

JACUZZI BRANDS INC  
Form 10-K  
December 15, 2005

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

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

**For the fiscal year ended October 1, 2005  
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 1-14557**

**Jacuzzi Brands, Inc.**

*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of  
incorporation or organization)*

**22-3568449**

*(I.R.S. employer  
identification number)*

**777 S. Flagler Drive;**

**Suite 1100 West**

**West Palm Beach, FL**

*(Address of principal executive offices)*

**33401**

*(Zip code)*

**(561) 514-3838**

*(Registrant's telephone number, including area code)*

Securities registered pursuant to Section 12(b) of the Act:

**Title of Each Class**

**Name of each exchange on which registered**

Common Stock, par value \$.01 per share

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

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

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes  No

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of April 2, 2005 (based on the last reported sale price of such stock on the New York Stock Exchange on such date) was approximately \$737,009,028.

As of November 30, 2005, the registrant had 77,076,132 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the registrant's definitive proxy statement pursuant to Regulation 14A of the Securities Exchange Act of 1934 in connection with the annual meeting of stockholders of the registrant to be held on February 6, 2006 are incorporated by reference into Part III of this Report.

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**PART I**

**Item 1. Business**

We, through our operating subsidiaries, are a leading global producer of branded bath and plumbing products for the residential, commercial and institutional markets. Our Bath Products segment manufactures whirlpool baths, spas, showers, sanitary ware, including sinks and toilets, and bathtubs for the construction and remodeling markets. Our Plumbing Products segment manufactures professional grade drainage, water control, commercial brass and PEX piping products for the commercial and institutional construction, renovation and facilities maintenance markets.

Our products are marketed through their widely recognized brand names, including JACUZZI®, SUNDANCE®, ZURN®, and WILKINS™ a Zurn company ( WILKINS® ). Through the strength of these brands and the ability to leverage them effectively across multiple retail and wholesale distribution channels, we have built and maintained leadership positions within most of the markets we serve. The JACUZZI® and SUNDANCE® branded products hold leading positions in the whirlpool bath and spa markets in the U.S. and Europe, and the ZURN® branded products hold leading market positions in most of the domestic commercial and institutional markets they serve.

We were originally incorporated in 1995 when we were spun-off from Hanson plc ( Hanson ). At that time, we had holdings in 34 diverse businesses, including Jacuzzi. We subsequently merged with Zurn in 1998. Through asset disposal programs, we have transformed from a diversified industrial conglomerate into a focused operating company. These dispositions included our ladder business, our infant and children footwear business, our fire protection businesses, our European HVAC business and several other businesses in fiscal 2000. We also disposed of Ames True Temper, Lighting Corporation of America, Selkirk and Spear & Jackson in fiscal 2002; SiTeco, our swimming pool and equipment and hearth businesses in fiscal 2003; our water systems business in fiscal 2004; and our Rexair and Eljer businesses in fiscal 2005.

In fiscal 2005, we sold Eljer Plumbingware ( Eljer ), a business which had incurred losses for several years and consumed a significant amount of management's resources. We continue to explore various ways to improve operating efficiencies and the profitability of our businesses. Future plans may include, as they have in the past, closing or downsizing inefficient facilities, outsourcing products through lower cost suppliers and rationalization of unprofitable product lines.

We operate on a 52- or 53-week fiscal year ending on the last Saturday closest to September 30. Our public filings may be obtained through the Securities and Exchange Commission at its website at [www.sec.gov](http://www.sec.gov), free of charge. Our Internet address is [www.jacuzzibrands.com](http://www.jacuzzibrands.com). We also make our Annual Report on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, available on our website, free of charge, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission.

Financial information for the segments discussed below, including financial information by geographic areas, can be found in **Note 11** to our Consolidated Financial Statements.

**Bath Products Segment**

Our Bath Products segment manufactures and distributes whirlpool baths, spas, showers, sanitary ware, including sinks and toilets, and bathtubs for the domestic and international construction and remodeling markets.

*U.S. Bath Products.* We distribute bath products throughout the U.S. primarily under the flagship JACUZZI® brand name and spas under the flagship SUNDANCE® brand name. We also offer less expensive bath products under the BATHCRAFT® and REDMONT® brand names.

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We distribute these products through multiple distribution channels. These channels include wholesalers such as Ferguson, Hughes and Hajoca; home centers such as Lowe's and Menards; and specialty kitchen, bath and spa retailers. Wholesalers distribute our bath products to homebuilders and building and plumbing contractors.

Ferguson, the largest wholesale distributor in North America, has positioned JACUZZI® as the preferred high-end whirlpool bath in their showrooms which has allowed us to expand our market share in the U.S. in the whirlpool bath category. We are the preferred supplier of whirlpool baths to all of the now more than 1,125 stores in the Lowe's chain. Our product categories at Lowe's include JACUZZI® branded whirlpool bath and sanitary ware. We believe the strong brand power of the JACUZZI® name is instrumental to our presence at Lowe's.

Our spa products, SUNDANCE® and JACUZZI HOT TUBS®, are primarily sold through our network of over 1,100 independent specialty retailers. We act as the exclusive supplier to a majority of these retailers, and we support them with extensive product training, comprehensive point-of-purchase marketing materials, advertising and a national warranty service support program. We have more than 750 service centers, which perform service on our products and provide parts replacements. We serve mass merchant retailers primarily through private label offerings which provide them with brand exclusivity.

The majority of the bath products we distribute in the U.S. are manufactured domestically. Our whirlpool baths and showers are principally manufactured in a facility in Chino, CA which began operations in fiscal 2003. We also have a spa manufacturing facility in Chino, which began operating in 2001. We closed our spa manufacturing facility in Plant City, FL in November 2003, and the Chino facility began manufacturing these spas, without any interruption to our customers, in the first quarter of fiscal 2004. We will continue to evaluate ways to further reduce costs at all of our manufacturing facilities and enhance the quality of our products.

*International Bath Products.* We manufacture and distribute bath products in the same product categories in the European and other international construction and remodeling markets. For fiscal 2005, approximately 51% of our Bath Products segment net sales were derived from sales of bath products outside the U.S., most of which were in Europe. We offer our branded bath products in Europe under the following brand names: JACUZZI®, JACUZZI PREMIUM® and B.C. SANITAN® which serve premium retailers; FORDHAM® which serves the construction and builder markets; and NIAGARA® which serves wholesale distributors. We also market a full line of composite and stainless steel kitchen sinks under the ASTRACAST® brand name.

Our bath products are distributed in Europe through home centers including B&Q, Homebase and Focus; wholesalers including the Wolseley Group, St. Gobain, Mark II and Travis Perkins Group; and specialty kitchen and bath retailers. We serve the home centers primarily through private label offerings which provide them with brand exclusivity. In the U.K. and other parts of Europe, JACUZZI® products are marketed through a large network of specialty bath and kitchen boutiques. We primarily manufacture these bath products in Italy, the U. K., France and Malta.

We also sell our whirlpool bath, shower and spa products in South America and Asia under the JACUZZI® brand name. In South America, we distribute these products, which are principally manufactured from our plants in Brazil and Chile, through home centers, wholesalers and specialty kitchen and bath retailers. In Asia, we distribute these products primarily through specialty retailers and manufacture them mainly in the U.S. and Italy.

**Plumbing Products Segment**

Our Plumbing Products segment manufactures and distributes professional grade drainage, water control, commercial brass and PEX piping products for the commercial and institutional construction, renovation and facilities maintenance markets. Demand for these products is influenced by regulatory, building and plumbing code requirements. Many of these products must meet detailed specifications set forth by plumbing engineers, architects and other building designers for commercial and institutional application.

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Our specification drainage and brass tubular products are sold under the ZURN® brand name. Our water control products, including the WILKINS™ backflow preventer, are sold under the WILKINS™ brand name. We market our sensor-operated flush valves and faucets and manual flush valves under the ZURN AQUAFLUSH® brand name and our heavy-duty commercial faucets under the ZURN AQUASPEC® brand name. Our PEX piping products are marketed as ZURN PEX® piping products.

Product innovation is crucial in the commercial and institutional plumbing products markets since new products must continually be developed to meet specifications and regulatory demands. Our plumbing products are known in the industry for such innovation. For example, in fiscal 2005, we introduced various labor-savings products especially designed to reduce installation times for plumbing contractors and several water-conserving bathroom accessories that utilize sensor technology. We also continue to develop new PEX products to enhance the conversion of copper pipe to PEX pipe for residential water supplies as well as the conversion of forced-air heating to radiant heating.

We distribute our branded products through independent sales representatives; wholesalers such as Ferguson, Hughes, and Hajoca; home centers such as The Home Depot and Lowe's; and industry-specific distributors in the food service, industrial, janitorial and sanitation industries. Independent sales representatives work with wholesalers to assess and meet the needs of building contractors. They also combine knowledge of our products, installation and delivery with knowledge of the local markets to provide contractors with value added service. We use several hundred independent sales representatives nationwide, along with a network of approximately 80 warehouses, to provide our customers with 24-hour service and quick response times.

In addition to our domestic manufacturing facilities, we have maintained a global network of independent sources that manufacture high quality, lower cost component parts for our commercial and institutional products. These sources fabricate parts to our specifications using our proprietary designs and enable us to focus on product engineering, assembly, testing and quality control. By closely monitoring these sources and through extensive product testing, we are able to maintain product quality and be a low-cost producer of commercial and institutional products.

### **Rexair Segment**

In June 2005, we disposed of Rexair, Inc., which comprised our Rexair segment. Rexair manufactures premium vacuum cleaner systems for the global direct sales market. A comprehensive discussion of this disposition can be found in **Note 3** to our Consolidated Financial Statements.

### **Discontinued Operations**

In June 2005, we completed the sale of substantially all the assets and liabilities of Eljer to an affiliate of Sun Capital Partners, Inc. (Sun Capital). Eljer was previously included in the results of the Bath Products segment.

In February 2003, our Board of Directors adopted a formal disposal plan to dispose of our swimming pool and equipment, hearth and water systems businesses. We completed the disposals of the swimming pool and equipment and hearth businesses in fiscal 2003, and completed the disposal of the water systems business in fiscal 2004. All of these businesses were previously included in our Bath Products segment.

In December 2001, our Board of Directors approved a formal disposal plan in connection with our obligation to pay debt amortization as set forth in our then outstanding debt facilities. The disposal plan called for the sale of five businesses—Ames True Temper, Lighting Corporation of America, Selkirk, Spear & Jackson and SiTeco. We completed the disposals of all of the businesses in fiscal 2002 with the exception of SiTeco, which was completed in fiscal 2003. These businesses were previously included in our Lawn & Garden and Lighting segments.

A discussion of these disposals can be found in **Note 3** to our Consolidated Financial Statements.

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### **Seasonality**

Demand for our products is primarily driven by new home starts, remodeling and non-residential construction activity. Accordingly, many external factors affect our business including weather and the impact of the broader economy on our end markets. Weather is an important variable for us as it significantly impacts construction. Spring and summer months in the U.S. and Europe represent the main construction season for new housing starts and remodeling, as well as increased construction in the commercial and institutional markets. As a result, sales in our Bath Products and Plumbing Products segments increase significantly in our third and fourth fiscal quarters as compared to the first two quarters of our fiscal year. The autumn and winter months generally impede construction and installation activity.

### **Raw Materials, Energy and Suppliers**

We purchase a broad range of materials and components throughout the world in connection with our manufacturing activities in all of our segments. Major raw materials and components include acrylic, resin, natural gas, stainless steel, brass, plastic molded parts, lumber and spa siding, electronics and pumps. Our policy is to maintain alternate sources of supply for our important materials and components wherever possible. We have been able to successfully apply this policy, and consequently we are not dependent on a single source for any raw material or component. The materials and components required for our manufacturing operations have been readily available, and we do not foresee any significant shortages.

### **Patents, Trademarks and Licenses**

We have in excess of 900 U.S. and foreign patents, patent applications and registered trademarks that relate to the products we manufacture and sell. We believe that certain trademarks including JACUZZI®, SUNDANCE® and ASTRACAST® in our Bath Products segment and ZURN® and WILKINS™ in our Plumbing Products segment are of material importance to our product lines. None of the material trademarks are of limited duration, and we believe our intellectual property is adequately protected in customary fashion under applicable law. Although protection of our patents and related technologies is an important component of our business strategy, none of the individual patents is material to our company as a whole.

### **Competition**

We sell all of our products in highly competitive markets. We compete in each of our markets based on product design, quality of products and services, product performance, distribution and price. Some of our competitors have greater financial, marketing, manufacturing and distribution resources than we do. Our principal competitors in the Bath Products segment are Kohler, American Standard, Teuco, Roca, Sanitec and Masco. Though the plumbing market is relatively fragmented, one competitor, Watts, competes with us across several lines. Sloan is a competitor in flush valves while Wirsbo is a competitor in PEX piping. Geberit is a competitor in commercial faucets.

### **Backlog**

Our backlog orders were \$55.4 million and \$59.4 million as of the end of fiscal 2005 and fiscal 2004, respectively. The backlog orders are all in the Bath Products and Plumbing Products segments. Backlog is comprised of all open customer orders not yet shipped as of a particular date. For numerous reasons, including the timing of shipments, the product mix of, or adjustments to, customer orders and the mix of futures and at-once orders, our backlog as of any date may not be a reliable measure of sales or net income for future periods. We expect all of our backlog orders to be filled within one year.

### **Export and International Operations**

Certain of our domestic businesses generate revenue from export sales and/or revenue from operations conducted outside the U.S. Export sales amounted to 7%, 9% and 8% of consolidated net sales in fiscal 2005, 2004 and 2003, respectively, principally reflecting sales by Rexair to foreign distributors of



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RAINBOW® products in numerous countries. Revenue from international operations amounted to 31%, 31% and 30% of consolidated net sales in fiscal 2005, 2004 and 2003, respectively. Identifiable assets of international operations represented approximately 24%, 23% and 22% of total identifiable assets (excluding assets held for sale) at the end of fiscal years 2005, 2004 and 2003, respectively. These revenues and identifiable assets arise principally from international operations within our Bath Products segment.

Our export sales and international manufacturing and sourcing are subject to certain risks including currency fluctuation, transportation delays, political and economic instability, restrictions on the transfer of funds, the imposition of duties, tariffs and import and export controls and changes in governmental policies. We have a number of sourcing relationships with companies in Asia.

**Employee Relations**

We employed approximately 4,507 persons at October 1, 2005, of whom approximately 1,348 were salaried employees. Unions represented approximately 8% of our employees. We currently have collective bargaining agreements with two union locals in North America. None of the collective bargaining contracts covering North American locations are due to expire during fiscal 2006. We also have agreements covering employees at facilities in Italy, Malta and the U.K. The agreement in the U.K. is an annual agreement and covers approximately 45 employees. The agreement in Italy covers approximately 280 employees (69 of whom are members of a union). The first part of the contract, relating to norms and regulations, is valid for four years, and the second part of the contract, relating to compensation, is valid for two years. Even after these time periods elapse, the existing contract remains valid until national representatives negotiate a new agreement. As of October 1, 2005, we are still negotiating the renewal of the last agreement, which expired in May 2003. The agreement in Malta covers approximately 123 employees and expires in December 2007. We have not experienced any significant work stoppages in the last seven years with our ongoing businesses. We believe that our relations with our employees and unions are satisfactory.

**Environmental Regulation**

We are subject to numerous foreign, federal, state and local laws and regulations concerning such matters as zoning, health and safety and protection of the environment. Laws and regulations protecting the environment may in certain circumstances impose strict liability, rendering a person liable for environmental damage without regard to negligence or fault on the part of such person. In addition, from time to time, we may receive notices of violation or may be denied applications for environmental licenses or permits because the practices of the operating unit are not consistent with regulations or ordinances.

Our subsidiaries have made capital and maintenance expenditures over time to comply with these laws and regulations. While the amount of expenditures in future years will depend on legal and technological developments which cannot be predicted at this time, these expenditures may progressively increase if regulations become more stringent. In addition, while future costs for compliance cannot be predicted with precision, no information currently available reasonably suggests that these expenditures will have a material adverse effect on our financial condition, results of operations or cash flows.

We are investigating and remediating contamination at a number of present and former operating sites under the Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 ( CERCLA or Superfund ), the Federal Resource Conservation and Recovery Act ( RCRA ) or comparable state statutes or agreements with third parties. These proceedings are in various stages ranging from initial investigations to active settlement negotiations to the cleanup of sites. We have been named as a potentially responsible party at a number of Superfund sites under CERCLA or comparable state statutes. Under these statutes, responsibility for the entire cost of cleanup of a contaminated site can be imposed upon any current or former site owner or operator, or upon any party who sent waste to the site, regardless of the lawfulness of the original activities that led to the contamination. No information currently available reasonably suggests that projected expenditures associated with any of these proceedings

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or any remediation of these sites will have a material adverse effect on our financial condition, results of operations or cash flows.

As of October 1, 2005, we had accrued approximately \$7.7 million (\$0.9 million accrued as current liabilities and \$6.8 million as non-current liabilities), including \$1.0 million for discontinued operations, for environmental liabilities. These amounts are net of \$13.8 million held in escrow and have not been discounted. We accrue an amount for each case when the likelihood of an unfavorable outcome is probable and the amount of loss associated with such unfavorable outcome is reasonably estimable. We believe that the range of liability for these matters could reach \$16.2 million if it included cases where the likelihood of an unfavorable outcome is only reasonably possible. We cannot predict whether future developments in laws and regulations concerning environmental protection or unanticipated enforcement actions will require material capital expenditures or otherwise affect our financial condition, results of operations or cash flows in a materially adverse manner, or whether our businesses will be successful in meeting future demands of regulatory agencies in a manner which will not have a material adverse effect on our financial condition, results of operations or cash flows.

**Corporate Governance**

In accordance with the corporate governance rules of the New York Stock Exchange, we have adopted Corporate Governance Guidelines relating to certain key areas such as director qualifications and responsibilities, responsibilities of key board committees and director compensation. We have also adopted a Code of Business Conduct and Ethics for directors, officers and employees. Our Corporate Governance Guidelines, our Code of Business Conduct and Ethics and the charters of our Audit Committee, Compensation Committee and Nominating & Corporate Governance Committee are published on our website. We will disclose any amendments to our Code of Business Conduct and Ethics or waivers of any provision thereof on our website within four business days following the date of the amendment or waiver, and that information will remain available for at least a twelve-month period. We will provide any shareholder with printed versions of any of the foregoing guidelines, code or committee charters upon request.

**Executive Officers**

Set forth below are the names, positions and ages, as of October 1, 2005, of our executive officers:

<b>Name</b>	<b>Age</b>	<b>Position</b>
David H. Clarke	64	Chairman of the Board and Chief Executive Officer
Alex P. Marini	59	President and Chief Operating Officer
Steven C. Barre	46	Senior Vice President, General Counsel and Secretary
Marie S. Dreher	47	Senior Vice President Corporate Development and Strategy
Jeffrey B. Park	53	Senior Vice President, Chief Financial Officer and Treasurer
Diana E. Burton	60	Vice President Investor Relations
Francisco V. Puñal	46	Vice President and Corporate Controller

*David H. Clarke* has served as our Chairman and Chief Executive Officer since our spin-off from Hanson in 1995. Mr. Clarke was Vice Chairman of Hanson from 1993 until the spin-off, Deputy Chairman and Chief Executive Officer of Hanson Industries from 1992 until the spin-off and a director of Hanson from 1989 until May 1996. Mr. Clarke is a director of Fiduciary Trust International, a company engaged in investment management and administration of assets for individuals, which is a subsidiary of Franklin Templeton Investments. Mr. Clarke is also a director of DOBI Medical International, Inc., which

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is developing an optical imaging system for cancer diagnosis, iCurie, Inc., which is developing micro cooling systems for electronic products and United Pacific Industries Limited, which manufactures electronics and battery products in China.

*Alex P. Marini* was appointed President and Chief Operating Officer in August 2005. Mr. Marini also serves as President of Zurn Industries, Inc. ( Zurn ), our Commercial Plumbing Products business, a position he has held since 1996. He joined Zurn in 1969 and held a variety of financial positions, including Vice President and Group Controller. He was promoted to Vice President of Sales, Marketing and Administration in 1984, and in 1987 was named President of Wilkins, a Zurn division, a position he held until becoming President of Zurn.

*Steven C. Barre* has served as our Senior Vice President, General Counsel and Secretary since September 2001. From April 2000 to September 2001, Mr. Barre served as our Vice President, General Counsel and Secretary. Prior to that date, Mr. Barre served as our Associate General Counsel beginning with our spin-off from Hanson in 1995.

*Marie S. Dreher* was named Senior Vice President, Corporate Development and Strategy in August 2005. Ms. Dreher joined our Company from Millennium Chemicals, Inc ( Millennium ), a manufacturer of titanium dioxide and other chemical products. She was made Vice President and Corporate Controller in 1996 following their spin-off from Hanson. She was named Senior Vice President, Strategy and Corporate Development of Millennium in 2003.

*Jeffrey B. Park* has served as our Senior Vice President and Chief Financial Officer since April 2003 and Treasurer since February 2004. Mr. Park had served as Vice President and Chief Financial Officer of Jacuzzi, Inc., one of our wholly-owned subsidiaries, from August 2002 to April 2003. Prior to that, Mr. Park served as Vice President, Finance from April 2000 to August 2002 and Vice President, Corporate Controller from November 1986 to April 2000 of Gaylord Container Corporation, a manufacturer of packaging products.

*Diana E. Burton* has served as our Vice President, Investor Relations since our spin-off from Hanson in 1995. Ms. Burton served as a consultant to Hanson Industries from January 1995 through February 1995, when she became an employee of a Hanson subsidiary. Ms. Burton was Vice President and Corporate Secretary of Marine Harvest, a publicly held aquaculture company, with principal responsibility for administration and investor relations, from September 1991 until its acquisition in November 1994.

*Francisco V. Puñal* joined our company as Vice President of Finance in January 2001, and was promoted to Vice President and Corporate Controller in 2002. Mr. Puñal was previously associated with Vitas Healthcare Corporation, a privately held healthcare provider, where he was Vice President and Controller from 1997 to 2000. Prior to that, Mr. Puñal served as Director of Finance of Vitas Healthcare Corporation.

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**Item 1A. Risk Factors**

The following risk factors and other information included in this Annual Report on Form 10-K should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we presently deem less significant may also impair our business operations. If any of the following risks actually occur, our business, operating results, cash flows and financial condition could be materially adversely affected.

**Risks Related to Our Business**

***The seasonality of our sales and economic events may adversely affect our financial results and our ability to service our debt.***

Our businesses experience seasonal business swings. We experience downturns in the autumn and winter months of the northern hemisphere, which encompasses the vast majority of our markets. This seasonality requires us to manage our cash flows over the course of the year. If our sales were to fall substantially below what we would normally expect during certain periods, our annual financial results would be adversely impacted and our ability to service our debt may also be adversely affected.

***Weather could adversely affect the demand for our products and decrease our net sales.***

Demand for our products is primarily driven by new home starts, remodeling and construction activity. Weather is an important variable affecting our financial performance as it significantly impacts construction activity. Spring and summer months in the U.S. and Europe represent the main construction season for new housing starts and remodeling, as well as increased construction in the commercial and institutional markets. However, adverse weather conditions, such as prolonged periods of cold or rain, blizzards, hurricanes and other severe weather patterns, could delay or halt construction and remodeling activity. For example, an unusually severe winter can lead to reduced construction activity and magnify the seasonal decline in our net sales and earnings during the winter months. In addition, a prolonged winter season can delay construction and remodeling plans and hamper the seasonal increase in our net sales and earnings during the spring months.

***Demand for building and home improvement products may depend on availability of financing.***

Many customers who purchase building and home improvement products and our other products depend on financing either by independent consumer finance companies or, to a lesser extent, by independent distributors in order to make purchases. Fluctuations in the prevailing interest rates could affect the availability and cost of financing to our customers. The lack of availability of consumer credit could lead to a reduction in demand for our products and have a material adverse effect on our business, financial condition, cash flows and results of operations.

***We may be adversely affected by downturns in the markets we serve.***

Demand in the building and home improvement product industries is influenced by new construction activity and the level of repair and remodeling activity. The level of new construction and repair and remodeling activity is affected by a number of factors beyond our control, including the overall strength of the U.S., U.K. and European economies (including confidence in these economies by our customers), the strength of the residential and commercial real estate markets, institutional building activity, the age of existing housing stock, unemployment rates and interest rates. Any declines in new housing or commercial construction starts or demand for replacement building and home improvement products may adversely impact us, and there can be no assurance that any such adverse effects would not be material and would not continue for an indeterminate period of time. Further, while we attempt to minimize our exposure to economic or market fluctuations by serving a balanced mix of end markets and geographic regions, we cannot assure you that a significant or sustained downturn in a specific end market or geographic region would not have a material adverse effect on us.

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***The markets in which we sell our products are highly competitive.***

We compete against both large international and national rivals, as well as many regional competitors. Some of our competitors have greater financial, marketing and distribution resources than we do. Significant competition in any given market can result in substantial pressure on our pricing and profit margins, thereby adversely affecting our financial results. As a result of pricing pressures, we may in the future experience reductions in profit margins. We cannot assure you that we will be able to maintain or increase the current market share of our products successfully in the future.

