six Months Ended June 29, 2012 versus Six Months Ended July 1, 2011

Net sales decreased 1.3% from \$60.1 million during the six months ended July 1, 2011 to \$59.3 million during the six months ended June 29, 2012. The majority of the decrease was a result of volume shortfall in our Container and Gemtex business units. Changes in net sales resulting from pricing and currency translation were nominal. Gross margin was 10.6% for the six months ended June 29, 2012, an increase of 1.7 percentage points from the same period a year ago. The increase was primarily a result of decreased inefficiencies experienced in our Wilen operation after the relocation from Atlanta, Georgia to Bridgeton, Missouri in 2010.

SG&A expenses were flat at \$9.4 million for the six months ended June 29, 2012 and July 1, 2011, respectively.

Operating loss decreased from \$4.0 million during the six months ended July 1, 2011 to \$3.1 million during the six months ended June 29, 2012 primarily due to the increase in gross margin noted in our Wilen operations.

Interest expense decreased by \$0.4 million during the six months ended June 29, 2012 as compared to the six months ended July 1, 2011 as a result of lower interest rates and 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 six months ended July 1, 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.

Loss from continuing operations decreased from \$4.7 million for the for the six months ended July 1, 2011 to \$3.3 million for the six months ended June 29, 2012 primarily due to the increase in gross margin and lower interest expense.

With the sale of the DISCO division on October 4, 2011, all activity associated with this division has been classified as discontinued operations. Income from operations for this division was \$1.9 million for the six months ended July 1, 2011.

Overall, we reported a net loss of \$3.3 million, or \$0.42 per share, for the six months ended June 29, 2012, as compared to a net loss of \$2.6 million, or \$0.32 per share, for the first half of 2011.

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 June 29, 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 June 29, 2012, we had outstanding borrowings of \$15.4 million (63% of total capitalization) under the PB Loan Agreement. Our unused borrowing availability at June 29, 2012 on the Revolving Credit Facility (as defined below) was \$2.6 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.

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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 \$15.4 million and \$14.4 million outstanding under the PB Loan Agreement as of June 29, 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 \$20.0 million at June 29, 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 June 29, 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, of which \$1.5 million was still outstanding at June 29, 2012. The cash advance is recorded within other current assets and the revolving credit agreement in the Consolidated Balance Sheets. At June 29, 2012, total outstanding letters of credit were \$2.5 million, of which \$1.5 million is issued by PNC Bank under the PNC Credit Agreement until they are transferred to PrivateBank under the PB Loan Agreement.

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 June 29, 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 June 29, 2012. Subsequent to October 26, 2012 the PB Loan agreement will replace 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 June 29, 2012. For the three and six months ended June 29, 2012, the Company had amortization of debt issuance costs, included within interest expense, of \$49,000 and \$89,000, respectively. For the three and six months ended July 1, 2011, the Company had amortization of debt issuance costs, included within interest expense, of \$0.1 million and \$0.3 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, excluding discontinued operations, was \$0.2 million in the first half of 2012 as compared to \$0.9 million in the same period of 2011. Changes in operating assets and liabilities provided \$0.6 million in the first half of 2012 as compared to a use of \$0.8 million in the same period of 2011. This variance was primarily a result of a decrease in inventories as we continue to manage inventory levels, a decrease in accounts payable as we continue to work to improve payment history with our vendors and a decrease in other assets due to a return of cash collateral posted in connection with our lines of credit.

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Cash flows used in financing activities in the first half of 2012 reflect a \$1.0 million increase in our debt levels and a \$0.2 million decrease in our book overdraft since December 31, 2011.

OFF-BALANCE SHEET ARRANGEMENTS

As of June 29, 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 June 29, 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.

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 June 29, 2012 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 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

Not Applicable.

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. | |

* Indicates incorporated by reference.

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: August 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