

KATY INDUSTRIES INC
Form 10-K/A
October 18, 2006

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

FORM 10-K/A
Amendment No. 1

Annual Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

For the fiscal year ended: December 31, 2005

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission file number 1-5558

Katy Industries, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

75-1277589

(IRS Employer Identification Number)

2461 South Clark Street, Suite 630, Arlington, VA 22202
(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: (703) 236-4300

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

(Title of each class)
Common Stock, \$1.00 par value
Common Stock Purchase Rights

(Name of each exchange on which registered)
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 Section 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

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. [X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer ___ Accelerated filer ___ Non-accelerated filer

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

The aggregate market value of the voting common stock held by non-affiliates of the registrant* (based upon its closing transaction price on the New York Stock Exchange Composite Tape on June 30, 2005), as of June 30, 2005 was \$15,778,722. As of March 15, 2006, 7,993,177 shares of common stock, \$1.00 par value, were outstanding, the only class of the registrant's common stock.

* Calculated by excluding all shares held by executive officers and directors of the registrant without conceding that all such persons are “affiliates” of the registrant for purposes of federal securities laws.

DOCUMENTS INCORPORATED BY REFERENCE

Proxy Statement for the 2006 annual meeting - Part III.

EXPLANATORY NOTE

This Amendment No. 1 to our Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (“Amendment No. 1”) amends and restates Part IV Item 15 of our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2006. Additionally, this Amendment No. 1 includes the consent of the independent public accounting firms of Sahlman Holding Company, Inc. (“Sahlman Holding”), an equity investment in which Katy Industries, Inc. holds a 43% interest, relating to the financial statements and related audit report of Sahlman Holding. No other information in our Annual Report on Form 10-K for the 2005 fiscal year, as amended, is amended hereby. This Amendment No. 1 does not reflect events occurring after the filing of our Form 10-K for the 2005 fiscal year or modify or update those disclosures affected by subsequent events.

Pursuant to the Rule 3-09 of Regulation S-X, a registrant is required to file separate financial statements for certain significant equity method investments. We are filing Amendment No. 1 to include the financial statements and related audit reports of Sahlman Holding. These financial statements were audited in accordance with United States generally accepted auditing standards and United States generally accepted accounting principles.

Part IV

Item 15. EXHIBITS AND FINANCIAL STATEMENTS SCHEDULES

(a) 1. Financial Statements

The following financial statements of Katy are set forth in Part II, Item 8, of this Form 10-K:

- Consolidated Balance Sheets as of December 31, 2005 and 2004 *
- Consolidated Statements of Operations for the years ended December 31, 2005, 2004 and 2003 *
- Consolidated Statements of Stockholders' Equity for the years ended December 31, 2005, 2004 and 2003 *
- Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2004 and 2003 *
- Notes to Consolidated Financial Statements *

* Previously filed on March 31, 2006

2. Financial Statement Schedules

The financial statement schedule filed with this report is listed on the "Index to Financial Statement Schedules" on page 4 of this Form 10-K/A Amendment No. 1.

3. Exhibits

The exhibits filed with this report are listed on the "Exhibit Index."

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: October 18, 2006 KATY INDUSTRIES, INC.
Registrant

/s/ Anthony T. Castor III
Anthony T. Castor III
President and Chief Executive Officer

/s/ Amir Rosenthal
Amir Rosenthal
Vice President, Chief Financial Officer,
General Counsel and Secretary

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Consent of Independent Public Accounting Firm	**
Consent of Independent Public Accounting Firm	**

* Previously filed on March 31, 2006

** Indicates filed herewith

All other schedules are omitted because they are not applicable, or not required, or because the required information is included in the Consolidated Financial Statements of Katy or the Notes thereto.

FINANCIAL STATEMENT SCHEDULES

Financial Statements (Unaudited) of Sahlman Holding Company, Inc.

SAHLMAN HOLDING COMPANY, INC.