***The loss of any significant customer could adversely affect our business.***

We have certain customers, such as Lowe's and Ferguson, that are very important to our business. Our competitors may adopt more aggressive sales policies and devote greater resources to the development, promotion and sale of their products than we do, which could result in a loss of customers. The loss of one or more of our major customers or deterioration in our relationship with any of them could have a material adverse effect on our business, results of operations and financial condition.

***An increase in the price of raw materials, components, finished goods and other commodities could adversely affect our operations.***

We purchase most of the raw materials for our products on the open market, and rely on third parties for the sourcing of certain finished goods. Accordingly, our cost of products may be affected by changes in the market price of raw materials or sourced components or finished goods. In addition, our operating costs for our Bath Products and Plumbing Products segments are also significantly affected by the cost of natural gas used for fuel and the cost of electricity. Natural gas and electricity prices have historically been volatile, particularly in California and the U.K., where we have a significant manufacturing presence. We do not generally engage in commodity hedging transactions for raw materials. Significant increases in the prices of raw materials, sourced components or finished goods or other commodities could require us to increase the prices of our products, which may reduce consumer demand for our products or make us more susceptible to competition. Furthermore, in the event we are unable to pass along increases in our operating costs to our customers, our margins and profitability may be adversely affected.

***We are exposed to political, economic and other risks that arise from operating a multinational business.***

We have significant operations outside the U.S. We currently have operations in Europe, Asia, Canada and South America, with approximately 24% of our assets (excluding assets held for sale) located outside the U.S. as of the end of fiscal 2005. Further, certain of our businesses obtain raw materials and finished goods from foreign suppliers. Accordingly, our business is subject to the political, economic and other risks that are inherent in operating in numerous countries. These risks include:

- the difficulty of enforcing agreements and collecting receivables through foreign legal systems;
- trade protection measures and import or export licensing requirements;
- tax rates in certain foreign countries that exceed those in the U.S. and the imposition of withholding requirements on foreign earnings;
- the imposition of tariffs, exchange controls or other restrictions;
- difficulty in staffing and managing widespread operations and the application of foreign labor regulations;
- required compliance with a variety of foreign laws and regulations; and
- changes in general economic and political conditions in countries where we operate, particularly in emerging markets.

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Our business success depends in part on our ability to anticipate and effectively manage these and other risks. We cannot assure you that these and other factors will not have a material adverse effect on our international operations or on our business as a whole.

***We are subject to currency exchange rate and other related risks.***

We conduct operations in and generate sales from many areas of the world involving transactions denominated in a variety of currencies. We are subject to currency exchange rate risk to the extent that our costs are denominated in currencies other than those in which we earn revenues. In addition, since our financial statements are denominated in U.S. dollars, changes in currency exchange rates between the U.S. dollar and other currencies have had, and will continue to have, an impact on our earnings. We cannot assure you that currency exchange rate fluctuations will not adversely affect our results of operations and financial condition.

We also face risks arising from the imposition of exchange controls and currency devaluations. Exchange controls may limit our ability to convert foreign currencies into U.S. dollars or to remit dividends and other payments by our foreign subsidiaries or businesses located in or conducted within a country imposing controls. Currency devaluations result in a diminished value of funds denominated in the currency of the country instituting the devaluation. Actions of this nature, if they occur or continue for significant periods of time, could have an adverse effect on our results of operations and financial condition in any given period.

***Adverse investment returns and other factors may increase our pension liability and pension expense.***

We have defined benefit pension plans covering many of our U.S. and U.K. employees, former employees and retirees. Our pension plan assets are invested primarily in equity securities, fixed-income securities and short-term securities. At present, our U.S. aggregate pension plan assets exceed the present value of the accrued benefit liabilities, while the U.K. plan has liabilities that exceed their assets. Under applicable law, we are required to make cash contributions to underfunded pension plans to the extent necessary to comply with minimum funding requirements imposed by regulatory requirements. The amount of such required cash contributions is based on an actuarial valuation of the plans. The funding status of the plans can change as a result of changes in the investment returns on plan assets, discount rates, mortality rates of plan participants, and a number of other factors. We cannot provide assurance that the value of our pension plan assets or the investment returns on plan assets will continue to be sufficient in the future. It is possible that we could be required to make significant additional cash contributions to our plans, which would reduce the cash available for our business and other needs, or to incur a significant pension liability adjustment.

***Our financial statements are based upon estimates and assumptions that may differ from actual results.***

Our financial statements have been prepared in accordance with U.S. generally accepted accounting principles and necessarily include amounts based on estimates and assumptions made by us or by our actuaries. Actual results could differ from these amounts. Significant items subject to such estimates and assumptions include allowances for doubtful accounts receivable, carrying values of long-lived assets, liabilities for litigation and claims, liabilities for self-insurance, liabilities for deferred taxes, reserves for future warranty costs, and pension plan liabilities, among others.

***We are subject to numerous asbestos claims that could adversely affect us.***

Zurn operates as one of our wholly-owned subsidiaries. Zurn, along with many other unrelated companies, is a co-defendant in numerous asbestos related lawsuits pending in the U.S. Plaintiffs' claims primarily allege personal injuries allegedly caused by exposure to asbestos used primarily in industrial boilers formerly manufactured by a segment of Zurn that has been accounted for as a discontinued operation. For further information, refer to **Item 3.**

**Legal Proceedings.**

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***We are subject to environmental regulation and incur costs relating to environmental matters.***

Our past and present business operations and our past and present ownership and operation of real property are subject to extensive and changing federal, state, local and foreign environmental laws and regulations pertaining to the discharge of materials into the environment, the generation, storage, use, transportation, handling and disposal of wastes (including solid and hazardous wastes) and the exposure to hazardous substances. If our operating units fail to completely comply with these laws and regulations, we could be fined or otherwise sanctioned or we could incur liability for cleanup costs or other damages. Changes in environmental regulations or their interpretation, or other unanticipated events may also give rise to increased expenditures or liabilities.

We are investigating and remediating contamination at a number of present and former operating sites and we have been named as a potentially responsible party at a number of Superfund sites pursuant to CERCLA, RCRA or comparable state statutes. Our actual costs to clean up these sites may exceed our current estimates due to factors beyond our control, such as the discovery of presently unknown environmental conditions, changes in environmental laws and regulations and the insolvency of other responsible parties at the sites at which we are involved.

***We may not be able to protect our intellectual property rights.***

We believe that a number of our U.S. and foreign patents, patent applications and registered trademarks are important to our success, potential growth and competitive position. Our actions to establish and protect our trademarks and other proprietary rights, however, may not prevent imitation of our products by others or prevent others from claiming violations of their trademarks and proprietary rights by us. Any infringement or related claims, even if not meritorious, may be costly and time consuming to defend, may distract management from our business and may result in the loss of significant financial and managerial resources.

***Our failure to attract and retain qualified resources could have an adverse effect on us.***

Our success depends in part on our ability to attract, hire, train and retain qualified managerial, marketing and sales resources. The market for these resources is competitive. We may be unsuccessful in attracting and retaining the resources we require to generate sales and to expand our operations successfully, and, in such event, our business could be materially and adversely affected. Our success also depends to a significant extent on the continued service of our senior management team. The loss of any member of our senior management team could impair our ability to execute our business plan and could therefore have an adverse effect on our business, results of operations and financial condition.

***Work stoppages and other labor problems could affect us.***

As of October 1, 2005, approximately 8% of our employees in the U.S. and abroad were represented by labor unions. While we believe our relations with our employees are satisfactory, a lengthy work stoppage at any of our facilities could have a material adverse effect on us. The collective bargaining agreements with two local unions in North America (covering 117 employees) are due for renegotiation in fiscal 2010. Three foreign agreements will expire through the end of calendar year 2007. One agreement expired in May 2003 (covering approximately 280 employees), but remains in effect until the new agreement is finalized; one agreement expires in August 2006 (covering approximately 45 employees) and another agreement will expire in December 2007 (covering approximately 123 employees). Negotiations for the extension of these agreements may result in modifications to the terms of these agreements, and these modifications could cause us to incur increased costs relating to our labor force.

**Risks Related to Our Indebtedness**

Refer to **Liquidity and Capital Resources** in **Item 7** of this Annual Report on Form 10-K for more information and definitions related to our indebtedness.

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***We have substantial indebtedness and servicing our indebtedness reduces funds available to operate our business.***

We and our subsidiaries may be able to incur substantial additional indebtedness in the future. Our substantial indebtedness could interfere with our ability to operate our business. For example, it could:

increase our vulnerability to general adverse economic and industry conditions;

limit our ability to obtain additional financing;

require us to dedicate a substantial portion of our cash flow from operations to the payment of principal and interest on our indebtedness, reducing the amount of our cash flow available for other general corporate purposes, including capital expenditures, research and development efforts and working capital;

require us to sell other securities or to sell some of our core assets, possibly on unfavorable terms, to meet payment obligations;

restrict us from making strategic acquisitions, investing in new products or capital assets or taking advantage of business opportunities;

limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate; and

place us at a possible competitive disadvantage compared to less leveraged competitors.

***Our debt instruments contain covenants which will limit our ability to operate our business.***

Our financing arrangements, including our bank facilities and the indenture governing the senior notes, contain various provisions that limit management's discretion by restricting our ability to, among other things:

incur additional debt or enter into sale-and-lease-back transactions;

pay dividends or distributions on our capital stock or repurchase our capital stock;

issue preferred stock of subsidiaries;

make certain investments;

create liens to secure debt;

enter into transactions with affiliates;

merge or consolidate with another company; and

transfer and sell assets.

In addition, our bank facilities require that we meet specified financial ratios and tests. These restrictions could limit our ability to plan for or react to market conditions or meet extraordinary capital needs or could otherwise restrict corporate activities.

Upon our failure to comply with any of the covenants in our financing arrangements, the lenders under those agreements might be able (even without declaring a default) to cause us to use all of our available cash and free cash flow to service their indebtedness or otherwise prevent us from making payments of principal or interest on the senior notes. In addition, if following a default any of our lenders declares an event of default or accelerates our indebtedness, other creditors with cross default provisions in their debt instruments may be able to declare a default and accelerate their indebtedness. If any of our indebtedness is accelerated, we may not have sufficient funds available



to make the required payments under our indebtedness.

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***To service our indebtedness, we will require a significant amount of cash. Our ability to generate cash depends on many factors beyond our control.***

Our ability to make payments on and to refinance our indebtedness, including the senior notes, and to fund operations will depend on our ability to generate cash in the future. Our ability to generate cash is subject to general economic, financial, competitive, business and other factors that are beyond our control.

Our historical financial results have been, and we anticipate that our future financial results will be, subject to fluctuations. We cannot assure you that our business will generate sufficient cash flows from operations, that currently anticipated cost savings and operating improvements will be realized on schedule or that future borrowings will be available to us under our credit facilities or otherwise in amounts sufficient to enable us to pay our indebtedness, including the senior notes, or to fund our other liquidity needs. If we are unable to meet our debt obligations or fund our other liquidity needs, we may need to restructure or refinance all or a portion of our indebtedness, on or before maturity. We cannot assure you that we will be able to restructure or refinance any of our indebtedness on satisfactory terms, if at all, which could cause us to default on our obligations and impair our liquidity. Our ability to restructure or refinance our debt will depend on the condition of the capital markets and our financial condition at such time. Any refinancing of our debt could be at higher interest rates and may require us to comply with more restrictive covenants, which could further restrict our business operations.

**Item 2. Properties**

We lease approximately 15,134 square feet of office space for our headquarters in West Palm Beach, Florida. The principal properties of each of our operating companies as of October 1, 2005, and the location, primary use, approximate square footage and ownership status, are set forth below:

Location	Use	Approximate Square Footage	Owned/Leased
<b>Bath Products:</b>			
<b><i>Europe/ Asia</i></b>			
Valvasone, Italy	Manufacturing/Warehouse	251,472	Owned
Newcastle, England	Manufacturing	99,429	Owned
Bradford, England	Manufacturing/Office Warehouse	528,256	Owned
Birstal, England	Manufacturing/Showroom	136,375	Owned
Hilton, England	Warehouse	125,000	Leased
Paris, France	Warehouse	79,653	Leased
Cedex, France	Manufacturing	10,764	Owned
Marsa, Malta	Manufacturing	57,834	Leased
<b><i>South America</i></b>			
Itu, Brazil	Manufacturing/Office	234,695	Owned
Santiago, Chile	Manufacturing/Office/Showroom	52,480	Owned
<b><i>United States</i></b>			
Chino, California	Spa Manufacturing/Warehouse	350,000	Leased
Chino, California	Spa Office Space & Bath		
	Manufacturing	90,000	Owned
Chino, California	Whirlpool Bath		
	Manufacturing/Warehouse	306,700	Leased
Carrollton, Texas	Manufacturing/Warehousing/Testing	11,440	Leased
Plant City, Florida	Office	1,000	Leased
Valdosta, Georgia	Manufacturing/Office	363,876	Leased
Statesville, Georgia	Warehouse	12,000	Leased
Salem, Ohio	Warehouse	479,644	Owned

Addison, Texas

Office

110,649

Leased

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Location	Use	Approximate Square Footage	Owned/Leased
<b>Plumbing Products:</b>			
<b>Canada</b>			
Mississauga, Ontario	Manufacturing/Warehouse	27,878	Leased
<b>United States</b>			
Gardena, California	Office/Warehouse/Distribution	73,987	Owned
Paso Robles, California	Manufacturing/Office	158,000	Owned
Norcross, Georgia	Warehouse/Office	57,600	Leased
Elkhart, Indiana	Manufacturing/Distribution	110,000	Owned
Hayward, California	Warehouse/Office	23,640	Leased
Sacramento, California	Warehouse	16,000	Leased
Falconer, New York	Manufacturing/Warehouse/Distribution	151,520	Leased
Sanford, North Carolina	Assembly/Office	78,000	Owned
Northwood, Ohio	Warehouse	17,920	Leased
Ben Salem, Pennsylvania	Warehouse/Office	40,000	Leased
Erie, Pennsylvania	Manufacturing/Office/Distribution	310,562	Leased
Harborcreek, Pennsylvania	Warehouse/Office	100,000	Leased
Commerce, Texas	Manufacturing/Distribution	175,000	Owned
Dallas, Texas	Warehouse/Office	33,000	Leased

In addition, we lease sales office space in Idaho Falls, Idaho; Singapore; Nice, France; Lohne, Germany; Rome, Italy; Barcelona, Spain; Kuala Lumpur, Malaysia; Taipei, R.O.C.; Dubai, UAE and Bensheim, Germany and an engineering and sourcing center in Zhuhai, China. We lease additional warehouse space in southern California on a week-to-week basis as it is needed. We also own several properties being held for sale in: Thomasville, North Carolina; Milford, Virginia; and Itu, Brazil. We believe our owned/leased properties are sufficient for our current and future needs.

**Item 3. Legal Proceedings**

We and our subsidiaries are parties to legal proceedings that we believe to be either ordinary, routine litigation incidental to the business of present and former operations or immaterial to our financial condition, results of operations or cash flows.

Certain of our subsidiaries are defendants or plaintiffs in lawsuits that have arisen in the normal course of business. While certain of these matters involve substantial amounts, it is management's opinion, based on the advice of counsel, that the ultimate resolution of such litigation and environmental matters will not have a material adverse effect on our financial condition, results of operations or cash flows.

In April 2005, we reached an agreement to recover \$3.5 million of warranty costs from the previous owners of the Sundance Spas business. The excess recovery of \$2.2 million reduced our warranty expense for fiscal 2005.

In June 1998, we acquired Zurn, which operates as one of our wholly-owned subsidiaries. At the time of the acquisition, Zurn had itself owned various subsidiaries. Zurn, along with many other unrelated companies, is a co-defendant in numerous asbestos related lawsuits pending in the U.S. Plaintiffs' claims primarily allege personal injuries allegedly caused by exposure to asbestos used primarily in industrial boilers formerly manufactured by a segment of Zurn that has been accounted for as a discontinued operation. Zurn did not manufacture asbestos or asbestos components. Instead, Zurn purchased it from suppliers.

Federal legislation has been proposed that would remove asbestos claims from the current tort system and place them in a trust fund system. This trust would be funded by the insurers and defendant



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companies. There can be no assurance as to when or if this or any other legislation will be passed and become law or what, if any, the financial impact it could have on Zurn.

New claims filed against Zurn were lower year-over-year. During fiscal 2005, approximately 10,400 new asbestos claims were filed against Zurn versus 25,000 in fiscal 2004. As of October 1, 2005, the number of asbestos claims pending against Zurn was approximately 69,900 compared to 75,500 as of October 2, 2004. The pending claims against Zurn as of October 1, 2005 were included in approximately 7,900 lawsuits, in which Zurn and an average of 100 other companies are named as defendants, and which cumulatively allege damages of approximately \$16.8 billion against all defendants. The claims are handled pursuant to a defense strategy funded by Zurn's insurers. Defense costs currently do not erode the coverage amounts in the insurance policies, although a few policies that will be accessed in the future may count defense costs toward aggregate limits.

During fiscal 2005 and as of the end of such period, approximately 17,000 claims were paid and/or pending payment and approximately 13,600 claims were dismissed and/or pending dismissal. During fiscal 2004 and as of the end of such period, approximately 26,000 claims were paid and/or pending payment and approximately 4,900 claims were dismissed and/or pending dismissal. Since Zurn received its first asbestos claim in the 1980s, Zurn has paid or dismissed or agreed to settle or dismiss approximately 115,900 asbestos claims including dismissals or agreements to dismiss of approximately 23,900 of such claims through the end of fiscal 2005 compared to 100,600 and 10,600 claims, respectively, through the end of fiscal 2004.

Zurn used an independent economic consulting firm with substantial experience in asbestos liability valuations to assist in the estimation of Zurn's potential asbestos liability. At October 1, 2005, that firm estimated that Zurn's potential liability for asbestos claims pending against it and for claims estimated to be filed through 2015 is approximately \$153 million, of which Zurn expects to pay approximately \$114 million through 2015 on such claims, with the balance of the estimated liability being paid in subsequent years. As discussed below in more detail, Zurn expects all such payments to be paid by its carriers.

This asbestos liability estimate was based on the current and anticipated number of future asbestos claims, the timing and amounts of asbestos payments, the status of ongoing litigation and the potential impact of defense strategies and settlement initiatives. However, there are inherent uncertainties involved in estimating the number of future asbestos claims, future settlement costs, and the effectiveness of Zurn's defense strategies and settlement initiatives. In addition, Zurn's current estimate could be affected due to changes in law and other factors beyond its control. As a result, Zurn's actual liability could differ from Zurn's estimate described herein.

Zurn's current estimate of its asbestos liability of \$153 million for claims filed through 2015 assumes that (i) its continuous vigorous defense strategy will remain effective; (ii) new asbestos claims filed annually against it will decline modestly through 2015; (iii) the values by disease will remain consistent with past experience; and (iv) its insurers will continue to pay defense costs without eroding the coverage amounts of its insurance policies. While Zurn believes there is evidence, in its claims settlements experience, for such an impact of a successful defense strategy, if the defense strategy ultimately is not successful to the extent assumed by Zurn, the severity and frequency of asbestos claims could increase substantially above Zurn's estimates. Further, while Zurn's current asbestos liability is based on an estimate of claims through 2015, such liability may continue beyond 2015, and such liability could be substantial.

Zurn estimates that its available insurance to cover its potential asbestos liability as of October 1, 2005 is approximately \$293 million. Zurn estimated that its available insurance to cover its potential asbestos liability as of October 2, 2004 was approximately \$302 million. Zurn believes, based on its experience in defending and dismissing such claims and the coverage available, that it has sufficient insurance to cover the pending and reasonably estimable future claims. This conclusion was reached after considering Zurn's experience in asbestos litigation, the insurance payments made to date by Zurn's insurance carriers, existing insurance policies, the industry ratings of the insurers and the advice of

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insurance coverage counsel with respect to applicable insurance coverage law relating to the terms and conditions of those policies. As of October 1, 2005 and October 2, 2004, Zurn recorded a receivable from its insurance carriers of \$153 million and \$171 million, respectively, which corresponds to the amount of Zurn's potential asbestos liability that is covered by available insurance and is probable of recovery.

However, there is no assurance that \$293 million of insurance coverage will ultimately be available or that Zurn's asbestos liability will not ultimately exceed this amount. Factors that could cause a decrease in the amount of available coverage include changes in law governing the policies, potential disputes with the carriers on the scope of coverage and insolvencies of one or more of Zurn's carriers.

Principally as a result of the past insolvency of certain of Zurn's insurance carriers, coverage analysis reveals that certain gaps exist in Zurn's insurance coverage, but only if and after Zurn uses approximately \$223 million of its remaining approximate \$293 million of insurance coverage. As noted above, the estimate of Zurn's potential liability for asbestos claims pending against it and for claims estimated to be filed through 2015 is \$153 million with the expected amount to be paid through 2015 being \$114 million. In order to use approximately \$268 million of the \$293 million of its insurance coverage from solvent carriers, Zurn estimates that it would need to satisfy approximately \$14 million of asbestos claims, with additional gaps of \$80 million layered within the final \$25 million of the \$293 million of coverage. We will pursue, if necessary, any available recoveries on our approximately \$148 million of coverage with insolvent carriers, which includes approximately \$83 million of coverage attributable to the gaps discussed above. These estimates are subject to the factors noted above.

After review of the foregoing with Zurn and its consultants, we believe that the resolution of Zurn's pending and reasonably estimable asbestos claims will not have a material adverse effect on Zurn's financial condition, results of operations or cash flows.

**Item 4. Submission of Matters to a Vote of Security Holders**

We did not submit any matter to a vote of security holders during the last quarter of fiscal 2005.

**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

## (a) Market Information.

Our common stock is traded on the NYSE under the symbol JJZ. The following table sets forth, for the fiscal periods indicated, the high and low closing sales price per share of common stock as reported by the NYSE.

	Fiscal 2005		Fiscal 2004	
	High	Low	High	Low
First Quarter	\$ 9.75	\$ 7.94	\$ 7.50	\$ 6.00
Second Quarter	\$ 10.85	\$ 8.28	\$ 9.51	\$ 7.72
Third Quarter	\$ 11.35	\$ 8.09	\$ 9.93	\$ 7.40
Fourth Quarter	\$ 11.57	\$ 7.23	\$ 9.61	\$ 7.50

## (b) Holders.

As of November 30, 2005, there were approximately 16,831 record holders of our common stock.

## (c) Dividends.

We have not paid cash dividends in the past three fiscal years. Our bank facilities include a restriction on the payment of dividends (See **Liquidity and Capital Resources** in **Item 7** of this Annual Report on Form 10-K).

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(d) Securities authorized for issuance under equity compensation plans.

The following table sets forth information, as of the end of fiscal year 2005, with respect to our compensation plans under which shares of our common stock is or was authorized for issuance and is outstanding:

<b>Plan Category</b>	<b>Column(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights</b>	<b>Column(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights</b>	<b>Column(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans<sup>(1)</sup></b>
Equity compensation plans:			
Approved by security holders	1,266,032	\$ 5.37	3,240,255
Not approved by security holders			
Total	1,266,032	\$ 5.37	3,240,255

<sup>(1)</sup> Excluding securities reflected in Column (a).

**Item 6. Selected Financial Data**

Our business has undergone significant changes during the last five years. Accordingly, results from any one period may not be comparable to results from any other year. The following matters affect the comparability of the selected financial data included in the table that follows.

We disposed of the Rexair segment on June 30, 2005 and obtained an approximately 30% equity interest in Rexair's new parent company in conjunction with this transaction. As a result of the sale, only nine months of Rexair's sales and operating income are included in our consolidated sales and consolidated operating income results for fiscal 2005. The 30% equity interest is accounted for under the equity method of accounting. Rexair is not being accounted for as a discontinued operation as a result of this continuing investment. Operating income in fiscal 2005 includes restructuring charges of \$9.4 million. Income from continuing operations in fiscal 2005 includes a pre-tax gain on the sale of Rexair of \$24.7 million, pre-tax equity earnings from our investment in Rexair's parent company of \$0.6 million and a tax benefit of \$8.8 million. Income from continuing operations also includes pre-tax charges of \$3.2 million associated with the retirement of the term loan.

Operating income in fiscal 2004 includes impairment, restructuring, and other charges of \$2.9 million related to downsizing initiatives as well as the consolidation of administrative functions into our shared services center.

Net sales in fiscal 2003 include \$8.6 million from the sale of a license for certain patented technology. Operating income in fiscal 2003 includes impairment, restructuring and other charges of \$9.6 million. Income from continuing operations in fiscal 2003 includes pre-tax charges of \$21.5 million associated with the extension and eventual



refinancing of our debt in July 2003. Income from continuing operations also includes a tax benefit of \$13.6 million recorded as a result of an IRS audit settlement.

Operating income in fiscal 2002 includes impairment, restructuring and other charges of \$7.2 million. Income from continuing operations in fiscal 2002 includes \$9.2 million of pre-tax charges related to financing initiatives. Also, we recorded a tax benefit of \$29.6 million in fiscal 2002 largely attributable to the utilization of loss carry backs.

Operating loss in fiscal 2001 includes impairment, restructuring and other charges of \$60.8 million. Loss from continuing operations in fiscal 2001 includes pre-tax charges of \$45.1 million related to the impairment of note securities, \$23.6 million associated with the restructuring of our debt and \$8.1 million for professional fees associated with the previously planned spin-off of a group of our businesses. Financial data in fiscal 2001 includes the Rexair business from the date of purchase in August 2001.

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Operating (loss) income for fiscal 2001 includes goodwill amortization of \$8.6 million. We stopped amortizing goodwill after adoption of SFAS No. 142, *Goodwill and other Intangible Assets*, on October 1, 2001.

In March 2001, the Board of Directors indefinitely suspended the quarterly payment of cash dividends. Furthermore, our bank facilities include a restriction on the payment of dividends (See **Liquidity and Capital Resources** under **Item 7** of this Annual Report on Form 10-K).

The following table presents summary historical consolidated financial data. The summary consolidated financial data for the fiscal years 2005, 2004 and 2003 has been derived from our audited consolidated financial statements included in **Item 8** of this Annual Report on Form 10-K. You should read the following summary consolidated financial data in conjunction with **Items 7** and **8** of this Annual Report on Form 10-K.

**For the Fiscal Years Ended**

	<b>October 1, 2005</b>	<b>October 2, 2004*</b>	<b>September 27, 2003*</b>	<b>September 28, 2002*</b>	<b>September 29, 2001*</b>
		<b>(Restated)</b>	<b>(Restated)</b>	<b>(Restated)</b>	<b>(Restated)</b>
	<b>(in millions, except per share amounts)</b>				
<b>Statements of Operations:</b>					
Net sales	\$ 1,210.0	\$ 1,201.2	\$ 1,025.2	\$ 904.1	\$ 854.6
Operating income	94.4	127.2	99.1	95.2	17.2
Earnings (loss) from continuing operations	58.0	48.3	21.4	32.4	(121.3)
(Loss) earnings from discontinued operations, net of tax	(63.6)	(19.9)	(50.4)	8.5	(385.2)
Cumulative effect of accounting change, net of tax					(0.7)
Net (loss) earnings	(5.6)	28.4	(29.0)	40.9	(507.2)
Basic (loss) earnings per share:					
Earnings (loss) from continuing operations	0.77	0.64	0.29	0.44	(1.64)
(Loss) earnings from discontinued operations	(0.84)	(0.26)	(0.68)	0.11	(5.20)
Cumulative effect of accounting change					(0.01)
Net (loss) earnings	(0.07)	0.38	(0.39)	0.55	(6.85)
Diluted (loss) earnings per share:					
Earnings (loss) from continuing operations	0.76	0.64	0.29	0.44	(1.64)
(Loss) earnings from discontinued operations	(0.83)	(0.27)	(0.68)	0.11	(5.20)
Cumulative effect of accounting change					(0.01)
Net (loss) earnings	(0.07)	0.37	(0.39)	0.55	(6.85)
Cash dividend declared per share					0.05

**Balance Sheet Data (at period end):**

Cash and cash equivalents	\$ 110.2	\$ 39.6	\$ 31.2	\$ 32.1	\$ 65.2
Working capital	260.7	240.7	194.8	293.0	449.0
Total assets	1,289.5	1,380.4	1,327.8	1,686.9	2,180.0
Total debt	407.0	471.8	500.1	808.1	1,226.8
Stockholders equity	285.2	288.5	245.5	254.4	217.0

\* Amounts have been restated to reflect our increased ownership in Spear & Jackson, which has been classified as a discontinued operation (see **Note 1** to our Consolidated Financial Statements). In addition, amounts have been reclassified to reflect Eljer as a discontinued operation (see **Note 3** to our Consolidated Financial Statements).

Table of Contents**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**Overview**

We are a leading global producer of branded bath and plumbing products for the residential, commercial and institutional markets. Our results of operations are reported in three business segments, consisting of the Bath Products segment, the Plumbing Products segment and the Rexair segment. Our Bath Products segment manufactures whirlpool baths, spas, showers, sanitary ware, including sinks and toilets, and bathtubs for the construction and remodeling markets. Our Plumbing Products segment manufactures professional grade drainage, water control, commercial brass and PEX piping products for the commercial and institutional construction, renovation and facilities maintenance markets. The Rexair segment, which was sold in fiscal 2005, manufactures premium vacuum cleaner systems sold through independent distributors in the direct sales retail channel.

On June 30, 2005, we completed the sale of Rexair to Rhone Capital, LLC (Rhone) in a transaction valued at \$170 million. We recorded a gain of \$24.7 million and debt retirement costs of \$3.2 million associated with this transaction. We also obtained an approximate 30% equity interest in Rexair's new parent company in conjunction with this transaction. This investment is accounted for under the equity method in accordance with Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* (APB No. 18). Rexair is not being accounted for as a discontinued operation as a result of this continuing investment. Beginning in the fourth quarter of fiscal 2005, our share of Rexair's earnings has been recorded in other income (expense), net. In all periods prior to the fourth quarter of fiscal 2005, Rexair's sales and operating income are included in our consolidated sales and operating income results. Refer to **Note 3** to our Consolidated Financial Statements and **Liquidity and Capital Resources** for more information regarding the Rexair sale.

In the third quarter of fiscal 2005, we completed the sale of substantially all the assets and liabilities of Eljer to Sun Capital. Eljer's operations are classified as discontinued for all periods presented and are excluded from the following discussion of continuing operations. Eljer was previously accounted for as part of the Bath Products segment. Refer to **Note 3** to our Consolidated Financial Statements and **Liquidity and Capital Resources** for more information regarding the Eljer sale.

Demand for our products is primarily driven by new home starts, remodeling and commercial construction activity. Accordingly, many external factors affect our business including weather and the impact of the broader economy on our end markets. Weather is an important variable for us as it significantly impacts construction. Spring and summer months in the U.S. and Europe represent the main construction season for new housing starts and remodeling, as well as increased construction in the commercial and institutional markets. As a result, sales in our Bath Products and Plumbing Products segments increase in our third and fourth fiscal quarters as compared to the first two quarters of our fiscal year. The autumn and winter months generally impede construction and installation activity.

Housing starts, residential re-sales, consumer spending and remodeling expenditures have a major impact on our consumer-focused bath and spa businesses of our Bath Products segment. The Bath Products segment generates the majority of its sales in the residential construction and remodeling markets. We believe that worldwide macro-economic and demographic factors such as population growth and household formation will continue to drive demand in these markets over the long-term.

Our Plumbing Products business is dependent upon commercial and institutional construction activity and is therefore affected by macro-economic factors such as economic growth and interest rates. The U.S. commercial and institutional construction market is cyclical in nature. Commercial and institutional construction increased slightly in 2004 after a few years of decline, and this market has continued to show signs of improvement during 2005. Sales of our products have grown at rates in excess of market growth over the past few years as a result of product innovation, targeted marketing programs and an emphasis on customer service. We believe that macro-economic and demographic factors such as population growth and infrastructure demands will ultimately drive growth in these markets over the long-term.

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Our Board of Directors approved a formal disposal plan for the sale of five businesses in December 2001 (the 2001 Disposal Plan ) and a formal disposal plan for the sale of three businesses in February 2003 (the 2003 Disposal Plan ). We have completed the sale of all businesses under both disposal plans.

On April 15, 2005, we adopted a plan to dispose of our investment in Spear & Jackson ( SJ ). See **Note 1** of our Consolidated Financial Statements for additional information regarding the SJ transaction.

Each of these disposal plans, in addition to the sale of Eljer discussed earlier, qualified for treatment as discontinued operations, and accordingly, are not included in our discussion of **Results of Operations** of this Annual Report on Form 10-K. Summarized results of the discontinued operations through the dates of sale are as follows:

	<b>For the Fiscal Years Ended</b>		
	<b>October 1, 2005</b>	<b>October 2, 2004</b>	<b>September 27, 2003</b>
	(in millions)		
Net sales	\$ 133.0	\$ 148.1	\$ 233.3
Operating loss	(9.1)	(31.6)	(18.6)
Loss from discontinued operations	(63.6)	(19.9)	(50.4)

The decrease in net sales and operating loss over the periods presented is primarily the result of the lost contribution from the businesses for the periods subsequent to their sale. In addition, loss from discontinued operations for fiscal 2005 included the loss on the disposal of Eljer of \$57.8 million, net of tax, and fiscal 2003 included the loss on the disposal of the swimming pool and equipment, hearth and water systems businesses of \$39.9 million, net of tax. Loss from discontinued operations for all three years also includes our share of SJ 's net income. Our share of SJ 's net sales and operating income (loss) have been included in the respective lines of the above table from the date of consolidation in the third quarter of fiscal 2005. Prior to consolidation, net sales and operating loss would not have been impacted by the equity earnings. Changes in estimates for all of our previously discontinued operations are recorded in the period in which they arise. Refer to **Note 3** to our Consolidated Financial Statements for additional information regarding the businesses sold and the corresponding sale dates.

**Results of Operations**

The following table presents our results of operations by segment for the periods indicated. Certain amounts reported for the prior periods have been reclassified to conform to the current year 's presentation.

	<b>For the Fiscal Years Ended</b>		
	<b>October 1, 2005</b>	<b>October 2, 2004</b>	<b>September 27, 2003</b>
		(Restated)	(Restated)
		(in millions)	
<b>Net Sales</b>			
Bath Products	\$ 780.8	\$ 788.4	\$ 646.5
Plumbing Products	353.1	308.0	276.6
Rexair <sup>(1)</sup>	76.1	104.8	102.1
<b>Total Net Sales</b>	\$ 1,210.0	\$ 1,201.2	\$ 1,025.2
<b>Operating Income</b>			
Bath Products	\$ 30.1	\$ 57.2	\$ 25.3

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Plumbing Products	75.3	60.7	62.1
Rexair <sup>(1)</sup>	19.0	27.3	26.6
	124.4	145.2	114.0
<b>Corporate Expenses</b>	<b>(30.0)</b>	<b>(18.0)</b>	<b>(14.9)</b>
<b>Total Operating Income</b>	<b>\$ (94.4)</b>	<b>\$ 127.2</b>	<b>\$ 99.1</b>

(1) Reflects sales and operating income through June 30, 2005.

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**Table of Contents*****Fiscal 2005 Compared to Fiscal 2004******Overall***

Overall net sales increased \$8.8 million in fiscal 2005 compared to fiscal 2004. The overall sales increase was driven by a 14.6% increase in Plumbing Products segment sales, which offset a slight decline in Bath Product segment sales and the absence of Rexair sales following the June 30, 2005 disposition mentioned in the **Overview** section. Rexair contributed \$24.1 million of sales in the fourth quarter of fiscal 2004. Sales in fiscal 2005 also benefited from \$13.5 million of favorable foreign currency exchange rate fluctuations.

Operating income decreased \$32.8 million in fiscal 2005 compared to the prior year primarily as a result of the absence of Rexair's earnings for the fourth quarter of fiscal 2005 and a decrease in Bath Products unit sales. Rexair provided \$7.1 million in operating income in the fourth quarter of fiscal 2004. The Plumbing Products segment reported an increase in operating income, which partially mitigated the decline in the Bath Products segment. Operating income included restructuring charges of \$9.4 million in fiscal 2005 compared to \$2.9 million in fiscal 2004. In addition, operating income included a \$1.1 million benefit from favorable foreign currency exchange rates in fiscal 2005.

***Bath Products***

Sales in the Bath Products segment decreased slightly in fiscal 2005 as compared to fiscal 2004. Foreign currency benefits of \$13.5 million were offset by a decline in unit sales primarily caused by a slow down in the U.K. market and softness in the Italian bath and U.S. spa markets. Bath sales benefited from higher product pricing initiated to help offset higher energy, freight and raw material costs. However, these higher prices were not enough to offset the reduced volume, primarily in our U.K. markets. Sales in the U.K., our largest market outside the U.S., declined by 7.4% in local currency as the slow down in the U.K. market, which began in the second quarter of fiscal 2005, continued through the end of the fiscal year. As retail sales in the U.K. declined, customers reacted by reducing their inventory levels. Although we do not anticipate any significant recovery in the U.K. bath and sink markets or the U.S. spa market, we expect sales growth in the upcoming year to be driven by increased market share and continued growth in our emerging markets, primarily in Europe. We anticipate energy, freight and raw material costs to continue to escalate in the coming months, but at a slower rate than fiscal 2005. We intend to increase prices as necessary to help offset cost increases.

Operating income decreased \$27.1 million in fiscal 2005 compared to last year. The decline in unit sales also triggered decreases in production levels, which resulted in lower absorption of fixed manufacturing costs. The U.K. and Italian bath businesses were also affected by a shift in mix to lower margin products. Fiscal 2005 operating income also included higher costs associated with our global branding, marketing and product development initiatives, costs associated with the enhancement of our overseas sourcing capabilities and the expansion of the Malta stainless steel sink plant. These costs were partially offset by the settlement of a dispute with the previous owners of the Sundance Spas business over pre-acquisition warranty costs for \$3.5 million, resulting in a reduction in warranty costs of \$2.2 million. Results for fiscal 2004 included a \$4.1 million increase in bad debt reserves associated with financial difficulties encountered by several Brazilian distributors and \$1.0 million in severance related to the replacement of the management team and staffing reductions in Brazil. Our Brazilian operations experienced significant increases in sales and operating income in fiscal 2005 as a result of the organizational changes and new programs implemented by the new management team.

Operating income included net restructuring charges of \$4.5 million in fiscal 2005 and \$3.5 million in fiscal 2004. Refer to **Note 4** to our Consolidated Financial Statements for a discussion of these charges.

***Plumbing Products***

Sales in the Plumbing Products segment increased 14.6% to \$353.1 million in fiscal 2005 compared to last year. The higher sales were driven by continued growth in principal markets, successful new product

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introductions and improved pricing. We believe we will see continued growth in the plumbing business in the coming year.

Operating income for fiscal 2005 increased 24.0% to \$75.3 million as compared to fiscal 2004 primarily as a result of strong sales volume. Increased brass, steel and resin costs were offset by favorable pricing and lower purchased parts costs resulting from new sourcing initiatives. We expect costs to continue to increase, but at a slower pace than last year. We intend to increase prices as necessary to help offset cost increases.

*Rexair*

As discussed above in the **Overview** section, we sold our investment in Rexair to Rhone on June 30, 2005. Therefore, the table above only includes Rexair operations through the sale date, whereas fiscal 2004 reflects a full year of operations.

*Corporate Expenses*

Corporate expenses increased \$12.0 million in fiscal 2005 compared to fiscal 2004. Fiscal 2005 expenses included restructuring charges of \$4.9 million primarily related to the elimination of certain executive positions. In addition to the restructuring charge, the year-over-year increase was primarily attributable to a reserve for an intangible tax settlement (\$2.0 million), reduced pension income due to a lower discount rate and increased amortization of net actuarial losses (\$4.2 million), and increased audit and other fees associated with Sarbanes-Oxley compliance (\$3.8 million) partially offset by a reduction in compensation and benefit costs (\$1.3 million). Fiscal 2004 included a reversal of the restructuring reserve for unused leased space of \$0.6 million associated with the customer service function that was relocated to the shared services operations center.

*Interest Income and Expense*

The decrease in interest expense of \$2.4 million from fiscal 2004 to fiscal 2005 was primarily due to lower debt balances. Interest income in fiscal 2004 includes interest of \$2.5 million received from the IRS for an audit settlement.

*Other Expense, net*

Other expense, net consists of the following:

	<b>For the Fiscal Years Ended</b>	
	<b>October 1, 2005</b>	<b>October 2, 2004</b>
	<b>(in millions)</b>	
Keller Ladder expenses	\$ 1.0	\$ 1.6
Loss (gain) on sales of other non-operating assets	0.7	(2.5)
(Gain) loss on sale of excess properties and equipment	(1.7)	0.1
Foreign currency transaction (gains) losses	(0.4)	1.9
Debt retirement costs	3.2	
Earnings on equity investment in Rexair	(0.6)	
Other, net	3.8	2.1
	<b>\$ 6.0</b>	<b>\$ 3.2</b>

We retained certain obligations related to our Keller Ladder subsidiary after the October 1999 sale. We continue to incur expenses related to those obligations. The debt retirement costs are associated with the pay down of the term loan, which was retired with proceeds from the sale of Rexair.



**Table of Contents***Taxes*

Our effective tax rate for fiscal 2005 declined as a result of the following:

No taxes will be incurred on the Rexair gain because it resulted in a capital loss for tax purposes.

A \$2.9 million tax benefit was recognized in the second quarter of fiscal 2005 upon the completion of a Federal tax audit of a subsidiary.

A \$5.9 million tax benefit was recognized in fiscal 2005 as a result of a Federal tax audit of our consolidated tax returns for the fiscal years 1998 through 2002. The benefit resulted from agreed upon computational adjustments. The IRS provided their final report for this audit in August 2005. We filed an appeal with the IRS in September 2005 regarding various issues that we could not reach agreement on. We have adequate reserves to cover the current proposed adjustments.

Excluding the impact of these three items, our effective tax rate for the year has increased as a result of the change in the mix of foreign and domestic earnings after the sales of Rexair and Eljer.

During fiscal 2004, we received a refund of \$4.0 million relating to the examination of the federal income tax returns for the fiscal years 1995 through 1997. This refund was already included in our tax rates in prior periods. In addition to the tax refund, we received \$2.5 million in interest relating to the refund, which was included in interest income in 2004.

***Fiscal 2004 Compared to Fiscal 2003****Overall*

Overall, net sales increased 17.2% to \$1.2 billion in fiscal year 2004 as compared to fiscal 2003. The increase reflects strong sales in our Bath Products and Plumbing Products segments. Fiscal 2003 results include \$8.6 million in sales recognized upon the granting of a license for certain technology that had been the subject of patent litigation. Operating income increased \$28.1 million or 28.4% in fiscal 2004 when compared to fiscal 2003 primarily due to strong operating results in our Bath Products segment. Included in our fiscal 2004 results are \$2.9 million of restructuring charges, while fiscal 2003 results included \$9.6 million of restructuring charges.

*Bath Products*

Net sales in our Bath Products segment increased \$141.9 million or 21.9% in fiscal 2004 as compared to fiscal 2003. The increase was primarily the result of continued growth in the domestic spa and bath businesses, due to an expanded specialty retailer base, as well as growth in the European bath and sink businesses, which was primarily the result of continued higher sales to the home center channel. Fiscal 2004 sales also included a \$38.3 million benefit from favorable currency exchange rates mainly due to the firming of the British pound and the euro against the U.S. dollar.

Operating income of \$57.2 million for fiscal 2004 increased \$31.9 million or 126.1% compared to fiscal 2003, due primarily to strong sales and margin growth in the domestic spa and whirlpool bath businesses. Gross margin increased as a percentage of net sales mainly due to increased volume over fixed overhead and improved manufacturing efficiencies. These efficiencies were experienced segment-wide, but especially in the new Chino, CA plant which became operational in fiscal 2003. Included in operating income was \$3.5 million in restructuring charges, while fiscal 2003 included \$4.3 million. These charges are discussed more fully in **Note 4** to our Consolidated Financial Statements. Fiscal 2004 was also impacted by a \$4.1 million increase in our bad debt reserves associated with financial difficulties encountered by several Brazilian bath product distributors and \$1.0 million in severance related to staffing reductions in Brazil. In fiscal 2003, we also established a \$2.5 million bad debt reserve against a receivable from one of the same Brazilian distributors. We have since taken over sales responsibility for the Brazilian home center channel. Operating income in fiscal 2003 was negatively impacted by the aforementioned restructuring charges as well as labor inefficiencies and start up costs related to the move to the new whirlpool bath manufacturing facility in Chino, CA, costs of process improvements to enhance quality and

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future operating efficiencies at the new Chino, CA plant, costs related to the Lowe's roll-out and increased marketing expenses. Favorable currency exchange rates improved earnings in fiscal 2004 when compared to fiscal 2003 by \$3.9 million.

*Plumbing Products*

Net sales in the Plumbing Products segment increased \$31.4 million or 11.4% in fiscal 2004 when compared with fiscal 2003. Sales in fiscal 2004 increased as a result of continued market penetration particularly in the PEX and commercial Brass product lines. Sales in these product lines were driven by superior sensor technology and the market's continued conversion of copper pipe to PEX tubing in plumbing applications. Fiscal 2003 sales included \$8.6 million from the sale of a license for technology that had been the subject of patent litigation.

Operating income decreased \$1.4 million or 2.3% in fiscal 2004 as compared to fiscal 2003. Excluding the \$8.6 million gain on the sale of the technology license in fiscal 2003, operating income increased in fiscal 2004 as a result of improved sales and favorable pricing, which helped to offset higher scrap iron and steel costs. We implemented initiatives targeting procurement and finished product pricing to offset the increased raw material costs. We began realizing the benefits of these procurement and pricing initiatives in the latter half of fiscal 2004.

*Rexair*

Net sales increased \$2.7 million or 2.6% in fiscal 2004 as compared with the previous fiscal year. The increase was due to the higher price points of the new *e2* RAINBOW<sup>tm</sup> vacuum cleaner system, which was launched earlier that year. The rollout of the new *e2* model was completed during the second quarter of fiscal 2004.

Operating income in fiscal 2004 increased \$0.7 million or 2.6% when compared with fiscal 2003. Fiscal 2004 operating income was negatively impacted by \$1.4 million in costs associated with the aforementioned launch of the new *e2* model. The year-over-year comparison was also impacted by an inventory reduction program implemented in fiscal 2003 that negatively impacted operating income by approximately \$1.0 million that year.

*Corporate Expenses*

Corporate expenses increased \$3.1 million in fiscal 2004 as compared to the prior year. The increase was attributable to reductions in pension income due to a lower discount rate, costs associated with Sarbanes-Oxley compliance, an increase in consulting fees and an increase in personnel costs reflecting our new operating company organization. Fiscal 2004 also includes charges and amortization totaling \$1.6 million associated with an employee stock option buy back and exchange offer. Corporate expenses in fiscal 2003 include \$5.3 million of restructuring charges associated with the consolidation of our corporate offices, net of a favorable adjustment reversing previously established reserves for vacant leased space now occupied by the shared services center in Dallas, TX. Fiscal 2004 also includes a reversal of the restructuring reserve for unused leased space of \$0.6 million.

*Interest Income and Expense*

The decrease in interest expense of \$10.1 million from fiscal 2003 to fiscal 2004 was due to lower debt balances and lower interest rates realized as a result of the July 2003 refinancing and the June 2004 bank amendment. The increase in interest income in fiscal 2004 was due to \$2.5 million of interest received from the IRS related to a prior year audit settlement.

*Other Expense, Net*

Other expense, net was \$3.2 million in fiscal 2004 compared to \$26.6 million in fiscal 2003. Included in other expense, net for both years are expenses associated with retained liabilities of our ladder

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operations, which was sold in October 1999. Fiscal 2004 also includes foreign currency transaction losses and a loss for the decrease in the value of the Polyair call option (see **Note 2** to our Consolidated Financial Statements) offset by a gain of \$3.2 million resulting from the resolution of litigation that was under appeal for several years. Fiscal 2003 includes \$19.2 million of charges associated with the refinancing of our debt facilities in July 2003, gains on the sale of real estate of \$3.5 million and \$2.3 million of other financing charges related to the restructuring of our debt facilities.

*Taxes*

During fiscal 2003, the IRS completed its examination of the federal income tax returns for fiscal 1995 through 1997. As a result of the audit settlement, a tax benefit of \$13.6 million was recorded in fiscal 2003.

**Liquidity and Capital Resources**

Our primary sources of liquidity and capital resources are cash and cash equivalents, cash provided from operations and available borrowings. We expect to satisfy operating needs including the cash requirements related to capital expenditures, acquisitions and restructuring programs through operating cash flows, cash on hand and borrowings under our existing bank facilities.

Net cash provided by operating activities of continuing operations was \$52.2 million for fiscal 2005, compared to \$59.4 million for fiscal 2004. In fiscal 2005, we received \$3.5 million from the previous owners of the Sundance Spas business as a result of the resolution of a litigation claim and a \$2.1 million Canadian tax refund. During fiscal 2004, we collected \$10.1 million in long-term receivables and a \$6.5 million tax refund. We typically use cash in the first half of the fiscal year due to the seasonality of most of our businesses. Weather can significantly impact construction and installation, which ultimately impacts sales in our Bath Products and Plumbing Products segments. Sales of outdoor jetted spas and other products are also sensitive to weather conditions and tend to decrease during the fall and winter months (predominantly the first and second fiscal quarters).

Subsequent to year-end, we approved offers to buyout certain vested post employment benefit plan liabilities owed to participants who are currently retired or terminated. Assuming 100% acceptance of such offers, approximately \$8 million in cash will be utilized for the buyout. In addition, we collected \$9.9 million in October 2005 from Woodlands Ventures, LLC, a property developer from whom we had obtained a note receivable upon the sale of a piece of property in October 2002.