TAMPA, FLORIDA

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2005 AND 2004

(Unaudited)

SAHLMAN HOLDING COMPANY, INC.CONSOLIDATED BALANCE SHEETS

Unaudited

ASSETS	DECEMBER 31,	
	2005	2004
CURRENT ASSETS		
Cash and cash equivalents	\$ 4,676,235	\$ 114,822
Accounts receivable - net of allowance for doubtful accounts of \$9,755 and \$14,406	1,742,836	1,224,575
Inventories	4,245,352	3,079,474
Current portion of net investment in sales-type lease	2,162,250	-
Note and other receivables	701,222	225,076
Prepaid expenses	400,463	438,542
Prepaid and recoverable income taxes	-	48,900
Deferred income taxes	117,300	212,395
Total current assets	14,045,658	5,343,784
PROPERTY, PLANT AND EQUIPMENT, NET	5,469,618	17,763,310
OTHER ASSETS		
Net investment in sales-type lease, net of current portion	4,366,500	-
Foreclosed property	158,139	179,744
Goodwill, net	-	165,366
Other, net	95,913	116,875
	4,620,552	461,985
	\$ 24,135,828	\$ 23,569,079
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 550,740	\$ 1,200,481
Accrued expenses	891,521	480,275
Short-term debt	-	1,264,439
Current maturities of long-term debt	1,362,250	246,200
Current portion of stock buyback obligation	293,800	-
Income taxes payable	675,267	185,430
Total current liabilities	3,773,578	3,376,825

LONG-TERM DEBT	2,775,011	2,146,518
STOCK BUYBACK OBLIGATION	753,429	-
DEFERRED INCOME TAXES	292,310	2,783,796
Total liabilities	7,594,328	8,307,139
SHAREHOLDERS' EQUITY	16,541,500	15,261,940
	\$ 24,135,828	\$ 23,569,079

The accompanying Notes are an integral part of these Consolidated Financial Statements

SAHLMAN HOLDING COMPANY, INC.CONSOLIDATED STATEMENTS OF OPERATIONS

Unaudited

	YEAR ENDED DECEMBER 31,	
	2005	2004
GROSS SALES	\$ 18,952,948	\$ 16,925,341
EXPENSES		
Cost of goods sold	16,148,153	15,177,632
Selling, general and administrative expense	2,350,534	2,187,016
Total expenses	18,498,687	17,364,648
GAIN ON SALE OF ASSETS, NET	1,674,366	116
INCOME (LOSS) FROM OPERATIONS	2,128,627	(439,191)
OTHER INCOME AND (EXPENSE)		
Interest expense	(184,671)	(181,878)
Goodwill impairment loss	(165,366)	-
Other income	552,490	295,738
Other expense	(532,951)	(174,967)
INCOME (LOSS) BEFORE INCOME TAXES	1,798,129	(500,298)
BENEFIT FROM INCOME TAXES	(745,745)	(239,700)
NET INCOME (LOSS)	\$ 2,543,874	\$ (260,598)

The accompanying Notes are an integral part of these Consolidated Financial Statements

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SAHLMAN HOLDING COMPANY, INC.CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Unaudited

YEAR ENDED DECEMBER 31, 2005

	TREASURY STOCK		COMMON STOCK		ADDITIONAL FOREIGN PAID-IN CAPITAL		CURRENCY TRANSLATION	RETAINED EARNINGS	TOTAL SHAREHOLDERS' EQUITY
	SHARES	AMOUNT	SHARES	AMOUNT					
BALANCE, JANUARY 1, 2005	(11,182)	\$ (1,805,111)	80,000	\$ 8,000	\$ 1,949,000	\$ (231,375)		\$ 15,341,426	\$ 15,261,940
PURCHASE OF TREASURY STOCK	(835)	(217,085)	-	-	-	-	-	-	(217,085)
OBLIGATION TO REPURCHASE STOCK	-	-	-	-	(1,047,229)	-	-	-	(1,047,229)
NET INCOME	-	-	-	-	-	-	-	2,543,874	2,543,874
BALANCE, DECEMBER 31, 2005	(12,017)	\$ (2,022,196)	80,000	\$ 8,000	\$ 901,771	\$ (231,375)		\$ 17,885,300	\$ 16,541,500