During fiscal 2005, we paid approximately \$11.2 million related to our restructuring plans, and expect to pay approximately \$4.0 million in the next 12 months (see **Note 4** to our Consolidated Financial Statements) including \$1.3 million of charges to be incurred during fiscal 2006. During fiscal 2004, we paid approximately \$7.6 million related to our restructuring plans.

Net cash used by discontinued operations in fiscal 2005 was \$31.2 million as compared to net cash used of \$14.6 million in fiscal 2004. The net cash used in fiscal 2005 pertained to the operations of Eljer, while the cash used in 2004 was associated with the operations of Eljer and our water systems business, which was sold in October 2003. The increase in cash used was primarily the result of payments associated with Eljer liabilities retained subsequent to the sale.

Net cash provided by investing activities during fiscal 2005 was \$125.4 million compared to cash used of \$12.3 million last year. Net cash provided in fiscal 2005 consisted mainly of net proceeds of \$149.2 million from the sale of Rexair, net of \$8.5 million of costs associated with the sale of Eljer, as well as the sale of a \$4.4 million note receivable in March 2005. The note was obtained in conjunction with the sale of our swimming pool and equipment business in May 2003. We also received net proceeds of \$3.0 million from the sale of excess property and fixed assets. These proceeds were partially offset by cash used for capital expenditures of \$22.7 million. Net cash used in investing activities in fiscal 2004 included \$23.0 million in capital expenditures, net proceeds of \$4.5 million associated with the sale of two discontinued businesses and proceeds of \$3.8 million from the sale of an excess property and fixed assets.

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We expect total capital expenditures for fiscal 2006 to be approximately \$18 to \$22 million for new business requirements, system upgrades and implementations, initiatives involving the consolidation of workflows and improvement of manufacturing efficiencies and other capital requirements in the ordinary course of business. We are also considering broadening our Plumbing Products segment product portfolio through acquisitions, remaining mindful that any such purchase be strategic in fit and accretive to earnings.

Net cash used in financing activities was \$76.6 million in fiscal 2005 and \$31.3 million in fiscal 2004. During fiscal 2005, we reduced our total debt borrowings by \$64.4 million. In addition, we paid \$1.0 million in fees associated with the retirement of our term loan, and we deposited \$12.4 million into restricted cash collateral accounts in conjunction with the sales of Rexair and Eljer. The outflows were partially offset by \$1.4 million in proceeds from stock option exercises. Cash used during fiscal 2004 included net payments on long-term debt and notes of \$30.3 million, \$1.5 million in financing fees and proceeds of \$0.9 million from stock option exercises.

The outstanding debt balances and the maximum availability under these debt instruments at October 1, 2005 were as follows:

	<b>Maximum Availability</b>	<b>Amount Outstanding</b>	<b>Applicable Interest Rate</b>
(in millions)			
Senior Notes	\$ 380.0	\$ 380.0	9.625%
Asset-based credit facility <sup>(1)</sup>	121.9		2.25% over LIBOR or 0.25% over Prime
US Brass note	5.0	5.0	Interest imputed at 9.5%
Total	\$ 506.9	\$ 385.0	

<sup>(1)</sup> In addition, \$41.5 million of the facility is utilized for letters of credit at the end of fiscal 2005.

On July 15, 2003, we completed a comprehensive re-financing of our corporate debt by closing on the issuance of \$380.0 million in aggregate principal amount of 9.625% senior secured notes (the Senior Notes), as well as a five-year \$200.0 million asset-based revolving credit facility and a five-year \$65.0 million term loan. The net cash proceeds from the Senior Notes were approximately \$367.4 million after transaction fees. Transaction fees were capitalized and are being amortized over the seven-year term of the Senior Notes. The net proceeds from the Senior Notes, together with the initial borrowings under the term loan and asset-based loan, were used to repay the debt and redeem senior notes that were outstanding at that time.

The Senior Notes, which were previously registered with the Securities and Exchange Commission under the Securities Act, were de-registered on March 2, 2005. The Senior Notes are due on July 1, 2010 and require the payment of interest of \$18.3 million on January 1 and July 1 of each year. The indentures to the Senior Notes limit our ability to pay dividends, repurchase stock and make other restricted payments as defined therein.

On and after July 1, 2007, we can redeem the Senior Notes subject to a redemption premium of 104.8% for the first 12 months and 102.4% for the following 12 months. On and after July 1, 2009, the Senior Notes can be redeemed at face value. In addition, until July 1, 2006, we can redeem up to 35% of the Senior Notes with the net cash proceeds of an equity offering.

The term loan, which was scheduled to mature July 15, 2009, was retired with \$57.4 million of the proceeds from the sale of Rexair. We paid a prepayment penalty of \$1.0 million and expensed \$2.2 million of deferred loan costs in connection with the termination of the term loan. The term loan bore interest at LIBOR plus 5.0%. The weighted-average interest rate associated with the term loan was 7.35% for fiscal 2005 and 8.88% for fiscal 2004.

The five-year asset-based revolving credit facility matures on July 15, 2008. Under this facility, we can borrow up to \$200.0 million subject to a borrowing base consisting of eligible accounts receivable and

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eligible inventory. There are several fees associated with the asset-based credit facility including an unused commitment fee of 0.5%, a letter of credit fee equal to the applicable LIBOR margin and a fronting fee of 0.125% on all outstanding letters of credit. The weighted-average interest rate was 5.22% for fiscal 2005 and 3.98% for fiscal 2004.

The asset-based credit facility requires us to maintain a minimum consolidated fixed charge coverage ratio, which is only applicable if our availability under the asset-based credit facility falls below \$20.0 million. We were not subject to this debt covenant at fiscal 2005 year-end because our availability exceeded the required threshold. We expect to maintain availability in excess of \$20.0 million for the foreseeable future. This credit facility also includes a restriction on the payment of dividends.

The availability under our asset-based credit facility must be reduced by the amount that our cash balance falls below the \$42.0 million excess proceeds we received from the sale of Rexair. We are required to either reinvest the excess proceeds in our business or offer to redeem the Senior Notes at par within one year of the date of sale. Our cash balance exceeded \$42.0 million at September 30, 2005, thus the availability under the asset-based credit facility was not impacted by this bank facility requirement.

Certain of our existing and future domestic restricted subsidiaries guarantee the Senior Notes, jointly and severally, on a senior basis. The Senior Notes are secured by an eligible first lien on domestic property, plant and equipment, and a second lien on the assets that secure the Bank Facilities. The asset-based credit facility is secured by a first lien on accounts receivable, inventory, intangibles, the stock of our domestic subsidiaries and 65% of the stock of our first-tier foreign subsidiaries. In addition, the asset-based credit facility has a second lien on the property, plant and equipment securing the Senior Notes.

We paid \$45.3 million and \$45.1 million of interest on our borrowings in fiscal 2005 and 2004, respectively.

**Commitments**

At October 1, 2005, we had approximately \$121.9 million available to be borrowed under the asset-based facility, of which we had utilized approximately \$41.5 million for letters of credit, leaving \$80.4 million available for additional borrowings. In addition, we have outstanding foreign commercial letters of credit of \$2.1 million, which do not affect availability under the asset-based facility. We do not have any other significant off-balance sheet obligations.

Below is a summary of our significant contractual cash obligations as of October 1, 2005:

	Total	Payments Due in Fiscal			Payments Due Thereafter
		2006	2007-2008	2009-2010	
		(in millions)			
Long-term debt	\$ 385.0	\$ 1.5	\$ 3.5	\$ 380.0	\$
Notes payable	22.0	22.0			
Lease obligations	41.3	8.8	13.9	7.0	11.6
Purchase obligations <sup>(1)</sup>	82.6	82.6			
Interest payments <sup>(2)</sup>	173.8	36.6	73.2	64.0	
Other <sup>(3)</sup>	37.3	18.9	9.8	4.6	4.0
<b>Total</b>	<b>\$ 742.00</b>	<b>\$ 170.4</b>	<b>\$ 100.4</b>	<b>\$ 455.6</b>	<b>\$ 15.6</b>

<sup>(1)</sup> Purchase obligations are all open purchase orders at October 1, 2005. Of this amount, \$6.6 million represents obligations that were relieved by October 6, 2005.

- (2) Interest payments represent interest on the Senior Notes.
- (3) Other includes obligations relating to restructuring initiatives and indemnifications for assets and previously sold businesses.

**Table of Contents*****Guarantees and Indemnifications***

We continue to guarantee the lease payments of an Ames True Temper master distribution center. The lease obligation will expire in 2015. The scheduled lease payments totaled \$3.8 million for fiscal 2005, and increase by 2.25% each year thereafter. In connection with the sale of Ames True Temper in January 2002, we obtained a security interest and indemnification from Ames True Temper on the lease that would enable us to exercise remedies in the event of default.

We have an agreement with a third party financing company that we will repurchase any new or salable spas returned to us within twelve months of the original sale date. The costs associated with this agreement have been minimal to date.

We have sold a number of assets and businesses over the last several years and have, on occasion, provided indemnifications for liabilities relating to product liability, environmental, insurance and other claims. We have recorded reserves totaling approximately \$22.4 million as of October 1, 2005 for asserted and probable unasserted claims related to these liabilities. These amounts have not been discounted.

We are in active negotiation with a state regarding past due taxes on property. We have accrued \$2.5 million (including \$0.5 million of interest) for the eventual settlement of this liability and believe that it is reasonably possible that the settlement could eventually total an additional \$1.5 million.

***New Accounting Pronouncements***

In June 2005, the Emerging Issues Task Force reached a consensus on Issue No. 04-05, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights* ( EITF 04-05 ). EITF 04-05 requires that a general partner in a limited partnership consolidate the partnership unless the presumption of control can be overcome by showing that the limited partners have the ability to dissolve the partnership or otherwise remove the general partner without cause or possess substantive participating rights. EITF 04-05 is effective for (a) general partners of all newly formed limited partnerships and (b) existing limited partnerships for which the partnership agreements are modified. For general partners in all other limited partnerships, it is effective no later than the beginning of the first reporting period in fiscal years beginning after December 15, 2005. We are in the process of determining the impact of EITF 04-05 on our results of operations; however, we do not expect the impact to be material to our financial position or results of operations.

In June 2005, the FASB issued Statement No. 154, *Accounting Changes and Error Corrections - A Replacement of APB Opinion No. 20 and FASB Statement No. 3* ( SFAS No. 154 ). This Statement requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the basis of the new accounting principle, unless it is impracticable to do so. SFAS No. 154 also provides that 1) a change in method of depreciating or amortizing a long-lived non-financial asset be accounted for as a change in estimate (prospectively) that was effected by a change in accounting principle, and 2) redefines restatement as the revising of previously issued financial statements to reflect the correction of an error. The new standard is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. The impact of SFAS No. 154 cannot be determined unless and until a change in accounting principle or estimate arises. We do not anticipate any changes in accounting principle at this time.

In March 2005, the FASB issued Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* ( FIN 47 ). This Interpretation clarifies that conditional asset retirement obligations meet the definition of a liability and should be recognized when incurred if the fair value can be reasonably estimated. FIN 47 also provides guidance as to when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective for fiscal years ending after December 15, 2005. We do not expect the adoption of FIN 47 to have a material impact on our financial position or results of operations.



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In December 2004, the FASB issued Statement No. 123 (revised 2004), *Share-Based Payment* ( SFAS No. 123R ), which is a revision of FASB Statement No. 123, *Accounting for Stock-Based Compensation* ( SFAS No. 123 ). The Statement supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees* ( APB No. 25 ), and amends FASB Statement No. 95, *Statement of Cash Flows*. SFAS No. 123R focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. Generally, the approach in SFAS No. 123R is similar to the approach described in SFAS No. 123. However, SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. SFAS No. 123R also requires the benefits of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow, as prescribed under current accounting rules. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. Total cash flow will remain unchanged from what would have been reported under prior accounting rules. In April 2005, the Securities and Exchange Commission adopted a new rule that amends the effective dates for SFAS No. 123R. In accordance with the new rule, the accounting provisions of SFAS No. 123R will be effective for us beginning in the first quarter of fiscal 2006.

SFAS No. 123R permits public companies to adopt its requirements using one of two methods- modified prospective or modified retrospective . The modified prospective method requires compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123R for all share-based payments granted, modified or settled after the effective date and (b) based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date. The modified retrospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate, based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures, either (a) all prior periods presented or (b) prior interim periods of the year of adoption. We plan to adopt SFAS No. 123R using the modified prospective method.

As permitted by SFAS No. 123, we currently account for share-based payments to employees using APB No. 25 s intrinsic value method and, as such, generally recognize no compensation cost for employee stock options. Accordingly, the adoption of SFAS No. 123R s fair value method will not affect our total cash flows or financial position, but it will reduce reported income. The impact of adoption of SFAS No. 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had we adopted SFAS No. 123R in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income and earnings per share in **Note 2** to our Consolidated Financial Statements. In addition, in the first quarter of fiscal 2006, upon adoption of SFAS No. 123R using the modified prospective application method, we expect to recognize an immaterial one-time pre-tax gain, representing the reversal of compensation costs recorded in prior years for restricted stock awards that are not expected to vest due to future forfeitures. We currently recognize compensation costs over the explicit service period for restricted stock awards subject to acceleration of vesting upon retirement. However, this policy must change upon adoption of SFAS No. 123R. For awards granted prior to the adoption of SFAS 123R, we will continue to recognize compensation cost over the explicit service period and accelerate any remaining unrecognized compensation cost when an employee actually retires. For awards granted or modified after the adoption of SFAS 123R and subject to acceleration of vesting upon retirement, we will recognize compensation cost over a period to the date the employee first becomes eligible for retirement. Had we recognized compensation cost at the point an employee is eligible for retirement, recognized compensation cost would have increased by approximately \$1.3 million in fiscal 2004. Compensation cost in fiscal 2005 and fiscal 2003 would have remained approximately the same. We are in the process of determining how the guidance regarding valuing share-based compensation as prescribed by SFAS No. 123R will be applied to valuing share-based awards granted after the effective date and the impact that the recognition of compensation expense related to such awards will have on our financial statements.

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In December 2004, the FASB issued FASB Staff Position No. FAS 109-1, *Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004* (the Act) ( FSP No. 109-1 ), and FASB Staff Position No. FAS 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004* ( FSP No. 109-2 ). FSP No. 109-1 provides that the tax deduction on qualified production activities allowed under the Act should be treated as a special deduction rather than a tax rate deduction. The Act allows us to begin taking this deduction beginning in fiscal 2006. We have not yet assessed the impact these potential tax deductions will have on our financial position and results of operations. FSP No. 109-2 provides accounting and disclosure guidance for a special one-time dividends received deduction allowed on the repatriation of certain foreign earnings to a U.S. taxpayer, provided certain criteria are met. This guidance became effective for us in the first quarter of 2005; however, it allows for an exception to the requirement to reflect in the period of enactment the effect of a new tax law. We have a policy of repatriating foreign earnings. In addition, various provisions under the Internal Revenue Code have created situations that result in deemed dividends. We have completed our evaluation of the potential benefits of these deductions under the Act. The law requires that we distribute the deemed dividends before any dividends are eligible for the tax deduction. The law also requires that we exceed an average historical level of dividends before any dividend we declared would be eligible for the benefit. We currently have approximately \$67.1 million of deemed dividends that have not been distributed. As of September 30, 2005, we had approximately \$1.8 million of earnings that would qualify for the new dividend deduction. Given the level of actual and deemed dividends over the past five years, we will not benefit from this deduction.

In November 2004, FASB Statement No. 151, *Inventory Costs, an Amendment of ARB No. 43, Chapter 4* ( SFAS No. 151 ), was issued. The amendments made by SFAS No. 151 clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and require the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. SFAS No. 151 will become effective for us beginning in fiscal 2006. We do not expect the adoption of SFAS No. 151 to have a material impact on our financial position or results of operations.

**Foreign Currency Matters**

The functional currency of each of our foreign operations is the local currency. Assets and liabilities of foreign subsidiaries are translated at the exchange rates in effect at the balance sheet dates, while net sales, expenses and cash flows are translated at average exchange rates for the period. Translation gains and losses are reported as a component of stockholders' equity.

**Effects of Inflation**

Because of the relatively low level of inflation experienced in most of our principal markets, general inflation did not have a material impact on our results of operations during the periods presented. We have, however, experienced increased energy, freight, oil and metal based raw material costs. Favorable pricing of our products have helped to offset these increases.

**Critical Accounting Policies and Estimates**

Management's discussion and analysis of its financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, sales and expenses as well as the disclosure of contingent assets and liabilities. We regularly review our estimates and assumptions. These estimates and assumptions, which are based upon historical experience and on various other factors believed to be reasonable under the circumstances, form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Reported amounts and disclosures may have been different had management used different estimates and assumptions or if

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different conditions had occurred in the periods presented. Our accounting policies can be found in **Note 2** to our Consolidated Financial Statements. Below is a discussion of the policies that we believe may involve a high degree of judgment and complexity.

***Trade Receivables***

We record an allowance for doubtful accounts, reducing our receivables balance to an amount we estimate is collectible from our customers. We use significant judgment in estimating uncollectible amounts, considering numerous factors such as current overall economic conditions, industry specific economic conditions, historical and current customer performance and customer relationships. Although we consider our allowances for uncollectible accounts to be adequate and proper, changes in economic conditions or customer circumstances could have a material effect on the reserve balances required. Historically, actual results have not deviated significantly from those previously estimated by management.

***Inventories***

Our inventories are stated at the lower of cost or market value. We review our inventory balances to determine if inventories can be sold at amounts equal to or greater than their recorded values. The review includes the identification of slow-moving inventories, obsolete inventories and discontinued products based on the historical performance of the inventories and current operational plans for inventories, as well as estimated future customer demand for the inventories. Historically, actual results have not deviated significantly from those previously estimated by management.

***Income Taxes***

Deferred tax assets and liabilities represent the tax effects, based on current law, of any temporary differences in the timing of when net sales and expenses are recognized for tax purposes and when they are recognized for financial statement purposes. Management reviews the deferred tax assets periodically for recoverability, and valuation allowances are provided as necessary. We consider expected future income and gains from investments as well as tax planning strategies, including the potential sale of certain assets, in assessing the need for a valuation allowance against our deferred tax assets. If future taxable income is different than expected, we may need to change our valuation allowance on our deferred tax assets.

Significant judgment is required in determining our effective tax rate and in evaluation of our tax provisions. Despite our belief that our tax return positions are fully supportable, we estimate tax exposures and establish reserves when in our judgment we believe that certain positions are likely to be challenged and that we may not succeed. We adjust these reserves in light of changing facts and circumstances, such as the progress of a tax audit.

***Assets Held for Sale and Liabilities Associated with Assets Held for Sale***

We record reserves for the difference between the carrying value and the net realizable value of our net assets held for sale. These reserves require that management make assumptions about estimated proceeds, based on the demand for these assets and current market conditions, and about estimated costs to sell, based on management's professional knowledge and experience. We monitor these reserves on an on-going basis and record adjustments to our estimates based on actual results and management's updated knowledge. Assets held for sale have been evaluated for impairment in accordance with SFAS No. 144, *Accounting for Impairment or Disposal of Long-lived Assets* ( SFAS No. 144 ).

***Goodwill***

We have significant intangible assets related to goodwill. The determination of related estimated useful lives and whether or not these assets are impaired involves significant judgment. Changes in strategy, reporting unit operating results and/or market conditions could significantly impact our judgment and could require adjustments to recorded asset balances. In accordance with SFAS No. 142, *Goodwill and Intangible Assets* ( SFAS No. 142 ), we test our goodwill for impairment at the reporting unit level

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annually in the fourth quarter of each fiscal year, or earlier in the year if indications of impairment arise. The results of any of these tests could require adjustments to recorded asset balances in future periods.

***Costs Associated with Exit or Disposal Activities***

In establishing accruals for restructuring costs associated with exit or disposal activities, we measure our liability at fair value in the period in which the liability is incurred in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. In estimating the fair value of expected exit and disposal costs, we make certain assumptions to determine the remaining lease obligations, sublease income, severance costs, relocation costs and other exit costs. While we feel our assumptions are appropriate, there can be no assurance that actual costs will not differ from estimates used to establish the restructuring reserves. If actual results differ from our estimates, we may need to adjust, upward or downward, our restructuring reserves in the future. Additionally, long-lived assets are evaluated for impairment in accordance with SFAS No. 144, which involves the use of estimates to calculate fair value, future cash flows and costs to sell. These estimates may differ from actual amounts realized in future periods.

***Commitments and Contingencies***

We are subject to proceedings, lawsuits and other claims related to environmental, labor, product and other matters. We are required to assess the likelihood of any adverse judgments or outcomes to these matters as well as potential ranges of probable losses. We determine the amount of reserves needed, if any, for each individual issue based on our professional knowledge and experience and discussions with legal counsel. The required reserves may change in the future due to new developments in each matter, the ultimate resolution of each matter or changes in approach, such as a change in settlement strategy, in dealing with these matters.

We have sold a number of assets and businesses over the last several years and have, on occasion, provided indemnification for liabilities relating to product liability, environmental and other claims. We have recorded reserves for claims related to these obligations when appropriate and, on certain occasions, have obtained the assistance of an independent actuary in the determination of those reserves. If actual experience deviates from our estimates, we may need to record adjustments to these liabilities in future periods.

Our insurance programs for workers' compensation, general liability, vehicle liability and employee-related health care benefits are effectively self-insured. We record self-insurance accruals based on our estimates of the fully developed cost of claims filed and claims incurred but not reported. Estimates of claims development and claims incurred but not reported are developed by us with the help of an independent actuary. If actual experience of claims development is significantly different than our estimates, an adjustment to our self-insurance accruals may need to be recorded in future periods.

***Warranty Reserves***

Reserves are recorded on our consolidated balance sheets to reflect our contractual liabilities relating to warranty commitments to our customers. We provide warranty coverage of various lengths and terms to our customers depending on standard offerings and negotiated contractual agreements. We record an estimate for warranty expense at the time of sale based on historical warranty return rates and repair costs. Should future warranty experience differ materially from our historical experience, we may be required to record additional warranty reserves which could have a material adverse effect on our results of operations in the period in which these additional reserves are required.

***Pension and Other Post-Employment Benefits***

We have significant pension and post-retirement benefit income and expense and assets/liabilities that are developed from actuarial valuations. These valuations include key assumptions regarding discount rates, expected return on plan assets, mortality rates, merit and promotion increases and the current health care

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cost trend rate. We consider current market conditions in selecting these assumptions. Changes in the related pension and post-retirement benefit income/costs or assets/liabilities may occur in the future due to changes in the assumptions and changes in asset values.

When valuing the pension plans at the end of fiscal 2005, we reduced our discount rate by 40 basis points for our domestic plan and 50 basis points for our U.K. plan. Future changes in the assumptions underlying our pension valuations, including those that arise as a result of declines in equity markets and interest rates, could result in further reductions in pension income, which could negatively affect our consolidated results of operations in future periods.

We recognized \$0.3 million of pension expense in fiscal 2005 and \$4.9 million and \$8.3 million of pension income in fiscal 2004 and 2003, respectively. These amounts affected our operating income by an equal amount for each of the respective periods. Excluding service costs, we recognize pension income related to our domestic Master Pension Plan. This income is included as a reduction of our corporate expenses. Our domestic Master Pension Plan covers certain employees in our operating segments and our corporate office, as well as certain employees of companies that we previously owned. Service costs associated with our domestic Master Pension Plan are allocated to the operating segments and corporate based on employee data. Pension expense associated with our foreign pension plans and our other post-employment benefit plans are recorded by the business whose employees benefit from such plans and are not shared between operating segments.

***Environmental Liabilities***

We accrue an estimated liability for each environmental matter when the likelihood of an unfavorable outcome is probable and the amount of loss associated with such unfavorable outcome is reasonably estimable. We presume that a matter is probable of an unfavorable outcome if (a) litigation has commenced or a claim has been asserted or if commencement of litigation or assertion of a claim is probable and (b) if we are somehow associated with the site. In addition, if the reporting entity has been named as a Potentially Responsible Party ( PRP ), an unfavorable outcome is presumed.

Estimating environmental remediation liabilities involves an array of issues at any point in time. In the early stages of the process, cost estimates can be difficult to derive because of uncertainties about a variety of factors. For this reason, estimates developed in the early stages of remediation can vary significantly; and, in many cases, early estimates later require significant revision. The following are some of the factors that are integral to developing cost estimates:

The extent and types of hazardous substances at a site;

The range of technologies that can be used for remediation;

Evolving standards of what constitutes acceptable remediation; and

The number and financial condition of other PRPs and the extent of their responsibility for the remediation.

An estimate of the range of an environmental remediation liability typically is derived by combining estimates of various components of the liability, which themselves are likely to be ranges. At the early stages of the remediation process, particular components of the overall liability may not be reasonably estimable. This fact does not preclude our recognition of a liability. Rather, the components of the liability that can be reasonably estimated are viewed as a surrogate for the minimum in the range of our overall liability. Estimated legal and consulting fees are included as a component of our overall liability.

Certain environmental contamination treatment costs are capitalized in accordance with EITF Issue No. 90-8, *Capitalization of Costs to Treat Environmental Contamination*, while most of them are charged

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to expense when they are incurred. If the costs are recoverable, they are capitalized only if one of following criteria is met:

The costs extend the life, increase the capacity or improve the safety or efficiency of property owned. The condition of that property after the costs are incurred must be improved as compared with the condition of that property when originally constructed or acquired.

The costs mitigate or prevent environmental contamination that has yet to occur and that otherwise may result from future operations or activities. In addition, the costs improve the property compared with its condition when constructed or acquired.

The costs are incurred in preparing for sale that property which is currently held for sale.

***Asbestos Claims and Insurance for Asbestos Claims***

As noted in **Item 3 Legal Proceedings** of this Annual Report on Form 10-K, Zurn records a liability for pending and potential future asbestos claims, as well as a receivable for insurance coverage of such liability. The valuation of Zurn's potential asbestos liability, which was performed this year by an independent economic consulting firm with substantial experience in asbestos liability valuations, was based on the number and severity of future asbestos claims, future settlement costs, and the effectiveness of Zurn's defense strategies and settlement initiatives.

Zurn's present estimate of its asbestos liability assumes (i) its continuous vigorous defense strategy will remain effective; (ii) new asbestos claims filed annually against it will decline modestly through 2015; (iii) the values by disease will remain consistent with past experience and (iv) its insurers will continue to pay defense costs without eroding the coverage amounts of its insurance policies. Zurn's potential asbestos liability could be adversely affected by changes in law and other factors beyond its control. Further, while Zurn's current asbestos liability is based on an estimate of claims through 2015, such liability may continue beyond 2015, and such liability could be substantial.

Zurn estimates that its available insurance to cover its potential asbestos liability as of the end of fiscal 2005 is greater than its potential asbestos liability. This conclusion was reached after considering Zurn's experience in asbestos litigation, the insurance payments made to date by Zurn's insurance carriers, existing insurance policies, the industry ratings of the insurers and the advice of insurance coverage counsel with respect to applicable insurance coverage law relating to the terms and conditions of those policies. Zurn used these same considerations when evaluating the recoverability of its receivable for insurance coverage of potential asbestos claims.

***Revenue Recognition***

We recognize revenue when all of the following criteria are met: persuasive evidence of the arrangement exists; delivery has occurred and we have no remaining obligations; prices are fixed or determinable; and collectibility is probable. We make shipments to approved customers based on orders placed. Prices are fixed when the customer places the order. An approved customer is one that has been subjected to our credit evaluation. We record revenue when title passes, which is either at the time of shipment or upon delivery to the customer. The passage of title is dependent on the arrangements made with each customer. Provisions are made for sales returns and allowances at the time of sale.

We use significant judgment in estimating sales return costs, considering numerous factors such as current overall and industry-specific economic conditions and historical sales return rates. Although we consider our sales return reserves to be adequate and proper, changes in historical customer patterns could require adjustments to the reserves. Historically, however, actual results have not deviated significantly from those previously estimated by management. We also record reductions to our revenues for customer and distributor programs and incentive offerings including special pricing agreements, promotions and other volume-based incentives. We may take actions to increase customer incentive offerings possibly resulting in an incremental reduction of revenue at the time the incentive is offered.

**Table of Contents*****Accounting for Stock-Based Compensation***

FASB Statement No. 123, *Accounting for Stock-Based Compensation* ( SFAS No. 123 ), defines a fair value method of accounting for issuance of stock options and other equity instruments. Under the fair value method, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the service period, which is usually the vesting period. Pursuant to SFAS No. 123, we are not required to adopt the fair value method of accounting for employee stock-based transactions at this time. We are permitted to account for such transactions under APB Opinion No. 25, *Accounting for Stock Issued to Employees*, which defines an intrinsic value method of accounting for the issuance of stock options and other equity instruments, but are required to disclose in a note to our consolidated financial statements pro forma net income and per share amounts as if we had applied the methods prescribed by SFAS No. 123. For purposes of the pro forma disclosure, we calculate the fair value of our stock options using the Black-Scholes option-pricing model. To use this model, we must judgmentally determine the estimated life of the stock option, the projected volatility of our company stock over the estimated life of the stock option, the projected dividend yield of our company stock over the estimated life of the stock option and the risk-free interest rate. For further information regarding our stock option plans, see **Note 8** to our Consolidated Financial Statements.

***Discontinued Operations***

Effective October 1, 2002, we adopted SFAS, No. 144, which establishes a single accounting model for the impairment or disposal of long-lived assets, including discontinued operations. SFAS No. 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed Of*. The swimming pool and equipment, hearth and water systems businesses, Eljer and SJ have all been accounted for in accordance with SFAS No. 144. This accounting standard contains criteria that must be met in order for a business to be presented as a discontinued operation.

In connection with our accounting for these dispositions, we segregated the assets, liabilities and operations of the discontinued businesses. The operations are presented as discontinued operations in our consolidated statements of operations. The assets and liabilities of these businesses are included in assets held for sale and liabilities associated with assets held for sale in the balance sheets until they are sold.

***Variable Interest Entities***

Any potential variable interest entity ( VIE ) created after January 31, 2003 in which we hold a variable interest must be assessed to determine whether the VIE should be consolidated into our results based on criteria established by FASB Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51* ( FIN 46 ). Management uses judgment to determine whether an entity is a variable interest entity and whether we are the primary beneficiary. We have completed an evaluation of our variable interests and believe that we do not have any interests in any VIEs. However, even after exhaustive efforts, we have been unable to obtain information from Woodlands Ventures, LLC, a property developer from whom we obtained a \$9.3 million note receivable upon the sale of a piece of property in October 2002, that would allow us to assess whether the entity is a VIE. This note receivable was collected in October 2005.

**Disclosure Concerning Forward-Looking Statements and Factors That May Affect Future Results**

In December 1995, the Private Securities Litigation Reform Act of 1995 (the Act ) was enacted by the U.S. Congress. The Act, as amended, contains certain amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934. These amendments provide protection from liability in private lawsuits for forward-looking statements made by public companies. We take advantage of the safe harbor provisions of the Act.

Our Annual Report on Form 10-K and the Letter of the Chairman and Chief Executive Officer included in our Annual Report to Stockholders contains both historical information and other information that may be used to infer future performance. Examples of historical information include our annual

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financial statements and the commentary on past performance contained in the MD&A. While we have specifically identified certain information as being forward-looking in the context of its presentation, we caution the reader that, with the exception of information that is clearly historical, all the information contained in this Annual Report on Form 10-K and the letter of the Chairman and Chief Executive Officer included in the Report to Stockholders should be considered to be forward-looking statements as referred to in the Act. Without limitation, when we use the words believe, estimate, plan, expect, intend, anticipate, continue, project, probably, should, and similar intend to clearly express that the information deals with possible future events and is forward-looking in nature.

The following are some of the factors we believe could cause our actual results to differ materially from expected and historical results:

The seasonality of our sales and economic events may adversely affect our financial results and our ability to service our debt.

Weather could adversely affect the demand for our products and decrease our net sales.

Demand for building and home improvement products may depend on availability of financing.

We may be adversely affected by downturns in the markets we serve.

The markets in which we sell our products are highly competitive.

The loss of any significant customer could adversely affect our business.

An increase in the price of raw materials, components, finished goods and other commodities could adversely affect our operations.

We are exposed to political, economic and other risks that arise from operating a multi-national business.

We are subject to currency exchange rate and other related risks.

Adverse investment returns and other factors may increase our pension liability and pension expense.

Our financial statements are based upon estimates and assumptions that may differ from actual results.

We are subject to numerous asbestos claims that could adversely affect us.

We are subject to environmental regulation and incur costs relating to environmental matters.

We may not be able to protect our intellectual property rights.

Our failure to attract and retain qualified resources could have an adverse effect on us.

Work stoppages and other labor problems could affect us.

We have substantial indebtedness and servicing our indebtedness reduces funds available to operate our business.

Our debt instruments contain covenants which will limit our ability to operate our business.



To service our indebtedness, we will require a significant amount of cash. Our ability to generate cash depends on many factors beyond our control.

Other factors besides those listed here could also adversely affect results. For more information regarding these forward-looking statements and factors that may affect future results, refer to the **Risk Factors** section in **Item 1** of this Annual Report on Form 10-K.

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**Item 7A. *Qualitative and Quantitative Disclosures About Market Risk***

In the normal course of doing business, we are exposed to the risks associated with changes in currency exchange rates. To limit the risks from such fluctuations, we may enter into various hedging transactions that have been authorized pursuant to our policies, but we do not engage in such transactions for trading purposes. We did not have any variable interest rate debt at October 1, 2005, and we do not anticipate incurring substantial amounts of such debt during fiscal 2006. Therefore, market risks associated with interest rate changes are expected to be minimal for fiscal 2006.

We are exposed to foreign currency exchange risk related to our international operations as well as our U.S. businesses, which import or export goods. We have made limited use of financial instruments to manage this risk and have no such instruments outstanding as of October 1, 2005. Hypothetical unfavorable movements of 10% across each of the foreign exchange rates from which we have exposure would have decreased our estimated earnings from continuing operations by approximately \$1.8 million, before taxes, in fiscal 2005 and \$3.2 million, before taxes, in fiscal 2004. This calculation assumes that each exchange rate would change in the same direction relative to the U.S. dollar. In addition to the direct effects of changes in exchange rates, which are a changed dollar value of the resulting sales, changes in exchange rates also affect the volume of sales or the foreign currency sales price as competitors' products become more or less attractive. Our sensitivity analysis of the effects of changes in foreign currency exchange rates does not factor in a potential change in sales levels or local currency prices.

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**Item 8. *Financial Statements and Supplementary Data***

**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management of Jacuzzi Brands, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. We recognize that internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and is subject to the possibility of human error or the circumvention or the overriding of internal control. Therefore, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, we believe we have designed into the process safeguards to reduce, though not eliminate, this risk. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In order to ensure that the Company's internal control over financial reporting was effective as of September 30, 2005, we conducted an assessment of its effectiveness under the supervision and with the participation of our management group including our Chief Executive Officer and Chief Financial Officer. This assessment was based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In accordance with the SEC's published guidance, we have excluded from our evaluation the 2005 acquisition of Spear and Jackson, which is included in the 2005 consolidated financial statements of Jacuzzi Brands, Inc. and which in the aggregate represent 5.2% of consolidated total assets, 0.2% of consolidated stockholders' equity as of September 30, 2005, 0.0% of consolidated net revenues and 2.5% of loss from discontinued operations for the year ended September 30, 2005.

Based on our assessment of internal control over financial reporting under the criteria established in Internal Control Integrated Framework, we have concluded that, as of September 30, 2005, the Company's internal control over financial reporting is effective. Our assessment of the effectiveness of the Company's internal control over financial reporting as of September 30, 2005 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their attestation report which is included herein.

December 8, 2005

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders

Jacuzzi Brands, Inc.

We have audited the accompanying consolidated balance sheets of Jacuzzi Brands, Inc. as of September 30, 2005 and 2004, and the related consolidated statements of operations, cash flows and changes in stockholders' equity for each of the three years in the period ended September 30, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Jacuzzi Brands, Inc. at September 30, 2005 and 2004, and the consolidated results of its operations and its cash flows for each of the three years in the period ended September 30, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Jacuzzi Brands, Inc.'s internal control over financial reporting as of September 30, 2005, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated December 8, 2005 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP  
Certified Public Accountants

West Palm Beach, Florida  
December 8, 2005

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders

Jacuzzi Brands, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Jacuzzi Brands, Inc. maintained effective internal control over financial reporting as of September 30, 2005, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO Criteria). Jacuzzi Brands Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As indicated in the accompanying Management's Report on Internal Control Over Financial Reporting in Item 9A, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Spear & Jackson, Inc. (S&J), which became a consolidated subsidiary in the third quarter of fiscal 2005, as a result of an increase in the Company's ownership interest and is presented as a discontinued operation. S&J's assets available for sale represent 5.2% of the Company's total assets as of September 30, 2005, and its income from discontinued operations represented 2.5% of the Company's loss from discontinued operations for the year then ended. Our audit of internal control over financial reporting of the Company also did not include an evaluation of the internal control over financial reporting of S&J.

In our opinion, management's assessment that Jacuzzi Brands, Inc. maintained effective internal control over financial reporting as of September 30, 2005, is fairly stated, in all material respects, based on the COSO Criteria. Also in our opinion, Jacuzzi Brands, Inc. maintained, in all material respects, effective internal control over financial reporting as of September 30, 2005, based on the COSO Criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Jacuzzi Brands, Inc. as of September 30, 2005 and 2004, and the related consolidated statements of operations, cash flows and change in stockholders' equity for each of the three years in the period ended September 30, 2005 and our report dated December 8, 2005 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Certified Public Accountants

West Palm Beach, Florida  
December 8, 2005

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**JACUZZI BRANDS, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in millions, except per share amounts)

	For the Fiscal Years Ended September 30,		
	2005	2004	2003
		(Restated)	(Restated)
Net sales	\$ 1,210.0	\$ 1,201.2	\$ 1,025.2
Operating costs and expenses:			
Cost of products sold	820.4	802.4	682.7
Selling, general and administrative expenses	285.8	268.7	233.8
Impairment, restructuring and other charges	9.4	2.9	9.6
Operating income	94.4	127.2	99.1
Interest expense	(48.1)	(50.5)	(60.6)
Interest income	3.0	4.7	2.1
Gain on sale of business	24.7		
Other expense, net	(6.0)	(3.2)	(26.6)
Earnings before income taxes and discontinued operations	68.0	78.2	14.0
(Provision for) benefit from income taxes	(10.0)	(29.9)	7.4
Earnings from continuing operations	58.0	48.3	21.4
Discontinued operations:			
Loss from operations, net of tax benefit of \$2.3 in 2005, \$11.5 in 2004 and \$7.2 in 2003	(4.5)	(19.9)	(11.8)
Loss on disposals, net of tax provision of \$0.6 in 2005 and tax benefit of \$5.7 in 2003	(59.1)		(38.6)
Loss from discontinued operations	(63.6)	(19.9)	(50.4)
Net (loss) earnings	\$ (5.6)	\$ 28.4	\$ (29.0)
Basic (loss) earnings per share:			
Continuing operations	\$ 0.77	\$ 0.64	\$ 0.29
Discontinued operations	(0.84)	(0.26)	(0.68)
Net (loss) earnings	\$ (0.07)	\$ 0.38	\$ (0.39)
Diluted (loss) earnings per share:			
Continuing operations	\$ 0.76	\$ 0.64	\$ 0.29
Discontinued operations	(0.83)	(0.27)	(0.68)
Net (loss) earnings	\$ (0.07)	\$ 0.37	\$ (0.39)





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**JACUZZI BRANDS, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(in millions, except share data)

	At September 30,	
	2005	2004
		(Restated)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 110.2	\$ 39.6
Trade receivables, net of allowances of \$8.2 in 2005 and \$8.7 in 2004	200.5	220.1
Inventories	165.0	180.7
Deferred income taxes	27.9	27.8
Assets held for sale	69.7	70.2
Prepaid expenses and other current assets	22.6	22.1
<b>Total current assets</b>	<b>595.9</b>	<b>560.5</b>
Restricted cash collateral	12.4	
Property, plant and equipment, net	103.7	118.6
Pension assets	147.8	150.3
Insurance for asbestos claims	153.0	171.0
Goodwill	228.2	281.7
Other intangibles, net		59.7
Other non-current assets	48.5	38.6
<b>TOTAL ASSETS</b>	<b>\$ 1,289.5</b>	<b>\$ 1,380.4</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Notes payable	\$ 22.0	\$ 21.1
Current maturities of long-term debt	1.5	3.9
Trade accounts payable	105.7	113.3
Income taxes payable	24.7	18.2
Liabilities associated with assets held for sale	66.9	43.1
Accrued expenses and other current liabilities	114.4	120.2
<b>Total current liabilities</b>	<b>335.2</b>	<b>319.8</b>
Long-term debt	383.5	446.8
Deferred income taxes	5.6	34.3
Asbestos claims	153.0	171.0
Other liabilities	127.0	120.0
<b>Total liabilities</b>	<b>1,004.3</b>	<b>1,091.9</b>
Commitments and contingencies		
Stockholders equity:		

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Common stock (par value \$.01 per share, authorized 300,000,000 shares; issued 99,096,734 shares; outstanding 77,092,157 and 76,103,459 shares in 2005 and 2004, respectively)	1.0	1.0
Paid-in capital	630.7	639.7
Accumulated deficit	(8.8)	(3.2)
Unearned restricted stock	(5.2)	(4.6)
Cumulative foreign currency translation	12.8	14.0
Minimum pension liability	(29.4)	(25.0)
Unrealized gain on investments		0.2
Treasury stock (22,004,577 and 22,993,275 shares in 2005 and 2004, respectively), at cost	(315.9)	(333.6)
Total stockholders equity	285.2	288.5
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 1,289.5</b>	<b>\$ 1,380.4</b>

See Notes to Consolidated Financial Statements.

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**JACUZZI BRANDS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in millions)

	For the Fiscal Years Ended September 30,		
	2005	2004	2003
		(Restated)	(Restated)
<b>OPERATING ACTIVITIES:</b>			
Earnings from continuing operations	\$ 58.0	\$ 48.3	\$ 21.4
Adjustments to reconcile earnings from continuing operations to net cash provided by operating activities of continuing operations:			
Depreciation expense	21.7	19.2	18.1
Amortization of intangible assets	0.9	1.2	1.2
Amortization of unearned restricted stock	3.7	2.0	0.6
Amortization of debt issuance costs and other financing costs	3.3	3.7	8.9
Charges for debt restructuring and refinancing costs	3.2		21.5
(Benefit from) provision for deferred income taxes	4.7	2.1	(8.7)
Provision for doubtful accounts	3.1	5.0	5.7
Gain on sale of real estate	(1.8)	(0.5)	(3.5)
Other stock-based compensation expense, net	0.6	1.7	1.4
Loss on sale of property, plant and equipment	0.1	0.7	0.2
Loss on sale of notes	0.7		
Gain on sale of business	(24.7)		
Impairment, restructuring and other non-cash charges	1.3		3.4
Equity in earnings of investees	(0.5)		
Changes in operating assets and liabilities, excluding the effects of acquisition and dispositions:			
Trade receivables	3.5	(23.9)	(18.1)
Inventories	(4.1)	(27.1)	2.6
Other current assets	(1.2)	0.8	(1.9)
Other assets	(2.3)	(4.2)	(6.3)
Trade accounts payable	(5.2)	16.8	3.6
Income taxes payable	(5.2)	14.3	53.0
Accrued expenses and other current liabilities	(6.0)	5.0	(10.6)
Other liabilities	(1.6)	(5.7)	(8.9)
Other, net			(1.1)
Net cash provided by operating activities of continuing operations	52.2	59.4	82.5
Loss from discontinued operations	(63.6)	(19.9)	(50.4)
Adjustments to reconcile loss from discontinued operations to net cash used in discontinued operations:			
Loss on disposal of discontinued operations	59.1		38.6

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Other (increases) decreases in net assets held for sale	(26.7)	5.3	2.9
Net cash used in discontinued operations	(31.2)	(14.6)	(8.9)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>21.0</b>	<b>44.8</b>	<b>73.6</b>
<b>INVESTING ACTIVITIES:</b>			
Proceeds from sale of businesses	140.7	4.5	120.5
Proceeds from sale of notes	4.4	2.4	
Purchases of property, plant and equipment	(22.7)	(23.0)	(17.9)
Proceeds from sale of property, plant and equipment	0.2	0.3	0.2
Proceeds from sale of real estate	2.8	3.5	11.1
<b>NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES</b>	<b>125.4</b>	<b>(12.3)</b>	<b>113.9</b>
<b>FINANCING ACTIVITIES:</b>			
Proceeds from long-term debt	59.1	46.4	127.0
Repayment of long-term debt	(124.8)	(72.3)	(449.3)
Deposits into restricted cash collateral accounts	(12.4)		(66.5)
Withdrawals from restricted cash collateral accounts			224.3
Proceeds from issuance of Senior Notes			380.0
Redemption of Senior Notes			(375.0)
Payment of debt issuance, retirement and other financing costs	(1.0)	(1.5)	(45.6)
Proceeds from (repayment of) notes payable, net	1.3	(4.4)	7.2
Payment for stock option exchange	(0.2)	(0.4)	
Proceeds from issuance of common stock for option exercise	1.4	0.9	
<b>NET CASH USED IN FINANCING ACTIVITIES</b>	<b>(76.6)</b>	<b>(31.3)</b>	<b>(197.9)</b>
Effect of exchange rate changes on cash and cash equivalents	0.8	7.2	9.5
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>70.6</b>	<b>8.4</b>	<b>(0.9)</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<b>39.6</b>	<b>31.2</b>	<b>32.1</b>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b>\$ 110.2</b>	<b>\$ 39.6</b>	<b>\$ 31.2</b>

See Notes to Consolidated Financial Statements.

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**JACUZZI BRANDS, INC.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY**  
**For the Fiscal Years Ended September 30, 2005, 2004 and 2003**  
(in millions, except share data)

	Common Stock	Paid-in Capital	Accumulated Deficit	Unearned Restricted Stock	Accumulated Other Comprehensive Loss	Treasury Stock	Comprehensive Earnings (Loss)	Total
Balance at September 30, 2002	\$ 1.0	\$ 655.5	\$ (2.6)	\$ (1.7)	\$ (39.1)	\$ (358.7)		\$ 254.4
Net loss			(29.0)				\$ (29.0)	(29.0)
Amortization of unearned restricted stock				0.6				0.6
Treasury stock issued to directors (79,793 shares)		(1.0)				1.3		0.3
Treasury stock issued in 401K match (309,815 shares)		(4.1)				5.2		1.1
Forfeiture of restricted stock (12,500 shares)		(0.3)		0.3				
Exercise of stock options (2,375 shares)								
Foreign currency translation adjustment, net of tax provision of \$0.5					22.2		22.2	22.2
Minimum pension liability adjustment, net of tax benefit of \$2.3					(4.1)		(4.1)	(4.1)
Other comprehensive earnings							18.1	
Total comprehensive loss							\$ (10.9)	
Balance at September 30, 2003	1.0	650.1	(31.6)	(0.8)	(21.0)	(352.2)		245.5
Net earnings			28.4				\$ 28.4	28.4
Amortization of unearned restricted stock				2.1				2.1
Treasury stock issued to directors (6,988 shares)						0.1		0.1
Treasury stock issued in 401K match (135,098 shares)		(1.1)				2.4		1.3

Forfeiture of restricted stock (1,714 shares)								
Exercise of stock options (277,875 shares)	(3.7)					4.6		0.9
Issuance of restricted stock grants (698,230 shares)	(5.6)		(5.9)			11.5		
Foreign currency translation adjustment, net of tax provision of \$0.4					16.8		16.8	16.8
Minimum pension liability adjustment, net of tax benefit of \$1.9					(6.8)		(6.8)	(6.8)
Net unrealized losses on investments, net of tax provision of \$0.1					0.2		0.2	0.2
Other comprehensive earnings							10.2	
Total comprehensive earnings							\$ 38.6	
Balance at September 30, 2004	1.0	639.7	(3.2)	(4.6)	(10.8)	(333.6)		288.5
Net loss			(5.6)				\$ (5.6)	(5.6)
Amortization of unearned restricted stock				4.9				4.9
Treasury stock issued to directors (4,994 shares)	(0.1)					0.1		
Deferred directors stock units	0.9							0.9
Treasury stock issued in 401K match (30,922 shares)	(0.2)					0.6		0.4
Forfeiture of restricted stock (101,901 shares)	(0.2)		1.1			(0.9)		
Exercise of stock options (348,573 shares)	(4.0)					5.9		1.9
Issuance of restricted stock grants (706,110 shares)	(5.4)		(6.6)			12.0		
Foreign currency translation adjustment, net of tax benefit of \$0.8					(1.3)		(1.3)	(1.3)
Minimum pension liability adjustment, net of tax benefit of \$2.5					(4.4)		(4.4)	(4.4)
Net unrealized losses on investments, net of tax benefit of \$0.0					(0.1)		(0.1)	(0.1)
Other comprehensive loss							(5.8)	

Total comprehensive loss \$ (11.4)

Balance at September 30, 2005	\$ 1.0	\$ 630.7	\$ (8.8)	\$ (5.2)	\$ (16.6)	\$ (315.9)	\$ 285.2
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See Notes to Consolidated Financial Statements.

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 Basis of Presentation**

We manufacture and distribute a broad range of consumer and industrial products through our operating subsidiaries in three business segments – Bath Products, Plumbing Products and Rexair. Please refer to **Note 11** regarding our business segments.