YEAR ENDED DECEMBER
31, 2004

BALANCE, JANUARY 1, 2004	(11,182)	\$ (1,805,111)	80,000	\$ 8,000	\$ 1,949,000	\$ (231,375)		\$ 15,602,024	\$ 15,522,538
NET LOSS	-	-	-	-	-	-	-	(260,598)	(260,598)
BALANCE, DECEMBER 31, 2004	(11,182)	\$ (1,805,111)	80,000	\$ 8,000	\$ 1,949,000	\$ (231,375)		\$ 15,341,426	\$ 15,261,940

The accompanying Notes are an integral part of these Consolidated Financial Statements

SAHLMAN HOLDING COMPANY, INC.CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited

	YEAR ENDED DECEMBER 31,	
	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ 2,543,874	\$ (260,598)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities -		
Depreciation and amortization	919,328	1,326,853
Gain on sale of assets	(1,674,366)	(116)
Impairment of goodwill	165,366	-
Deferred income taxes	(2,437,476)	(369,516)
(Increase) decrease in operating assets -		
Accounts receivable	(518,261)	353,976
Inventories	(1,165,878)	125,096
Other receivables	62,790	(105,140)
Prepaid expenses	38,079	18,341
Prepaid and recoverable income taxes	-	176,726
Other assets	20,962	17,066
(Decrease) increase in operating liabilities -		
Accounts payable	(649,741)	258,080
Accrued expenses	411,250	4,737
Income taxes payable	489,837	(657,790)
Net cash (used in) provided by operating activities	(1,794,236)	887,715
CASH FLOWS FROM INVESTING ACTIVITIES		
Payments received on foreclosed property	21,605	-
Purchase of property, plant and equipment	(492,207)	(546,683)
Proceeds from sale of property, plant and equipment	13,630,918	1,250
Issuance of note receivable	(2,850,000)	-
Principal payments and proceeds from notes receivable	2,311,064	1,239
Issuance of lease receivable related to Shrimp Boat Management	(8,116,500)	-
Principal payments received on lease receivable	1,587,750	-
Net cash provided by (used in) investing activities	6,092,630	(544,194)
CASH FLOWS FROM FINANCING ACTIVITIES		
Finance costs	-	(33,324)
Proceeds from long-term debt	4,022,000	604,660
Payments on long-term debt	(2,277,457)	(569,102)
Net payments under line of credit	(1,264,439)	(466,561)
Purchase of treasury stock	(217,085)	-

Net cash provided by (used in) financing activities	263,019	(464,327)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	4,561,413	(120,806)
CASH AND CASH EQUIVALENTS - BEGINNING	114,822	235,628
CASH AND CASH EQUIVALENTS - ENDING	\$ 4,676,235	\$ 114,822

The accompanying Notes are an integral part of these Consolidated Financial Statements

SAHLMAN HOLDING COMPANY, INC.CONSOLIDATED STATEMENT OF CASH FLOWS

Unaudited

	YEAR ENDED DECEMBER 31,	
	2005	2004
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Income taxes paid	\$ 1,439,725	\$ 360,803
Interest paid	\$ 184,671	\$ 183,638
SUPPLEMENTAL DISCLOSURE OF NONCASH TRANSACTIONS		
Transfer of note receivable to other assets as a result of foreclosure on real property	\$ -	\$ 179,744

During the year ended December 31, 2005, the Company recorded an obligation to repurchase 4,036 shares of its common stock valued at \$1,047,229 (see Note 9).

The accompanying Notes are an integral part of these Consolidated Financial Statements

SAHLMAN HOLDING COMPANY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2005 AND 2004

Unaudited

NOTE 1 - DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business - Sahlman Holding Company, Inc. (Company), owns 100% of Sahlman Seafoods, Inc. (Sahlman or the Subsidiary), a wholesaler of shrimp and other seafood located in Tampa, Florida. Sahlman's customers are located throughout the United States. Sahlman has three wholly owned foreign subsidiaries. Two are located in Guyana and are involved in the harvesting and processing of shrimp and other seafood. The other foreign subsidiary is located in Nicaragua and is involved in the operation of a shrimp farm and processing plant.

Use of Estimates - The Company prepares its financial statements in conformity with accounting principles generally accepted in the United States of America. These principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosed contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Principles of Consolidation - The consolidated financial statements include the accounts of the Company and its subsidiaries after elimination of intercompany accounts and transactions.

Cash and Cash Equivalents - The Company considers all short-term highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Accounts Receivable - Trade accounts receivable are carried at their estimated collectible amounts and trade credit is generally extended on a short-term basis; thus trade receivables do not bear interest. Trade accounts receivable are periodically evaluated for collectibility based on past credit history with customers and their current financial condition.

The Company uses the reserve method of accounting for bad debts for financial reporting purposes and the direct write-off method for income tax purposes. Trade accounts receivable are charged against the allowance account when such receivables are deemed to be uncollectible.

Inventories - Inventories of materials and supplies are stated at lower of cost or market, determined under the average cost method. Inventories of finished products are valued at production cost under the average cost method, which is not more than market value. Stock in ponds consists of the direct and indirect costs incurred in the cultivation and maintenance of shrimp.

Other Assets - Prior to 2002, the Company amortized goodwill over a twenty-year period using the straight-line method. However, in accordance with Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and other Intangible Assets" (SFAS No. 142), the Company discontinued the amortization of goodwill effective January 1, 2002, and began performing an annual impairment test. See further information regarding goodwill in Note 4. Costs of acquiring loans are capitalized and amortized over the term of the loan using the straight-line method.

Property, Plant and Equipment - Property, plant and equipment are stated at cost, less accumulated depreciation. The Company computes depreciation using the straight-line method over the estimated useful lives of the assets as follows:

Land improvements	15 years
Building	5 - 30 years
Marine vessels	10 - 20 years
Machinery and equipment	5 - 20 years

For income tax purposes, buildings, marine vessels and machinery and equipment are depreciated under the lives and methods of the applicable income tax regulations in effect at the acquisition date.

Income Taxes - The Company accounts for its income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes," which requires the liability method of accounting for income taxes. Under this method, deferred taxes are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates.

Concentration of Credit Risk - The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents. The Company places its cash and temporary cash investments with high credit quality institutions. At times, such investments may be in excess of the FDIC insurance limit.

For the years ended December 31, 2005 and 2004, one customer accounted for \$3,619,688 and \$2,748,000 of the Company's sales, respectively.

Foreign Currency Translation - Financial statements for two of the foreign subsidiaries have been remeasured to U.S. dollars considering the dollar as the functional currency. Under this method, monetary assets and liabilities are remeasured as of the exchange rate in effect as of the financial statement date; nonmonetary assets and liabilities at the date when they were acquired or incurred; property and equipment at its acquisition date; and capital stock at the exchange rate in effect when recorded. Income and expenses are recorded at an average rate for the year, except for depreciation and amortization whose remeasurement is made at the historical exchange rate. Under this method, gains and losses from remeasurement are recognized in net income of the period. For the years ended December 31, 2005 and 2004, a net loss of \$1,706 and \$62,200 on remeasurement is included in other expense, respectively. The 2005 and 2004 loss on remeasurement net of income taxes is \$1,126 and \$41,000, respectively.

Advertising Costs - All of the Company's advertising costs are nondirect-response costs and are expensed as incurred. Advertising costs for the years ended December 31, 2005 and 2004 were \$18,508 and \$36,498, respectively.

Shipping and Handling Costs - Included in "selling, general and administrative expense" on the consolidated statements of operations is shipping and handling costs of \$251,248 and \$259,513 for 2005 and 2004, respectively.

Impairment of Long-Lived Assets (Excluding Goodwill) - The Company evaluates the recoverability of its long-lived assets whenever adverse events or changes in business climate indicate that the expected undiscounted future cash flows from the related assets may be less than previously anticipated. If the net book value of the related asset exceeds the undiscounted future cash flows of the asset, the carrying amount would be reduced to the present value of its expected future cash flows and an impairment loss would be recognized. As of December 31, 2005 and 2004, management does not believe that an impairment reserve is required.

Asset Disposals - During 2005, Sahlman sold the corporate headquarters building and related land for \$3,566,659, which resulted in a gain of \$3,063,992. A portion of the building was subsequently leased back to Sahlman for a one-year term ending September 30, 2006 and month-to-month thereafter. The lease calls for equal monthly installments of \$3,400. Total rent expense for 2005 for this and other operating leases amounted to approximately \$13,200.