On June 30, 2005, we completed the sale of Rexair, Inc. ( Rexair ) to an affiliate of Rhone Capital, LLC ( Rhone ), which was initially computed based on EITF 01-02, *Interpretations of APB Opinion No. 29* ( EITF No. 01-02 ). We received net cash of \$149.2 million and an approximately 30% equity interest in Rexair's new parent company. We recorded a gain of \$24.7 million and debt retirement costs of \$3.2 million associated with this transaction. The 30% equity interest is carried at \$5.0 million at September 30, 2005. This investment is accounted for under the equity method in accordance with Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* ( APB No. 18 ). Rexair is not being accounted for as a discontinued operation as a result of this continuing investment. Our share of Rexair's net earnings after the date of sale is recorded in other expense, net. Beginning July 1, 2005, Rexair's results are no longer reported in operating income as a separate business segment.

In the third quarter of 2005, we completed the sale of substantially all the assets and liabilities of Eljer Plumbingware ( Eljer ) to an affiliate of Sun Capital Partners, Inc. ( Sun Capital ). Eljer is now accounted for as a discontinued operation and is no longer included in the results of our Bath Products segment (see **Note 3**).

We operate on a 52- or 53-week fiscal year ending on the Saturday nearest to September 30. The fiscal year periods presented in our consolidated financial statements consist of the 52 weeks ended October 1, 2005 ( 2005 ), the 53 weeks ended on October 2, 2004 ( 2004 ) and the 52 weeks ended September 27, 2003 ( 2003 ), but are presented as of September 30 in each of those years for convenience. Businesses over which we had the ability to exercise significant influence, but are not consolidated into our results, were accounted for using the equity method. We eliminate inter-company balances and transactions when consolidating the account balances of our subsidiaries.

Any potential variable interest entity ( VIE ) in which we hold a variable interest has been assessed to determine whether the VIE should be consolidated into our results based on criteria established by FASB Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51* ( FIN 46 ). We have evaluated our interests in our wholly-owned subsidiaries and continue to consolidate them under the guidelines set forth in ARB No. 51, *Consolidated Financial Statements* ( ARB 51 ), and FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*. We have also completed an evaluation of all of our variable interests and believe that we do not have any interests in variable interest entities, as defined by FIN 46. However, even after exhaustive efforts, we have been unable to obtain information from Woodlands Ventures, LLC, a property developer from whom we obtained a \$9.3 million note receivable upon the sale of a piece of property in October 2002, that would allow us to assess whether the entity is a VIE. This note receivable was collected in October 2005.

Certain amounts have been reclassified in our prior year consolidated financial statements to conform them to the presentation used in the current year.

**Restatement**

Upon the sale of Spear & Jackson in September 2002, we retained 3,543,281 common shares of the buyer which subsequently changed its name to Spear & Jackson ( SJ ). We had been subject to restrictions on the voting of these shares and have not been involved in the management or operations of SJ. Previously, we accounted for our investment in SJ as an available-for-sale security and recorded unrealized gains or losses in other comprehensive income as its market value fluctuated. In the second



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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 1 Basis of Presentation (Continued)**

quarter of 2005, SJ's majority shareholder was required to return his common shares to SJ as part of a settlement reached with the SEC. As the number of SJ's outstanding shares decreased, our ownership percentage increased. As a result, we changed the accounting for our investment in SJ to the equity method. In the third quarter of 2005, SJ agreed to the termination of the agreement that was restricting our ability to vote all of our shares. We agreed to provide SJ and its affiliates (except the majority shareholder and his spouse) with a general release of liability. The termination agreement gave us a majority voting interest in SJ. Thus, we began consolidating SJ into our consolidated financial statements in accordance with ARB 51. SJ manufactures and distributes a broad line of hand tools, lawn and garden tools, industrial magnets and metrology tools primarily in the U.K., Europe, Australia, North and South America, Asia and the Far East.

Net earnings (loss) and earnings (loss) per share were restated to reflect the change in accounting for our investment in SJ as a result of the increase in our ownership percentage. A reconciliation of the net earnings and earnings per share previously reported in our consolidated statements of operations for 2004 and 2003 to the net earnings (loss) and earnings (loss) per share in this Report on Form 10-K is provided as follows:

	As Reported	SJ Adjustments	As Restated
(in millions)			
<b>Net earnings (loss)</b>			
2004	\$ 28.5	\$ (0.1)	\$ 28.4
2003	(31.1)	2.1	(29.0)
<b>Basic earnings (loss) per share</b>			
2004	\$ 0.38	\$	\$ 0.38
2003	(0.42)	0.03	(0.39)
<b>Diluted earnings (loss) per share</b>			
2004	\$ 0.37	\$	\$ 0.37
2003	(0.42)	0.03	(0.39)

**Note 2 Accounting Policies**

*Use of Estimates:* Generally accepted accounting principles require us to make estimates and assumptions that affect amounts reported in our financial statements and accompanying notes. Actual results could differ from those estimates.

*Foreign Currency Translation:* Our subsidiaries outside of the U.S. record transactions using their local currency as their functional currency. In accordance with FASB Statement No. 52, *Foreign Currency Translation*, the assets and liabilities of our foreign subsidiaries are translated into U.S. dollars using the exchange rates in effect at the balance sheet dates. Revenues, expenses and cash flow items are translated at average daily exchange rates for the period. The gains and losses resulting from the changes in exchange rates from year to year have been reported in other comprehensive earnings.

*Cash and Cash Equivalents:* We consider all highly liquid investments with original maturities of three months or less to be cash equivalents.

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 2 Accounting Policies (Continued)**

*Trade Receivables and Concentration of Credit Risk:* We record an allowance for doubtful accounts, reducing our receivables balance to an amount we estimate is collectible from our customers. A rollforward of the balances in allowances for doubtful accounts is as follows:

Description	Balance at Beginning of Period	Additions- Charged to Expense	Deductions- Write-offs, Payments and Other Adjustments	Balance at End of Period
(in millions)				
Allowance for doubtful accounts:				
2005	\$ 8.7	\$ 3.1	\$ (3.6)	\$ 8.2
2004	8.9	5.0	(5.2)	8.7
2003	6.9	5.7	(3.7)	8.9

We operate in the U.S., Europe and, to a lesser extent, in other regions of the world. We perform periodic credit evaluations of our customers' financial condition and generally do not require collateral. We encounter a certain amount of credit risk as a result of a concentration of receivables among a few significant customers, however, no single customer accounted for more than 10% of our total sales in 2005, 2004 or 2003. Credit losses have not been significant and have been within management's expectations.

*Income Taxes:* Deferred tax assets and liabilities represent the tax effects, based on current law, of any temporary differences in the timing of when revenues and expenses are recognized for tax purposes and when they are recognized for financial statement purposes. The deferred tax assets are reviewed periodically for recoverability and valuation allowances are provided as necessary.

*Inventories:* Our inventories are stated at the lower of cost or market value. We used the first-in-first-out (FIFO) method for determining the cost of approximately 52.4% of our inventories in 2005 and approximately 58.4% of our inventories in 2004, and the last-in-first-out (LIFO) method for the remainder of our inventories. The carrying value of our LIFO method inventories approximate their FIFO cost value at September 30, 2005 and 2004. The FIFO method approximates replacement cost. Our inventories are categorized as follows:

	At September 30,	
	2005	2004
(in millions)		
Finished products	\$ 108.7	\$ 121.5
In-process products	12.9	11.9
Raw materials	43.4	47.3
	\$ 165.0	\$ 180.7

*Property, Plant and Equipment:* We record our property, plant and equipment at cost. We record depreciation and amortization in a manner that recognizes the cost of our depreciable assets in operations over their estimated useful lives using the straight-line method. We estimate the useful lives of our depreciable assets to be 20-50 years for buildings and 1-15 years for machinery, equipment and furniture. Leasehold improvements are amortized over the shorter of the terms of the underlying leases, including probable renewal periods, or the estimated useful lives of the improvements.

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 2 Accounting Policies (Continued)**

Property, plant and equipment consist of:

	At September 30,	
	2005	2004
	(in millions)	
Land and buildings	\$ 63.6	\$ 70.0
Machinery, equipment and furniture	161.9	176.4
Accumulated depreciation	(121.8)	(127.8)
	\$ 103.7	\$ 118.6

*Other Non-current Assets:* In March 2005, we sold a \$5.0 million, 6% convertible note receivable, which we obtained from PolyAir Interpak, Inc. in conjunction with the sale of our swimming pool and equipment business in May 2003. We received \$4.4 million in net proceeds from the sale resulting in a \$0.7 million loss. The loss is included in other expense, net. The fair value of this note at September 30, 2004 was \$4.8 million.

Included in other non-current assets at September 30, 2005 is \$5.0 million related to our equity investment in Rexair. Upon the sale of Rexair in June 2005, we retained an approximate 30% equity interest in Rexair's new parent company. The investment is accounted for under the equity method in accordance with APB No. 18. Also included in other non-current assets is \$11.8 million of prepaid expenses, which consists mainly of debt related fees.

*Goodwill and Other Intangible Assets:* Goodwill and intangible assets deemed to have indefinite lives are not amortized, but are subject to annual impairment tests in accordance with FASB Statement No. 142, *Goodwill and Other Intangible Assets* ( SFAS No. 142 ). Finite-lived intangible assets are amortized over their useful lives and are subject to impairment evaluation under FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets* ( SFAS No. 144 ).

We test our goodwill and indefinite-lived intangible assets for impairment at the reporting unit level utilizing a two-step methodology. The initial step requires us to determine the fair value of each reporting unit and of each indefinite-lived intangible asset and compare it to the carrying value, including goodwill and other intangible assets, of such reporting unit or of such intangible asset. If the fair value exceeds the carrying value, no impairment loss is recognized and the second step, which is a calculation of the impairment, is not performed. However, if the carrying value of the reporting unit or intangible asset exceeds its fair value, an impairment charge equal to the difference in the values should be recorded. We perform an impairment test annually in the fourth quarter of each year, unless an event occurs earlier in the year that requires us to perform an interim test. In 2005 and 2004, the fair values of each of our reporting units exceeded their respective carrying values. Consequently, no impairment of our goodwill was indicated.

In accordance with SFAS No. 142, any allocation of goodwill to an entity sold is done based on relative fair values. We sold our Rexair and Eljer business during 2005. Rexair was the only business in the Rexair segment; thus, we wrote off all goodwill associated with that segment. Eljer was part of our Bath Products segment. However, none of the goodwill was allocated to Eljer as part of the sale since Eljer's fair value at the date of the transaction was minimal.

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 2 Accounting Policies (Continued)**

Goodwill by reporting unit is as follows:

	<b>At September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(in millions)</b>	
Bath Products	\$ 102.4	\$ 103.4
Plumbing Products	125.8	125.8
Rexair		52.5
	\$ 228.2	\$ 281.7

All of our identifiable intangible assets were included in the Rexair segment which was sold in June 2005. These assets were comprised of:

	<b>At September 30, 2004</b>		
	<b>Estimated Life</b>	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>
		<b>(in millions)</b>	
Patented technology	10 years	\$ 2.6	\$ 0.8
Distributor network	40 years	36.0	2.8
Trade name	Indefinite	24.7	
		\$ 63.3	\$ 3.6

*Accrued Expenses and Other Current Liabilities:* Accrued expenses and other current liabilities consist of the following:

	<b>At September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(in millions)</b>	
Compensation related	\$ 16.0	\$ 23.4
Insurance	4.8	8.0
Customer incentives	23.8	28.5
Interest	9.6	10.5
Warranty	12.2	11.6
Commissions	6.2	6.3

Other	41.8	31.9
	\$ 114.4	\$ 120.2

We record a reserve for future warranty costs based on current unit sales, historical experience and management's judgment regarding anticipated rates of warranty claims and cost per claim. The adequacy of the recorded warranty reserves is assessed each quarter and adjustments are made as necessary. The specific terms and conditions of the warranties vary depending on the products sold and the countries in which we do business.

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 2 Accounting Policies (Continued)**

Changes in our warranty reserves, a portion of which are classified as long-term on our consolidated balance sheets, during 2005 and 2004 are as follows:

	<b>At September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(in millions)</b>	
Beginning balance	\$ 25.3	\$ 20.9
Warranty accrual	15.4	21.1
Cash payments	(15.4)	(16.7)
Sale of Rexair (See <b>Note 3</b> )	(1.0)	
Ending balance	\$ 24.3	\$ 25.3

*Fair Value of Financial Instruments:* FASB Statement No. 107, *Disclosure about Fair Value of Financial Instruments*, requires that we disclose the fair value of our financial instruments when it is practical to estimate. We have determined the estimated fair values of our financial instruments, which are either recognized in our consolidated balance sheets or disclosed within these notes, using available market information and appropriate valuation methodologies. However, considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented are not necessarily indicative of the amounts we could realize in a current market exchange.

Short-term Assets and Liabilities: The fair values of our cash and cash equivalents, trade receivables and accounts payable approximate their carrying values because of their short-term nature.

Long-term Debt: The fair values of our Senior Notes (as defined in **Note 5**) were determined by reference to quoted market prices. The fair value of our remaining debt is determined by discounting the cash flows using current interest rates for financial instruments with similar characteristics and maturities. The fair value of our remaining debt approximates its carrying value as of September 30, 2005 and 2004.

There were no other significant differences as of September 30, 2005 and 2004 between the carrying value and fair value of our financial instruments except as disclosed below:

	<b>At September 30, 2005</b>		<b>At September 30, 2004</b>	
	<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Carrying Amount</b>	<b>Fair Value</b>
	<b>(in millions)</b>			
9.625% Senior Notes	\$ 380.0	\$ 402.8	\$ 380.0	\$ 418.6

*Revenue Recognition:* We recognize revenue when all of the following criteria are met: persuasive evidence of the arrangement exists; delivery has occurred and we have no remaining obligations; prices are fixed or determinable; and

collectibility is probable. We make shipments to approved customers based on orders placed. Prices are fixed when the customer places the order. An approved customer is one that has been subjected to our credit evaluation. We record revenue when title passes, which is either at the time of shipment or upon delivery to the customer. The passage of title is dependent on the arrangements made with each customer. Provisions are made for sales returns and allowances at the time of sale.

Management uses significant judgment in estimating sales returns, considering numerous factors such as current overall and industry-specific economic conditions and historical sales return rates. Although we consider our sales return reserves to be adequate and proper, changes in historical customer patterns could require adjustments to the reserves. We also record reductions to our revenues for customer and distributor



**Table of Contents****JACUZZI BRANDS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 2 Accounting Policies (Continued)**

programs and incentive offerings including special pricing agreements, promotions and other volume-based incentives.

As required by Emerging Issues Task Force Issue No. 01-09, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)*, we account for sales incentives, such as discounts, rebates and volume incentives, as a reduction of revenue at the later of 1) the date that the related revenue is recognized or 2) the date when the sales incentive is offered. In the case of volume incentives, we recognize the reduction of revenue ratably over the period of the underlying transactions that result in progress by the customer toward earning the incentive. We record free product given to customers as a sales incentive in cost of products sold.

*Shipping and Handling Fees and Costs:* We classify amounts charged to our customers for shipping and handling as revenues, while shipping and handling costs are recorded as cost of products sold.

*Other Expense, net:* Other expense, net consists of the following:

	<b>For the Fiscal Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>(in millions)</b>		
Keller Ladder expenses	\$ 1.0	\$ 1.6	\$ 3.7
Loss (gain) on sales of other non-operating assets	0.7	(2.5)	
(Gain) loss on sale of excess properties and equipment	(1.7)	0.1	(3.7)
Foreign currency translation (gains) losses	(0.4)	1.9	
Debt retirement costs	3.2		
Debt restructuring costs			2.3
Debt refinancing costs			19.2
Earnings on equity investment in Rexair	(0.6)		
Other, net	3.8	2.1	5.1
	<b>\$ 6.0</b>	<b>\$ 3.2</b>	<b>\$ 26.6</b>

We retained certain obligations related to our Keller Ladder operations when we sold them in October 1999. We continue to incur expenses related to those obligations. Debt restructuring costs are associated with the senior note exchange and the extension of our facilities in 2003, while the debt refinancing costs are associated with the refinancing of our debt in July 2003 and the debt retirement costs are associated with the paydown of the term loan, which was retired with the proceeds from the sale of Rexair in 2005.

*Advertising Costs:* Advertising costs are charged to expense when incurred. Advertising expense totaled \$37.3 million, \$27.8 million and \$23.1 million in 2005, 2004 and 2003, respectively.

*Research and Development Costs:* Research and development costs are expensed as incurred. Such amounts totaled \$7.2 million, \$4.1 million and \$5.0 million in 2005, 2004 and 2003, respectively.

*Stock-Based Compensation:* We account for stock-based compensation under the intrinsic value method in accordance with the provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees* ( APB No. 25 ), and related interpretations. Compensation cost recorded for our Stock Plans (as defined in **Note 8**) approximated \$4.4 million, \$3.8 million and \$1.7 million in 2005, 2004 and 2003, respectively. In December 2004, the FASB issued Statement No. 123 (revised 2004, Share-Based Payment ( SFAS No. 123R ), which is a revision of Statement No. 123, *Accounting for Stock-Based Compensation* ( SFAS No. 123 ). The Statement supersedes APB Opinion No. 25,

*Accounting for Stock*

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**Table of Contents****JACUZZI BRANDS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 2 Accounting Policies (Continued)**

Issued to Employees ( APB No. 25 ) and its related implementation guidance. Effective the first quarter of 2006, we are required to record compensation expense for its employee stock options in accordance with SFAS No. 123R.

Had compensation cost for awards under our stock-based compensation plans been determined using the fair value method prescribed by SFAS No. 123, our net earnings (loss) and earnings (loss) per share would have been reduced to the pro forma amounts presented below:

	<b>For the Fiscal Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>(in millions, except per share amounts)</b>		
Net (loss) earnings, as reported	\$ (5.6)	\$ 28.4	\$ (29.0)
Stock-based employee compensation expense, net of tax	2.5	2.2	1.0
Total stock-based employee compensation expense determined under fair value method, net of tax	(3.1)	(3.0)	(2.5)
Pro forma net (loss) earnings	\$ (6.2)	\$ 27.6	\$ (30.5)
(Loss) earnings per share:			
Basic as reported	\$ (0.07)	\$ 0.38	\$ (0.39)
Basic pro forma	(0.08)	0.37	(0.41)
Diluted as reported	\$ (0.07)	\$ 0.37	\$ (0.39)
Diluted pro forma	(0.08)	0.36	(0.41)

These pro forma results are not necessarily indicative of results that may be expected in future periods since additional options may be granted and the estimated fair value of the stock options is assumed to be amortized to expense over the vesting periods.

*(Loss) Earnings Per Share:* Net (loss) earnings per basic share is based on the weighted-average number of shares outstanding during each period, excluding the weighted average of restricted shares outstanding during each period (see **Note 8**). Net (loss) earnings per diluted share further assumes that, under the treasury stock method, any dilutive stock options are exercised, restricted stock awards are vested and any other dilutive equity instruments are converted.

The information required to compute net (loss) earnings per basic and diluted share is as follows:

	<b>For the Fiscal Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>(in millions)</b>		
Basic weighted-average number of common shares outstanding	75.5	75.0	74.6
Potential dilution of common shares	1.2	0.7	0.1
Diluted weighted-average number of common shares outstanding	76.7	75.7	74.7

Options to purchase 0.1 million, 1.0 million and 3.7 million shares in the years ended September 30, 2005, 2004 and 2003, respectively, were not included in the computation of earnings (loss) per share because the exercise prices of these options exceeded the average market price of the common shares during the respective periods.

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 2 Accounting Policies (Continued)**

*New Accounting Pronouncements:* In June 2005, the Emerging Issues Task Force reached a consensus on Issue No. 04-05, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights* ( EITF 04-05 ). EITF 04-05 requires that a general partner in a limited partnership consolidate the partnership unless the presumption of control can be overcome by showing that the limited partners have the ability to dissolve the partnership or otherwise remove the general partner without cause or possess substantive participating rights. EITF 04-05 is effective for (a) general partners of all newly formed limited partnerships and (b) existing limited partnerships for which the partnership agreements are modified. For general partners in all other limited partnerships, it is effective no later than the beginning of the first reporting period in fiscal years beginning after December 15, 2005. We are in the process of determining the impact of EITF 04-05 on our results of operations; however, we do not expect the impact to be material to our financial position or results of operations.

In March 2005, the FASB issued Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* ( FIN 47 ). This Interpretation clarifies that conditional asset retirement obligations meet the definition of a liability and should be recognized when incurred if the fair value can be reasonably estimated. FIN 47 also provides guidance as to when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective for fiscal years ending after December 15, 2005. We do not expect the adoption of FIN 47 to have a material impact on our financial position or results of operations.

In June 2005, the FASB issued Statement No. 154, *Accounting Changes and Error Corrections – A Replacement of APB Opinion No. 20 and FASB Statement No. 3* ( SFAS No. 154 ). This Statement requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the basis of the new accounting principle, unless it is impracticable to do so. SFAS No. 154 also provides that 1) a change in method of depreciating or amortizing a long-lived non-financial asset be accounted for as a change in estimate (prospectively) that was effected by a change in accounting principle, and 2) redefines restatement as the revising of previously issued financial statements to reflect the correction of an error. The new standard is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. The impact of SFAS No. 154 cannot be determined unless and until a change in accounting principle or estimate arises. We do not anticipate any changes in accounting principle at this time.

In December 2004, the FASB issued Statement No. 123 (revised 2004), *Share-Based Payment* ( SFAS No. 123R ), which is a revision of FASB Statement No. 123, *Accounting for Stock-Based Compensation* ( SFAS No. 123 ). The Statement supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees* ( APB No. 25 ), and amends FASB Statement No. 95, *Statement of Cash Flows*. SFAS No. 123R focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. Generally, the approach in SFAS No. 123R is similar to the approach described in SFAS No. 123. However, SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. SFAS No. 123R also requires the benefits of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow, as prescribed under current accounting rules. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. Total cash flow will remain unchanged from what would have been reported under prior accounting rules. In April 2005, the Securities and Exchange Commission adopted a new rule that amends the compliance dates for SFAS No. 123R. In accordance with the new rule, the accounting provisions of SFAS No. 123R will be effective for us beginning in the first quarter of fiscal 2006.

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 2 Accounting Policies (Continued)**

SFAS No. 123R permits public companies to adopt its requirements using one of two methods- modified prospective or modified retrospective. The modified prospective method requires compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123R for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123 for all awards granted to employee prior to the effective date of SFAS No. 123R that remain unvested on the effective date. The modified retrospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate, based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures, either (a) all prior periods presented or (b) prior interim periods of the year of adoption. We plan to adopt SFAS No. 123R using the modified prospective method.

As permitted by SFAS No. 123, we currently account for share-based payments to employees using APB No. 25's intrinsic value method and, as such, generally recognize no compensation cost for employee stock options. Accordingly, the adoption of SFAS No. 123R's fair value method will not affect our total cash flows or financial position, but it will reduce reported income. The impact of adoption of SFAS No. 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had we adopted SFAS No. 123R in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income and earnings per share in **Note 2** to our consolidated financial statements. In addition, in the first quarter of fiscal 2006, upon adoption of SFAS No. 123R using the modified prospective application method, we expect to recognize an immaterial one-time pre-tax gain, representing the reversal of compensation costs recorded in prior years for restricted stock awards that are not expected to vest due to future forfeitures. We currently recognize compensation costs over the explicit service period for restricted stock awards subject to acceleration of vesting upon retirement. However, this policy must change upon adoption of SFAS No. 123R. For awards granted prior to the adoption of SFAS 123R, we will continue to recognize compensation cost over the explicit service period and accelerate any remaining unrecognized compensation cost when an employee actually retires. For awards granted or modified after the adoption of SFAS 123R and subject to acceleration of vesting upon retirement, we will recognize compensation cost over a period to the date the employee first becomes eligible for retirement. Had we recognized compensation cost at the point an employee is eligible for retirement, recognized compensation cost would have increased by approximately \$1.3 million in 2004. Compensation cost in 2005 and 2003 would have remained approximately the same. We are in the process of determining how the guidance regarding valuing share-based compensation as prescribed by SFAS No. 123R will be applied to valuing share-based awards granted after the effective date and the impact that the recognition of compensation expense related to such awards will have on our financial statements.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-1, *Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004* (the Act) ( FSP No. 109-1 ), and FASB Staff Position No. FAS 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004* ( FSP No. 109-2 ). FSP No. 109-1 provides that the tax deduction on qualified production activities allowed under the Act should be treated as a special deduction rather than a tax rate deduction. The Act allows us to begin taking this deduction beginning in fiscal 2006. We have not yet assessed the impact these potential tax deductions will have on our financial position and results of operations. FSP No. 109-2 provides accounting and disclosure guidance for a special one-time dividends received deduction allowed on the repatriation of certain foreign earnings to a U.S. taxpayer, provided certain criteria are met. This guidance became effective for us in the first quarter of 2005; however, it allows for an exception to the requirement to reflect in the period of enactment the effect of a new tax law. We have a policy of repatriating foreign earnings. In addition,

**Table of Contents****JACUZZI BRANDS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 2 Accounting Policies (Continued)**

various provisions under the Internal Revenue Code have created situations that result in deemed dividends. We have completed our evaluation of the potential benefits of these deductions under the Act. The law requires that we distribute the deemed dividends before any dividends are eligible for the tax deduction. The law also requires that we exceed an average historical level of dividends before any dividend we declared would be eligible for the benefit. We currently have approximately \$67.1 million of deemed dividends that have not been distributed. As of September 30, 2005, we had approximately \$1.8 million of earnings that would qualify for the new dividend deduction. Given the level of actual and deemed dividends over the past five years, we will not benefit from this deduction.