Also in 2005, the Company sold all of the inventory and property, plant, and equipment of Georgetown Seafoods, a subsidiary of the Company. The assets sold had a net book value of \$1,686,027, and were sold in exchange for a note in the amount of \$2,850,000, which resulted in a gain of \$1,067,999 after deducting expenses incurred in connection with the sale. At December 31, 2005, the balance on the note amounted to \$538,396, which is due in March 2006.

Also in 2005, the Company entered into a sales-type lease transaction for all of the fishing vessels and supplies of Shrimp Boat Management (SBM), a subsidiary of the Company. The assets leased have a net book value of \$10,522,901 and were leased in exchange for a 38-month lease with total rental payments of \$9,224,894, of which \$8,116,500 has been allocated to principal. After deducting expenses of the transaction, SBM recognized a loss of

\$2,456,885. SBM recognizes interest revenue on the lease payments over the life of the lease (see Note 7).

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NOTE 2 - INVENTORIES

Inventories consist of the following:

	2005	2004
Seafood products	\$ 3,324,424	\$ 1,233,091
Supplies	810,053	1,751,653
Stock in ponds	110,875	94,730
Total inventories	\$ 4,245,352	\$ 3,079,474

NOTE 3 - PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	2005	2004
Land and land improvements	\$ 286,519	\$ 825,405
Buildings	5,010,332	6,054,805
Marine vessels	-	15,987,066
Machinery and equipment	3,395,906	5,418,794
Furniture and fixtures	112,144	350,041
Construction in progress	194,794	-
Total property, plant and equipment	8,999,695	28,636,111
Less accumulated depreciation	(3,530,077)	(10,872,801)
Property, plant and equipment, net	\$ 5,469,618	\$ 17,763,310

NOTE 4 - OTHER ASSETS

Other assets consist of the following:

	2005	2004
Net investment in sales-type lease (see Note 7)	\$ 4,366,500	\$ -
Foreclosed property	\$ 158,139	\$ 179,744
Goodwill	\$ 566,880	\$ 566,880
Less accumulated amortization	(566,880)	(401,514)
Goodwill, net	\$ -	\$ 165,366
Deferred financing costs	\$ 51,690	\$ 85,318
Less accumulated amortization	-	(44,479)
Deferred financing costs, net	51,690	40,839
Other assets (see Note 12)	44,223	76,036

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Total other assets, net	\$	95,913	\$	116,875
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During 2004, the Company began foreclosure proceedings to repossess real property in satisfaction of a note receivable defaulted upon by the owners of the property. Management anticipated that there would be a recovery in excess of the \$179,744 balance due on the note plus any expenses incurred. Therefore, as of December 31, 2004, \$179,744 was included on the balance sheet in other assets. Subsequent to December 31, 2005, the Company assigned all of its rights related to its foreclosed property in exchange for approximately \$232,000.

In accordance with the provisions of SFAS No. 142, which includes requirements to test goodwill and indefinite lived intangible assets for impairment rather than amortize them, the Company performed the annual impairment test during 2005. The Company determined that the carrying amount of its goodwill exceeded its fair value, which was estimated based on the present value of expected future cash inflows. Accordingly, a goodwill impairment loss of \$165,366 was recognized in the accompanying consolidated statements of operations. Changes in goodwill during 2005 are summarized in the following table:

Balance, January 1, 2005	\$ 165,366
Impairment loss	(165,366)
Balance, December 31, 2005	\$ -

As of December 31, 2005 and 2004, the gross carrying amount of deferred financing costs is \$51,690 and \$85,318, respectively. During 2005, new loan costs were incurred in the amount of \$51,690 that are to be amortized over two years. During 2004, new loan costs were incurred in the amount of \$33,324 that were to be amortized over one to three years. Amortization expense related to deferred financing costs included in other expense for the years ended December 31, 2005 and 2004 was \$0 and \$14,803, respectively.