In November 2004, FASB Statement No. 151, *Inventory Costs, an Amendment of ARB No. 43, Chapter 4* ( SFAS No. 151 ), was issued. The amendments made by SFAS No. 151 clarify that abnormal amounts of idle facility expense, freight, handling costs and wasted materials (spoilage) should be recognized as current-period charges and require the allocation of fixed production overhead to inventory based on the normal capacity of the production facilities. SFAS No. 151 will become effective for fiscal years beginning after June 15, 2005. We do not expect the adoption of SFAS No. 151 to have a material impact on our financial position or results of operations.

**Note 3 Dispositions and Discontinued Operations**

On December 28, 2001, our Board of Directors approved a formal disposal plan for five businesses. We sold all of these businesses in fiscal 2002, except for one SiTeco which was sold in the first quarter of 2003 for net cash proceeds of \$103.8 million.

In February 2003, our Board of Directors adopted a formal disposal plan to dispose of our swimming pool and equipment, hearth and water systems businesses (the 2003 Disposal Plan ). In connection with the disposal plan, we recorded a charge in 2003 of \$39.9 million, net of tax, which represents the difference between the historical net carrying value (including allocated goodwill of \$7.2 million) and the estimated net realizable value of these businesses. We sold the swimming pool and equipment business in May 2003, the hearth business in June 2003 and the water systems business in October 2003.

On April 15, 2005, we adopted a plan to dispose of our investment in SJ. In the third quarter of 2005, we began consolidating SJ into our financial statements and accounted for SJ as a discontinued operation in accordance with SFAS No. 144. See **Note 1** for additional information regarding the SJ transaction.

On May 20, 2005, the Board of Directors approved a plan to dispose of Eljer. In the third quarter of 2005, we completed the sale of substantially all the assets, the current liabilities, the long-term retiree medical liability and certain other liabilities of Eljer to Sun Capital. Sun Capital also took over our Ford City, PA and Tupelo, MS operations. We retained the Salem, OH manufacturing facility, which was closed in 2004, and several liabilities associated with events occurring before the acquisition, such as employee and environmental claims. We also agree to provide transition services at no cost for a period of up to four months after the sale and to pay any severance liabilities for any Eljer employee not retained by Sun Capital. The sale of Eljer resulted in a loss of \$57.8 million, net of tax. Eljer's operations were previously included in our Bath Products segment.

Each of these disposal plans qualified for treatment as discontinued operations. The operating loss of these discontinued operations was not included in our results from continuing operations. Instead, the results were recorded as loss from discontinued operations in the period in which they occurred in accordance with SFAS No. 144.

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 3 Dispositions and Discontinued Operations (Continued)**

Summarized results of the discontinued operations through the dates of sale are as follows:

	<b>For the Fiscal Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>(in millions)</b>		
Net sales	\$ 133.0	\$ 148.1	\$ 233.2
Operating loss	(9.1)	(31.6)	(18.6)
Loss from discontinued operations	(63.6)	(19.9)	(50.4)

In accordance with EITF Issue No. 87-24, *Allocation of Interest to Discontinued Operations*, we allocated a portion of our interest expense to discontinued operations. Amounts allocated reflect the interest expense on the estimated amount of debt that was repaid as a result of the disposal transactions. Amounts reclassified were inconsequential in 2005 and 2004, and was \$1.0 million in 2003.

The assets and liabilities of these businesses are included in assets held for sale and liabilities associated with assets held for sale, respectively, until they are sold. The Eljer business was sold prior to the end of 2005; thus, only the assets and liabilities of SJ are included in assets and liabilities held for sale at September 30, 2005.

The major classes of assets and liabilities classified as held for sale are as follows:

	<b>At September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(in millions)</b>	
Cash	\$ 7.3	\$
Trade receivables, net	16.4	27.6
Inventories	25.0	14.6
Other current assets	1.3	1.5
Deferred taxes	15.3	12.0
Property, plant and equipment, net	4.2	10.0
Equity investment	0.2	3.8
Other long-term assets		0.7
<b>Assets held for sale</b>	<b>\$ 69.7</b>	<b>\$ 70.2</b>
Notes payable	\$ 0.8	\$
Trade accounts payable	8.1	10.5
Other current liabilities	11.3	14.2
Other long-term liabilities	36.7	18.4
Minority interest	10.0	
<b>Liabilities associated with assets held for sale</b>	<b>\$ 66.9</b>	<b>\$ 43.1</b>



Included in assets held for sale under the classification of property, plant and equipment are properties held for sale of \$2.8 million at September 30, 2005 and \$3.6 million at September 30, 2004. These properties are currently being marketed for sale and meet all of the criteria for classification as held for sale at September 30, 2005 and 2004 as required by SFAS No. 144. These properties are recorded at the lower of their carrying value or fair value less cost to sell.

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 3 Dispositions and Discontinued Operations (Continued)*****Restructuring***

Restructuring charges incurred by Eljer have been reclassified to discontinued operations. We retained certain restructuring liabilities in conjunction with the Eljer sale. Approximately \$0.6 million of the retained accrued restructuring liabilities at September 30, 2005 are included in the balance sheet caption Accrued expenses and other current liabilities, while the remaining \$1.4 million are recorded in the balance sheet caption Other non-current liabilities.

***Pension Plan***

SJ operates a contributory defined benefit plan covering certain of its employees in the United Kingdom. The benefits provided by the plan are based on years of service and compensation history. Pension plan assets are primarily invested in equities, fixed income securities and Government stocks.

Amounts payable by SJ to the plan are determined on the advice of the plan's actuaries and after discussion with, and agreement by, the plan's trustees. SJ's funding policy with respect to the plan is to make contributions in respect of ongoing benefit accruals and the clearance of underfunding deficits which are at least the minimum amounts required in accordance with applicable U.K. law and pension regulations. In the years ended September 30, 2005, September 30, 2004, and September 30, 2003, contributions amounted to \$10.3 million, \$2.7 million and \$2.8 million, respectively. Contributions in the year ending September 30, 2005 included special contributions of approximately \$7.2 million. The reasons for the special contribution are explained below. Employer contributions in the year ending September 30, 2006 are expected to be approximately \$3.4 million.

The pension plan actuarial advisors carried out an actuarial valuation of the Plan as of December 31, 2004. This valuation showed an increase in the Plan's deficit compared to that calculated at April 5, 2002, the date of the last full actuarial valuation. Following discussions between SJ and the trustees of the plan, it was agreed that SJ would make a special contribution to the plan of approximately \$7.2 million. Approximately \$3.6 million was paid in June 2005 and the remainder was paid in September 2005. Also, from May 2005, SJ's annual pension contributions increased from 21.2% of pensionable salaries of approximately \$2.7 million to a fixed amount of approximately \$3.4 million. This rate of annual contribution will remain in place, subject to certain conditions, until April 2007 when it will be reviewed by the plan actuary.

Expected future benefit payment are as follows:

Year	Expected Benefit Payments
	(in millions)
2006	\$ 8.0
2007	8.3
2008	8.7
2009	9.1
2010	9.5
2011 - 2015	54.3
Total	\$ 97.9

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 3 Dispositions and Discontinued Operations (Continued)**

SJ's actuary carried out valuations of the plan under FASB Statement No. 87, *Employer's Accounting for Pensions* (SFAS No. 87), at September 30, 2005 and at September 30, 2004. The following table, as provided by the actuary, analyzes the movement in the pension plan liability between September 30, 2003, September 30, 2004 and September 30, 2005 and provides a reconciliation of changes in the projected benefit obligation, fair value of plan assets and the funded status of SJ's defined benefit pension plan with the amounts recognized in SJ's balance sheets at September 30, 2005 and September 30, 2004:

	<b>At September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(in millions)</b>	
<b>Change in projected benefit obligation:</b>		
Projected benefit obligation at the beginning of the year	\$ 180.4	\$ 154.1
Foreign currency exchange rate changes	(4.5)	12.8
Service cost	1.8	1.5
Interest cost	10.1	9.0
Employee contributions	0.9	0.9
Actuarial loss	32.2	9.5
Benefits paid	(7.4)	(7.4)
Projected benefit obligation at the end of the year	\$ 213.5	\$ 180.4
<b>Change in fair value of plan assets:</b>		
Fair value of plan assets at the beginning of the year	\$ 141.3	\$ 124.4
Foreign currency exchange rate changes	(3.5)	10.3
Actual return on plan assets	28.6	10.4
Employer contributions	10.2	2.7
Employee contributions	0.9	0.9
Benefits paid	(7.4)	(7.4)
Fair value of plan assets at the end of the year	\$ 170.1	\$ 141.3
<b>Funded status of plan:</b>		
Projected benefit obligation in excess of plan assets	\$ (43.4)	\$ (39.1)
Unrecognized net actuarial losses	69.9	59.9
Net amount recognized	\$ 26.5	\$ 20.8
<b>Amounts recognized in the balance sheet consist of:</b>		
Accrued benefit cost	\$ (36.0)	\$ (33.5)
Accumulated other comprehensive expense	62.5	54.3
Net amount recognized	\$ 26.5	\$ 20.8

At September 30, 2005 the projected benefit obligation, accumulated benefit obligation, and fair value of assets for SJ's pension plan were \$213.5 million, \$206.2 million, and \$170.1 million, respectively. At September 30, 2004 the projected benefit obligation, accumulated benefit obligation, and fair value of assets for SJ's pension plan were \$180.4 million, \$174.8 million and \$141.3 million, respectively.

In 2005, SJ recorded an additional minimum pension liability in accordance with the requirements of SFAS No. 87 which totaled \$8.2 million. We included our share, or \$4.5 million (\$2.8 million, net of

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 3 Dispositions and Discontinued Operations (Continued)**

taxes) of this adjustment in our accumulated other comprehensive loss as a direct charge to shareholders' equity, net of related tax effect. This increase is principally due to the adoption of a different mortality table in the calculation of the plan's benefit obligations together with a decrease in the discount rate assumption used at September 30, 2005 compared to that employed at the previous fiscal year end. In 2004, SJ recorded an additional minimum pension liability of \$7.6 million.

The components of net periodic cost are presented below:

	<b>For the Fiscal Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>(in millions)</b>		
<b>Components of net periodic benefit cost</b>			
Defined benefit plans:			
Service cost	\$ 1.8	\$ 1.5	\$ 1.4
Interest cost	10.1	9.0	8.0
Expected return on plan assets	(10.6)	(10.9)	(9.9)
Recognition of actuarial loss	2.7	1.7	0.8
<b>Net periodic cost</b>	<b>\$ 4.0</b>	<b>\$ 1.3</b>	<b>\$ 0.3</b>

Our share of SJ's pension benefit costs is included in loss from discontinued operations. The table above sets forth the historical components of net periodic pension cost for the employees associated with SJ and is not necessarily indicative of the amounts to be recognized by SJ on a prospective basis. SJ's net periodic pension cost for the year ended September 30, 2006 is estimated to be \$8.2 million.

The assumptions used to determine the net periodic pension cost for the defined benefit plan are presented below:

	<b>For the Fiscal Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Weighted average assumptions</b>			
Discount rate	5.00%	5.50%	5.50%
Rate of compensation increase	2.90%	2.80%	2.50%
Expected return on assets	6.50%	7.00%	7.50%

SJ's expected return on assets assumption is set in the light of an actuarial analysis of the long term return expectations for the assets held by the plan. The start point for the derivation of the rate is the return on U.K. government stocks with maturity dates matching the maturation of the plan's liabilities. Asset allocations are also taken into consideration in determining the rate. The expected return on assets assumed to determine the fiscal 2006 expense is 6.5% a year, while 7% was used to determine the 2005 expense.

The trustees aim to invest the assets of the plan prudently to ensure that the benefits promised to members are provided. In setting the investment strategy, the trustees first considered the lowest risk asset allocation that they could adopt in relation to the plan's liabilities (100% U.K. Government Bonds). The asset allocation strategy they have selected is designed to achieve a higher return than the lowest risk strategy while maintaining a prudent approach to meeting the plan's liabilities.

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 3 Dispositions and Discontinued Operations (Continued)**

The allocation of Plan investments to the various asset categories at September 30, 2005 and September 30, 2004 was as follows:

Asset category:	Target % Allocation	% of Assets at September 30,	
		2005	2004
Equities	50%	51%	48%
Bonds	50%	43%	49%
Cash	0%	6%	3%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

The target shown above is a short-term allocation.

**Sale of Rexair**

On June 30, 2005, we completed the sale of Rexair to Rhone. We received net cash of \$149.2 million and an approximate 30% equity interest in Rexair's new parent company. We recorded a gain of \$24.7 million and debt retirement costs of \$3.2 million associated with this transaction and the paydown of our term loan with the proceeds from the sale. The 30% equity interest, which was initially computed based on EITF 01-02, is carried at \$5.0 million at September 30, 2005. As a result of applying EITF No. 01-02, there is a difference between the carrying value and the underlying equity in the investment. This investment is accounted for under the equity method in accordance with APB No. 18. Our share of Rexair's net earnings after the date of sale is recorded in other expense, net. As of July 1, 2005, Rexair's results are no longer reported in operating income as a separate business segment.

**Note 4 Impairment, Restructuring and Other Charges**

The principal components of impairment, restructuring and other charges are:

	For the Fiscal Years Ended September 30,		
	2005	2004	2003
	(in millions)		
Impairment of other assets	\$	\$	\$ 3.1
Lease obligations and other commitments	0.4	(0.6)	(1.9)
Severance and related costs	9.0	3.5	8.4
	\$ 9.4	\$ 2.9	\$ 9.6
Cash charges	\$ 8.1	\$ 2.9	\$ 6.2
Non-cash charges	1.3		3.4

\$ 9.4      \$ 2.9      \$ 9.6



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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 4 Impairment, Restructuring and Other Charges (Continued)**

Below is a summary of the impairment, restructuring and other charges we incurred in 2005, 2004 and 2003. Charges are recorded when a liability is incurred in accordance with FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* ( SFAS No. 146 ), FASB Statement No. 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, and SFAS No. 144 or other applicable guidance.

	<b>For the Fiscal Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>(in millions)</b>		
<b>Bath Products:</b>			
Closure of Plant City, FL facility	\$	\$	\$ 3.9
Consolidation of administrative functions	4.5	3.5	0.4
Sub-total Bath Products	4.5	3.5	4.3
<b>Corporate Expenses:</b>			
Adjustment of estimated lease obligation		(0.6)	(3.2)
Corporate headquarters restructuring	4.9		8.5
Sub-total Corporate Expenses	4.9	(0.6)	5.3
	\$ 9.4	\$ 2.9	\$ 9.6

In 2005, we reorganized and restructured the senior management of the Bath Products segment and corporate offices, reduced staff in the U.K. and domestic bath business, and implemented other overhead reductions. In 2003, we adopted a plan to consolidate and relocate a number of administrative functions into a shared services operations center in Dallas, TX in an effort to reduce costs in our domestic bath and spa businesses. We incurred severance charges of \$3.5 million in 2004 and \$0.4 million in 2003 related to 113 employees that were terminated in conjunction with these initiatives.

The shared service center occupies a portion of the unused office space in Dallas, TX that had remained vacant since our closing of the Zurn Industries, Inc. ( Zurn ) corporate office. Favorable adjustments of \$0.6 million and \$3.2 million were recorded in 2004 and 2003, respectively, to reduce the associated accrual for lease costs that had originally been established in 2000.

In 2003, management approved a plan to close our Plant City, FL spa manufacturing plant, which was closed in November 2003. During 2003, we recorded a \$3.9 million charge associated with the closure of this facility. As a result of our decision to close the plant, we performed a recoverability test of the long-lived assets and determined that an impairment charge of \$3.1 million was required to reduce the carrying value of the property, plant and equipment to their estimated fair value. The estimated fair value of the plant was determined based on the value of comparable plants in the area plus the book value of the equipment that was transferred to our Chino facility.

In April 2003, management initiated a restructuring and consolidation of the corporate headquarters that included a number of management changes and the relocation and consolidation of the Jacuzzi headquarters in Walnut Creek,

CA into our principal offices in West Palm Beach, FL. Upon approval of our Board of Directors and stockholders, we also changed our name from U.S. Industries, Inc. to Jacuzzi Brands, Inc. We incurred charges of \$8.5 million during 2003 primarily for employee severance, lease termination costs, relocation expenses and other related exit costs.

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 4 Impairment, Restructuring and Other Charges (Continued)**

The activity in the restructuring liability accounts by cost category is as follows:

	<b>Lease and Contract Related Costs</b>	<b>Severance and Related Costs</b>	<b>Total Costs</b>
	(in millions)		
At September 30, 2003	\$ 5.2	\$ 5.1	\$ 10.3
2004 (credits) charges	(0.6)	3.5	2.9
Cash payments	(1.5)	(6.1)	(7.6)
At September 30, 2004	3.1	2.5	5.6
2005 charges	0.4	9.0	9.4
Cash payments	(1.8)	(9.4)	(11.2)
At September 30, 2005	\$ 1.7	\$ 2.1	\$ 3.8

At September 30, 2005, approximately \$2.7 million of the reserves are included in the balance sheet caption

Accrued expenses and other current liabilities, while the remaining \$1.1 million are recorded in the balance sheet caption Other liabilities. We expect the remaining accruals to be paid with cash over the periods provided by the severance and lease agreements over the next three years.

**Note 5 Long-term Debt**

Long-term debt consists of the following:

	<b>At September 30,</b>	
	<b>2005</b>	<b>2004</b>
	(in millions)	
Senior Notes	\$ 380.0	\$ 380.0
Bank Facilities:		
Asset-based credit facility		2.5
Term loan		61.8
Other long-term debt	5.0	6.4
	385.0	450.7
Less: current maturities	(1.5)	(3.9)
	\$ 383.5	\$ 446.8

On July 15, 2003, we completed a comprehensive re-financing of our corporate debt by closing on the issuance of \$380.0 million in aggregate principal amount of 9.625% senior secured notes (the Senior Notes ), as well as a five-year \$200.0 million asset-based revolving credit facility and a five-year \$65.0 million term loan. The net proceeds from the Senior Notes, together with the initial borrowings under the bank facilities, were used to repay the debt and redeem senior notes that were outstanding at that time.

The Senior Notes, which were previously registered with the Securities and Exchange Commission under the Securities Act, were de-registered on March 2, 2005. The Senior Notes are due on July 1, 2010 and require the payment of interest of \$18.3 million on January 1 and July 1 of each year.

We are restricted in the redemption of the Senior Notes per the terms of the agreement with the note holders (the Agreement ). Prior to July 1, 2006, we can redeem up to 35% of the Senior Notes with the

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 5 Long-term Debt (Continued)**

net cash proceeds of an equity offering, as defined in the Agreement. On and after July 1, 2007, we can redeem the Senior Notes subject to a redemption premium of 104.8% for the first 12 months and 102.4% for the following 12 months. On and after July 1, 2009, the Senior Notes can be redeemed at face value. We deposited \$12.4 million into restricted cash collateral accounts for the benefit of the bondholders upon the sales of Rexair and Eljer (see **Note 1**).

The term loan, which was scheduled to mature July 15, 2009, was retired with the proceeds from the sale of Rexair. We paid a prepayment penalty of \$1.0 million and expensed \$2.2 million of deferred loan costs in connection with the termination of the term loan. The term loan bore interest at LIBOR plus 5.0%. The weighted-average interest rate associated with the term loan was 7.35% for fiscal 2005 and 8.88% for 2004.

Under the five-year asset-based revolving credit facility, we can borrow up to \$200.0 million subject to a borrowing base consisting of eligible accounts receivable and eligible inventory. The interest rate under the facility is currently 2.25% over LIBOR or 0.25% over Prime. This rate will reset each quarter based on our Consolidated Leverage Ratio as defined in the agreement, and could range from 2.0% to 2.5% over LIBOR ( Applicable LIBOR Margin ). The weighted-average interest rate was 5.22% for 2005 and 3.98% for 2004.

The asset-based credit facility contains a subjective acceleration clause and a requirement to maintain a lockbox. As required by EITF Issue No. 95-22, *Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements that Include both a Subjective Acceleration Clause and a Lockbox Arrangement*, the entire balance of the asset-based facility at September 30, 2004 is included in current maturities of long-term debt. There were no outstanding balances under the asset-based facility at September 30, 2005.

Certain of our existing and future domestic restricted subsidiaries guarantee the Senior Notes, jointly and severally, on a senior basis. The Senior Notes are secured by an eligible first lien on domestic property, plant and equipment, and a second lien on the assets that secure the bank facilities. The asset-based credit facility is secured by a first lien on accounts receivable, inventory, the stock of our domestic subsidiaries and 65% of the stock of our first-tier foreign subsidiaries. In addition, the asset-based credit facility has a second lien on the property, plant and equipment securing the Senior Notes.

We paid \$45.3 million, \$45.1 million and \$56.7 million of interest on our borrowings in 2005, 2004 and 2003, respectively.

Principal reductions of senior debt and other borrowings for the next five years ended September 30 and thereafter are as follows (in millions):

2006	\$ 1.5
2007	1.7
2008	1.8
2009	
2010	380.0
	\$ 385.0

**Commitments**

At September 30, 2005, we had approximately \$121.9 million available to be borrowed under the asset-based facility, of which we had utilized approximately \$41.5 million for letters of credit, leaving

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 5 Long-term Debt (Continued)**

\$80.4 million available for additional borrowings. In addition, we have outstanding foreign commercial letters of credit of \$2.1 million which do not affect availability under the asset-based facility.

The availability under our asset-based credit facility must be reduced by the amount that our cash balance falls below the \$42.0 million excess proceeds we received from the sale of Rexair. We are required to either reinvest the excess proceeds in our business or offer to redeem the Senior Notes at par within one year of the date of sale. Our cash balance exceeded \$42.0 million at September 30, 2005, thus the availability under the asset-based credit facility was not impacted by this bank facility requirement.

We are in active negotiation with a state regarding past due taxes on property. We have accrued \$2.5 million (including \$0.5 million of interest) for the eventual settlement of this liability and believe that it is reasonably possible that the settlement could eventually total an additional \$1.5 million.

**Note 6 Pension and Retirement Plans**

We sponsor a number of domestic and foreign defined contribution plans. Contributions relating to defined contribution plans are made based upon the respective plans' provisions.

**Domestic Benefit Arrangements**

Prior to 2004, we sponsored a number of non-contributory defined benefit pension plans covering the majority of our U.S. employees. In 2004, all domestic pension plans were merged into a single pension plan. The benefits under this plan are based primarily on years of credited service and/or compensation as defined under the plan provisions. Our funding policy is to contribute amounts to the plan sufficient to meet the minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974, plus such additional amounts as we may determine to be appropriate from time to time.

We also provide health care and life insurance benefits to certain groups of retirees with most retirees contributing back to us a portion of our costs. These other post-employment benefit plans are presented as "Other Plans" in the tables that follow. We use a September 30 measurement date for the plans.

The following table provides a reconciliation of changes in the projected benefit obligation, fair value of plan assets and the funded status of our defined benefit pension and other post-employment benefit plans to the amounts recorded in our balance sheets:

	<b>Pension Plans at September 30,</b>		<b>Other Plans at September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	<b>(in millions)</b>			
Benefit obligation at beginning of year	\$ 338.4	\$ 306.9	\$ 16.7	\$ 16.8
Service cost	6.5	6.7	0.3	0.2
Interest cost	18.8	18.1	0.9	1.0
Plan amendments	1.2	14.8		
Actuarial losses	30.5	11.4	1.2	1.2
Benefits paid	(19.8)	(19.2)	(1.9)	(2.5)
Curtailments	(3.5)	(0.3)		
Benefit obligation at end of year	\$ 372.1	\$ 338.4	\$ 17.2	\$ 16.7



**Table of Contents****JACUZZI BRANDS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 6 Pension and Retirement Plans (Continued)**

	<b>Pension Plans at September 30,</b>		<b>Other Plans at September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	<b>(in millions)</b>			
Fair value of plan assets at beginning of year	\$ 369.8	\$ 342.5	\$	\$
Actual return on plan assets	56.4	42.9		
Contributions	0.8	3.6	1.9	2.5
Benefits paid	(19.8)	(19.2)	(1.9)	(2.5)
Fair value of plan assets at end of year	\$ 407.2	\$ 369.8	\$	\$
Plan assets in excess of (less than) projected benefit obligation	\$ 35.1	\$ 31.4	\$ (17.2)	\$ (16.7)
Unrecognized net actuarial losses (gains)	85.7	89.2	1.5	(5.4)
Unrecognized prior service cost (income)	11.7	16.3	(4.3)	
Net amount recognized	\$ 132.5	\$ 136.9	\$ (20.0)	\$ (22.1)
Prepaid benefits	\$ 145.4	\$ 148.7	\$	\$
Accrued benefits	(22.2)	(18.4)	(20.0)	(22.1)
Intangible assets	2.4	1.6		
Accumulated other comprehensive expense	6.9	5.0		
Net amount recognized	\$ 132.5	\$ 136.9	\$ (20.0)	\$ (22.1)

Certain portions of the pension were amended in 2004 as a result of union negotiations. For both years presented, the fair value of the pension plan's assets exceeded its accumulated benefit obligation and projected benefit obligation.



**Table of Contents****JACUZZI BRANDS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 6 Pension and Retirement Plans (Continued)**

The components of net periodic (income) expense for our domestic defined benefit pension and other plans are presented below:

	<b>Pension Plans for the Fiscal Years Ended September 30,</b>			<b>Other Plans for the Fiscal Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>(in millions)</b>					
Service cost	\$ 6.5	\$ 6.7	\$ 6.7	\$ 0.3	\$ 0.2	\$ 0.3
Interest cost	18.8	18.2	17.6	0.9	1.0	1.3
Expected return on plan assets	(31.5)	(31.8)	(32.3)			
Prior service cost	1.5	0.9	0.6	(1.0)	(1.0)	(0.1)
Net actuarial loss (gain)	5.1	1.9	0.1		(0.1)	(0.3)
Curtailments/settlements	4.8	2.5	2.9	(0.4)		
Periodic (income) expense of defined benefit plans	5.2	(1.6)	(4.4)	(0.2)	0.1	1.2
Net reclassification adjustment for discontinued operations	(4.5)	(3.9)	(4.1)			
Net periodic (income) expense:						
Defined benefit plans	0.7	(5.5)	(8.5)	(0.2)	0.1	1.2
Defined contribution plans	1.3	1.4	1.1			
	\$ 2.0	\$ (4.1)	\$ (7.4)	\$ (0.2)	\$ 0.1	\$ 1.2

*Assumptions*

The weighted-average assumptions used to determine the benefit obligation for our domestic defined benefit pension and other plans are as follows:

	<b>Pension Plans at September 30,</b>			<b>Other Plans at September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
Discount rate	5.35%	5.75%	6.00%	5.35%	5.75%	6.00%
Rate of compensation increases	3.25%	3.25%	3.25%			

The weighted-average assumptions used to determine the net periodic pension expense (income) for our domestic defined benefit pension and other plans are as follows:

<b>Pension Plans for the Fiscal Years</b>	<b>Other Plans for the Fiscal Years</b>
---	---

	Ended September 30,			Ended September 30,		
	2005	2004	2003	2005	2004	2003
Discount rate	5.75%	6.00%	6.75%	5.75%	6.00%	6.00%
Rate of compensation increases	3.25%	3.25%	3.25%			
Expected rate of return on assets	8.75%	8.75%	8.75%			

The expected rate of return on assets is based on several factors. Such factors include current and expected target asset allocation, the historical experience of returns provided by plan assets, the evaluation of market conditions and interest rates, tolerance for risk within plan guidelines and cash requirements for

Table of Contents**JACUZZI BRANDS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 6 Pension and Retirement Plans (Continued)**

benefit payments. In conjunction with our actuaries we analyze the foregoing factors as well as the advice of our pension investment advisors to develop the return on assets assumptions.

The weighted-average annual assumed rate of increase in the per capita cost of covered benefits (i.e., the health care cost trend rate) for the other post-employment benefit plans was 9.5% for 2005 and 10.0% for 2004. The rate used as of September 30, 2005 was 9.5% and is assumed to decrease 0.5% a year to 5.0%. A one-percentage-point change in the assumed health care cost trend rate would have had the following effects as of and for the year ended September 30, 2005 (in millions):

	<b>Increase (Decrease) Costs/Obligations</b>
Effect of a 1% increase in the health care cost trend rate on:	
Service cost plus interest cost	\$ 0.2
Accumulated post-employment benefit obligation	1.9
Effect of a 1% decrease in the health care cost trend rate on:	
Service cost plus interest cost	\$ (0.1)
Accumulated post-employment benefit obligation	(1.6)

*Plan Assets*

Our domestic defined benefit pension plan's weighted-average asset allocations by asset category are as follows:

	<b>At September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(in millions)</b>	
Equity securities	\$ 279.5	\$ 246.6
Debt securities	98.8	99.6
Other	28.9	23.6
	\$ 407.2	\$ 369.8

The overall investment strategy for our domestic pension plan is to manage the plan's assets in a prudent and productive manner. The selected investment managers seek to increase the aggregate value of the assets under management while conscious of the need to preserve asset value. Reasonable consistency of returns is expected on a year-to-year basis. Active management strategies are used to meet investment objectives of the pension plan, which are to satisfy all pension benefit payments and to realize investment returns in excess of market indices. Consistent with these investment objectives, the plan has set the following range of target percentages for the allocation of plan assets by each major category.

Equity securities	45%	75%
Debt securities	20%	40%
Real estate	0%	5%
Other	0%	25%

The assets for our domestic plan are included in a master trust which principally invests in listed stocks and bonds, including the common stock of our company. At September 30, 2005 and 2004, 1,333,100 shares of our common stock representing \$10.7 million and \$12.4 million of the master trust's assets as of September 30, 2005 and September 30, 2004, respectively, were included in plan assets.

**Table of Contents****JACUZZI BRANDS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 6 Pension and Retirement Plans (Continued)***Expected Contributions and Benefit Payments*

We do not expect to make any contributions to our domestic defined benefit pension plan in 2006. Based on our assumptions discussed above, we expect to make the following estimated future benefit payments under the plans as follows:

	<b>Pension Plans</b>	<b>Other Plans</b>
	<b>(in millions)</b>	
2006	\$ 17.9	\$ 1.0
2007	18.6	1.1
2008	19.2	1.1
2009	19.9	1.1
2010	20.5	1.2
2011 2015	138.1	6.2
	\$ 234.2	\$ 11.7

The tables above and on the previous pages set forth the historical components of net periodic pension cost and a reconciliation of the funded status of the pension and other plans for our domestic employees. This information, however, is not necessarily indicative of the amounts we will recognize on a prospective basis.

We recorded an additional minimum pension liability in accordance with SFAS No. 87, totaling \$1.9 million (\$1.2 million net of taxes) in 2005 and \$3.0 million (\$1.9 million net of taxes) in 2004 upon completion of our annual pension valuation for our domestic plans. The adjustment to the minimum pension liability was included in accumulated other comprehensive loss as a direct charge to shareholders' equity, net of related tax effect.

*Foreign Benefit Arrangements*

Our foreign defined benefit pension plans cover certain employees in our U.K. and Canadian operations. The following table provides a reconciliation of changes in the projected benefit obligation, the fair value of plan assets and the funded status of our foreign defined benefit pension plans with the amounts recognized on our balance sheets:

	<b>At September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(in millions)</b>	
Benefit obligation at beginning of year	\$ 69.2	\$ 51.4
Service cost	1.3	1.1
Interest cost	4.1	3.1
Employee contributions	0.9	0.8
Foreign currency exchange rate changes	(1.8)	4.4
Actuarial losses	10.4	9.6
Benefits paid	(2.2)	(1.2)
Benefit obligation at end of year	\$ 81.9	\$ 69.2



**Table of Contents****JACUZZI BRANDS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 6 Pension and Retirement Plans (Continued)**

	<b>At September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(in millions)</b>	
Fair value of plan assets at beginning of year	\$ 43.5	\$ 35.5
Actual return on plan assets	10.6	3.4
Foreign currency exchange rate changes	(1.2)	3.0
Employer contributions	2.1	2.1
Employee contributions	0.9	0.8
Benefits paid	(2.2)	(1.3)
Fair value of plan assets at end of year	\$ 53.7	\$ 43.5
Plan assets less than projected benefit obligation	\$ (28.2)	\$ (25.7)
Unrecognized net actuarial losses	38.3	36.2
	\$ 10.1	\$ 10.5
Accrued benefits	\$ (21.5)	\$ (21.2)
Accumulated other comprehensive expense	31.6	31.7
	\$ 10.1	\$ 10.5

The components of net periodic expense for our foreign defined benefit pension plans are presented below:

	<b>For the Fiscal Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>(in millions)</b>		
Service cost	\$ 1.3	\$ 1.1	\$ 1.1
Interest cost	4.1	3.2	2.5
Expected return on plan assets	(4.2)	(3.8)	(3.4)
Net actuarial loss	1.0	0.4	
Defined benefit plans	2.2	0.9	0.2
Defined contribution plans	0.3	0.3	0.3
	\$ 2.5	\$ 1.2	\$ 0.5

*Assumptions*

The weighted-average assumptions used to determine the benefit obligation for our foreign defined benefit plans are as follow:

	<b>At September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
Discount rate	5.25%	5.75%	5.75%
Rate of compensation increases	3.00%	3.25%	3.25%



**Table of Contents****JACUZZI BRANDS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 6 Pension and Retirement Plans (Continued)**

The weighted-average assumptions used to determine the net periodic pension expense for our foreign defined benefit pension plans are as follow:

	<b>For the Fiscal Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
Discount rate	5.25%	5.75%	5.75%
Rate of compensation increases	3.00%	3.00%	3.25%
Expected rate of return on assets	7.75%	8.00%	7.50%

The expected rate of return on assets is based on several factors. Such factors include current and expected target asset allocation, the historical experience of returns provided by plan assets, the evaluation of market conditions and interest rates, tolerance for risk within plan guidelines and cash requirements for benefit payments. Our actuaries and we analyze the foregoing factors as well as the advice of our pension investment advisor to develop the return on assets assumption.

*Plan Assets*

Our foreign defined benefit pension plans' weighted-average asset allocations by asset category are as follows:

	<b>At September 30,</b>	
	<b>2005</b>	<b>2004</b>
Equity securities	\$ 42.4	\$ 34.4
Debt securities	10.8	8.7
Other	0.5	0.4
	\$ 53.7	\$ 43.5

The plan's asset allocation strategy was determined with regard to the actuarial characteristics of the plan, in particular the strength of the funding position and the liability profile. It was based on the assumption that equity securities would outperform debt securities over the longer term. The trustees considered written advice from their investment advisers when choosing the plan's asset allocation strategy.

*Expected Contributions and Benefit Payments*

We expect to contribute \$3.9 million to our foreign defined benefit pension plans in 2006. Based on our assumptions discussed above, we expect to make the following estimated future benefit payments under the plan as follows (in millions):

2006	\$ 0.9
2007	0.9
2008	0.9
2009	1.0
2010	1.0

2010 2015

5.6

\$ 10.3

We recorded a reduction of our minimum pension liability for our foreign plans in accordance with SFAS No. 87, totaling \$0.1 million (\$0.4 million of additional minimum pension liability net of taxes and

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**Table of Contents****JACUZZI BRANDS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 6 Pension and Retirement Plans (Continued)**

foreign translation) in 2005 and an additional minimum pension liability of \$10.7 million (\$7.3 million net of taxes and foreign currency translation) in 2004 upon completion of our annual pension valuations. The adjustment to the minimum pension liability was included in accumulated other comprehensive loss as a direct charge to shareholders equity, net of related tax effect.

**Note 7 Income Taxes**

Earnings from continuing operations, before income taxes, consists of the following:

	<b>For the Fiscal Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>(in millions)</b>		
United States	\$ 47.0	\$ 49.0	\$ 0.3
Foreign	21.0	29.2	13.7
	<b>\$ 68.0</b>	<b>\$ 78.2</b>	<b>\$ 14.0</b>

The provision for (benefit from) income taxes attributable to our earnings (loss) from continuing operations before income taxes consists of the following:

	<b>For the Fiscal Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>(in millions)</b>		
Current:			
Federal	\$ (7.1)	\$ 10.8	\$ (7.7)
State	2.5	1.6	1.7
Foreign	9.9	15.4	7.3
Deferred	4.7	2.1	(8.7)
	<b>\$ 10.0</b>	<b>\$ 29.9</b>	<b>\$ (7.4)</b>

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 7 Income Taxes (Continued)**

The components of deferred income tax assets and liabilities are as follows:

	<b>At September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(In millions)</b>	
<b>Deferred tax assets:</b>		
Accruals and allowances	\$ 41.5	\$ 46.7
Post-employment benefits	7.7	8.7
Property, plant and equipment	3.0	
Inventory	3.0	2.1
Other	1.6	2.8
Foreign tax credits	18.8	18.2
Expected benefit from Disposal Plans & capital loss carryforwards	119.0	86.4
<b>Gross deferred tax assets</b>	<b>194.6</b>	<b>164.9</b>
Valuation allowance	(133.5)	(103.8)
<b>Total deferred tax assets</b>	<b>61.1</b>	<b>61.1</b>
<b>Deferred tax liabilities:</b>		
Net pension assets	34.2	39.1
Property, plant and equipment		1.2
Deductible goodwill	4.6	3.7
Purchased intangibles		22.2
Mark-to-market investments		1.4
<b>Total deferred tax liabilities</b>	<b>38.8</b>	<b>67.6</b>
<b>Net deferred tax assets (liabilities)</b>	<b>\$ 22.3</b>	<b>\$ (6.5)</b>

We have established a valuation allowance principally related to deferred tax assets resulting from the losses recognized in connection with disposals announced in 2001, foreign losses (ordinary) and U.S. foreign tax credits reflecting the uncertainty of the future realization of these assets. At September 30, 2005 and 2004, we had approximately \$200.2 million in capital loss carryforwards in the U.S. for which, tax effected, we established a valuation allowance of \$74.0 million in 2004. The valuation allowance remained unchanged in 2005. These capital losses expire in 2007. In connection with our disposal of Rexair, for tax purposes we incurred a capital loss carryforward of \$0.5 million for which, tax effected, we have established a valuation reserve of \$0.2 million at September 30, 2005. This capital loss will expire in 2010. In connection with the Eljer transaction a deferred tax asset of \$22.7 million was created in 2005. A full valuation allowance of \$22.7 million was established against the asset since the asset relates to a future capital loss. In addition, we had foreign tax credit carryforwards for which we established full valuation allowances of \$18.8 million and \$18.2 million at the end of 2005 and 2004, respectively. A substantial portion of these foreign tax credits will expire in 2011 and 2013. As of 2005 we recognized the existence

of state loss carryforwards of \$361 million. Tax effected, the state losses result in a tax benefit of \$13.6 million for which we have established a valuation allowance of \$11.5 million. During 2005 and 2004, we recognized the existence of U.K. and Canadian loss carryforwards and, at the same time, established full valuation allowance against them of \$6.3 million and \$11.6 million, respectively. We had Alternative Minimum Tax credit carryforwards of \$1.7 million and \$1.4 million at September 30 2005 and 2004, respectively. These credits have no expiration date.

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 7 Income Taxes (Continued)**

During 2003, the IRS completed its examination of our federal income tax returns for 1995 through 1997. As a result of the audit settlement, a tax benefit of \$13.6 million was recorded in 2003. The IRS did not include an interest calculation on the refund of taxes; therefore, interest income of \$2.5 million was recorded once it was determined in 2004. In early November 2003, the IRS informed us that it was ready to begin its audit of our returns for 1998 through 2002. The IRS provided their final report for this audit in August 2005. We filed an appeal with the IRS in September 2005 regarding various issues that we could not reach agreement on. We have recorded reserves that are adequate to cover any assessment if our appeals are rejected. A \$5.9 million tax benefit was recognized in 2005 as a result of a Federal tax audit of our consolidated tax returns for the fiscal years 1998 through 2002. The benefit resulted from agreed upon computational adjustments. In addition, several states and various other countries have examinations either in the planning stages or currently underway. One of our subsidiaries was also under audit by the IRS for 1997 and 1998, a period prior to our acquisition of that subsidiary. A \$2.9 million tax benefit was recognized in 2005 upon the completion of the Federal tax audit of that subsidiary.

The number of years with open tax audits varies depending on the tax jurisdiction. A number of years may elapse before a particular matter is audited and finally resolved. While it is often difficult to predict the final outcome or the timing of resolution of any particular tax matter, we believe that our financial statements reflect the probable outcome of known tax contingencies.

During 2004, a law was passed in Italy eliminating certain refunds of previously paid tax that would have been available when our Italian subsidiary declared a dividend. Under FASB Statement No. 109, *Accounting for Income Taxes* ( SFAS No. 109 ), a \$2.6 million dollar charge with an anticipated corresponding foreign tax credit was included in our tax provision in 2004.

The deferred tax balances have been classified in the balance sheets as follows:

	<b>At September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(In millions)</b>	
Current assets	\$ 27.9	\$ 27.8
Current liabilities		
Net current assets	27.9	27.8
Non-current assets	33.2	32.1
Non-current liabilities	(38.8)	(66.4)
Net non-current liabilities	(5.6)	(34.3)
Net deferred tax assets (liabilities)	\$ 22.3	\$ (6.5)

Our effective tax rate is based on expected income, statutory tax rates and tax planning opportunities available to us in the various jurisdictions in which we operate. The tax rate is sensitive to the jurisdiction where the income is earned since different jurisdictions will have different statutory tax rates. Significant judgment is required in determining our effective tax rate and in evaluation of our tax provisions. Despite our belief that our tax return positions are fully supportable, we estimate tax exposures and establish accruals when in our judgment we believe that

certain positions are likely to be challenged and that we may not succeed. We adjust these reserves in light of changing facts and circumstances, such as the progress of a tax audit.

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 7 Income Taxes (Continued)**

The following is a reconciliation of income taxes at the federal statutory rate of 35% to the provision for (benefit from) income taxes attributable to continuing operations:

	<b>For the Fiscal Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>(in millions)</b>		
Federal tax provision computed at the statutory rate	\$ 23.8	\$ 27.4	\$ 4.9
Foreign income tax differential	2.3	0.5	1.4
State income taxes (net of Federal benefit)	2.1	1.7	1.4
Rexair Disposition	(8.6)		
Resolution of tax contingencies	(8.8)		(13.6)
Other non-deductible items	0.2	0.4	
Valuation allowance	(0.6)	0.6	(1.7)
Other, net	(0.4)	(0.7)	0.2
	<b>\$ 10.0</b>	<b>\$ 29.9</b>	<b>\$ (7.4)</b>

Income taxes paid during 2005, 2004 and 2003 were \$13.9 million, \$16.9 million and \$18.0 million, respectively.

**Note 8 Employee Benefit Plans*****Incentive Stock Plans***

We maintain stock incentive plans (the *Stock Plans*) that provide for the grants of stock options and restricted stock awards to our directors, officers and key employees. As of September 30, 2005, there were 2,392,802 shares of common stock reserved for issuance to directors, officers and key employees under our Stock Plans. Under these Stock Plans, stock options must be granted at an option price equal to the market value of the stock on the date of the grant. Options granted under this plan become exercisable over four years in equal annual installments after the date of grant, provided that the individual is continuously employed by our company. All options granted expire ten years from the date of grant. We had authorization under the Stock Plan to grant 3,240,255 additional stock awards at September 30, 2005.

At September 30, 2005 and 2004, respectively, we had 1,012,204 and 776,989 restricted shares of our common stock (restricted stock awards) outstanding. In 2005, we granted 726,053 restricted stock awards to our employees. On March 17, 2004, in connection with an option exchange offer, we accepted for cancellation options to purchase 1,903,337 shares of our common stock, and granted 435,730 restricted stock awards in exchange. Participants tendered 100% of the options eligible to be exchanged. Later in 2004, an additional 215,000 restricted stock awards were granted to employees.

Restricted stock awards granted in the last year either vest in quarterly increments over four years or 100% at the end of three years. Restricted stock awards issued in prior years either vest in equal annual increments over four years or vest over seven years (either in thirds on the third year, fifth year and seventh year or solely at the end of the seventh year). Although subject to certain restrictions and forfeiture provisions, restricted stock awards are considered to be issued and outstanding common stock. The restricted stock award's intrinsic value, which is determined on the date of the grant, is amortized over the vesting period in tranches consistent with our accounting policy of recognizing expense for awards with graded vesting under the expense attribution method described in FASB Interpretation





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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 8 Employee Benefit Plans (Continued)**

compensation expense associated with the restricted stock awards is included in our balance sheets as a separate component of stockholders' equity. During 2005, 2004 and 2003, we recognized \$3.7 million, \$2.0 million and \$0.6 million, respectively, of compensation expense associated with our restricted stock awards.

In accordance with EITF No. 00-23, *Issues Related to the Accounting for Stock Compensation under APB Opinion No. 25, Accounting for Stock Issued to Employees*, and FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation*, employee stock options issued within six months of the option exchange are considered replacement awards and are subject to variable accounting until the award is exercised, forfeited or canceled. As of September 30, 2005, there are 70,875 employee stock options being accounted for under these provisions. During 2005 and 2004, less than \$0.1 million of expense was recognized under these variable accounting provisions.

**Retirement Savings Plans**

We have one 401(k) retirement savings plan that allow eligible employees to contribute up to 60% of their salaries, commissions and bonuses, up to \$14,000 annually, to the plan on a pretax basis in accordance with the provisions of Section 401(k) of the Internal Revenue Code. Matching contributions of common stock or cash that are made into the plan are equivalent to 50% of the first 6% of an employee's contributions. During 2005, 2004 and 2003, \$1.3 million, \$1.4 million and \$1.1 million, respectively, was recognized as compensation expense under these programs.

**Accounting for Stock-based Compensation**

We apply APB No. 25 and related Interpretations in accounting for our stock-based compensation plans. Thus, we use the intrinsic value method to determine the compensation cost for our stock-based awards. A summary of the status of and changes in our stock option plans for the last three years is presented below:

	2005		2004		2003	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding at beginning of year	2,640,559	\$ 6.35	5,190,202	\$ 9.97	5,202,796	\$ 11.88
Granted	134,524	9.45	298,750	9.42	849,250	3.39
Exercised	(347,225)	4.21	(277,875)	3.20	(875)	3.82
Canceled/ expired	(1,161,826)	8.42	(2,570,518)	13.93	(860,969)	13.96
Outstanding at end of year	1,266,032	5.37	2,640,559	6.35	5,190,202	9.97
Exercisable at end of year	753,657	5.25	1,632,434	7.42	3,743,793	11.87

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**JACUZZI BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 8 Employee Benefit Plans (Continued)**

The following table summarizes the status of the stock options outstanding and exercisable at September 30, 2005:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number of Options	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
\$2.20 to \$5.49	707,250	6.2	\$ 3.37	446,500	\$ 3.39
\$5.50 to \$7.99	211,500	8.1	6.53	73,375	6.44
\$8.00 to \$9.99	344,750	5.8	8.66	231,250	8.30
\$10.00 to \$20.50	2,532	1.2	20.50	2,532	20.50
	1,266,032	6.4	5.37	753,657	5.25

Had compensation cost for awards under our stock-based compensation plans been determined using the fair value method prescribed by SFAS No. 123, our net income (loss) and income (loss) per share would have been reduced to the pro forma amounts presented in **Note 2**. The pro forma information was determined using the Black-Scholes option-pricing model based on the following assumptions:

expected volatility rates of 63% for 2005 and 66% for both 2004 and 2003;

risk-free interest rates of 3.41% for 2005, 2.97% for 2004 and 2.66 % for 2003;

expected option lives of 4 years for all three years; and

expected dividend yield of 0% for all three years.

The weighted average fair values of options granted during 2005, 2004 and 2003 were \$4.63, \$5.73 and \$4.03 per option, respectively.

**Note 9 Capital Stock****Common Stock**

In March 2001, our Board of Directors indefinitely suspended the quarterly payment of dividends on our common stock.

**Stockholder Rights Plan**

We adopted a Stockholder Rights Plan (the "Rights Plan") effective October 15, 1998. Under the Rights Plan, each of our stockholders on the date of record were issued one right (the "Right") to acquire one-hundredth of a share of our Series A Junior Preferred Stock ("Preferred Stock"), having a market value of two times the exercise price for the Rights, for each outstanding share of Jacuzzi Brands, Inc. common stock they own.

Initially, the Rights trade with our common stock and are not exercisable. The Rights will separate from the Common Stock and only become exercisable when a single person or company acquires or makes an offer to acquire 15% or more of our outstanding common stock, unless otherwise agreed by our Board of Directors. Upon exercise of

the Right, the economic and voting terms of the Preferred Stock acquired by the stockholders will be equivalent to those possessed when they held shares of our Common Stock.

The Rights will expire on October 15, 2008 or 90 days following the date the Rights become exercisable, whichever is earlier. The Board of Directors has agreed to permit Southeastern Asset

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**JACUZZI BRANDS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 9 Capital Stock (Continued)**

Management, Inc. and its managed funds to purchase up to 24.0% of the outstanding voting securities without causing the Rights to separate and become exercisable, and we have entered into a standstill agreement with Southeastern Asset Management containing limitations and restrictions on the voting and transfer of shares of common stock acquired in excess of 15%.

**Note 10 Commitments and**