The future estimated amortization expense is as follows:

2006	\$ 30,804
2007	20,886
	\$ 51,690

NOTE 5 - SHORT-TERM DEBT

In 1997, the Company entered into the Second Amended and Restated Credit Agreement (Second Amended Credit Agreement) (see Note 6) with SouthTrust Bank now known as Wachovia Bank, N.A., (SouthTrust), which provided financing under a line of credit facility of up to \$2,000,000. During 2003, the line of credit was amended and restated by the Third Amended and Restated Credit Agreement and the First Amendment to Third Amended and Restated Credit Agreement (Third Amended Credit Agreement) with SouthTrust. The Company and the bank desired to amend and restate the Second Amended Credit Agreement to concisely and accurately reflect the current agreements of the parties. The Third Amended Credit Agreement consolidates two term notes outstanding with SouthTrust (see Note 6) and the line of credit was amended to allow for advances not to exceed \$2,250,000. Advances are limited based on a formula applied to assets and less any issued letters of credit and accrue interest at the Company's option at either LIBOR plus 130 to 225 basis points as determined by the Company's ratio of total liabilities to tangible net worth or the prime rate of SouthTrust.

During 2004, the line of credit was amended and restated by the Second Amendment to Third Amended and Restated Credit Agreement to extend additional credit to the Company and to modify certain provisions of the loan agreement. The Second Amendment allowed for advances not to exceed \$2,500,000 for the period commencing July 8, 2004 and ending November 4, 2004 and not to exceed \$2,250,000 at all other times. Advances accrued interest at LIBOR plus 225 basis points. At December 31, 2004 \$1,264,439 of advances were outstanding.

In 2005, the SouthTrust line of credit was paid off. On December 28, 2005, Sahlman closed on a \$2,500,000 revolving line of credit with Fifth Third Bank. Advances on the credit line are payable on demand, carry a variable rate per annum equal to the LIBOR rate plus the applicable margin basis points as defined in the credit agreement, and are limited to an amount equal to 85 percent of eligible accounts, plus 50 percent of eligible inventory, with a maximum

inventory cap not to exceed 75 percent of eligible accounts. The credit line is collateralized by all of the assets of Sahlman and matures on December 28, 2007. At December 31, 2005 no advances were outstanding.

NOTE 6 - LONG-TERM DEBT

Long-term debt consists of the following:

	2005	2004
Fifth Third term loan	\$ 4,000,000	\$ -
SouthTrust term loans	-	2,168,633
Sahlman Seafoods of Nicaragua, SA bank loan	137,261	224,085
Total long-term debt	4,137,261	2,392,718
Less current maturities of long-term debt	1,362,250	246,200
Total long-term debt	\$ 2,775,011	\$ 2,146,518

SouthTrust - During 1997, the Company paid off its revolving loan and consolidated the remaining debt balances of the original term loan and Vessel Acquisition Facility Note into one consolidated term loan governed by the provisions of the SouthTrust Second Amended Credit Agreement. On January 23, 2001, the Company refinanced the remaining balance due on this note as of that date into a new 2001 Consolidation Note. The total amount advanced under the agreement was \$1,200,000. Advances under the note accrued interest at the LIBOR rate plus 130 to 225 basis points as determined by the Company's ratio of total liabilities to tangible net worth. The note was secured by real property with a Negative Pledge Agreement on all shrimp trawlers of the Company.

In 2003, the 1999 term note and the 1999 Vessel Acquisition Facility were consolidated and refinanced with SouthTrust into a new term note, the 2003 Term Loan. The 2003 Term Loan was governed by the provisions of the Third Amended Credit Agreement. The original principal amount of the note was \$1,287,667. The note was renewed in August 2003 to increase the principal amount by \$250,000 for a note balance of \$1,430,362. The note accrued interest at the Company's option at either the LIBOR rate plus 155 to 250 basis points as determined by the Company's ratio of total liabilities to tangible net worth or the prime rate of SouthTrust. The loan was to mature on August 15, 2006 and was unsecured; however, SouthTrust required a Negative Pledge Agreement on all shrimp trawlers of the Company as a condition of, and as partial consideration for, entering into the credit agreement.

In 2004, the 2001 Consolidation Note and the 2003 term loan were consolidated and refinanced with SouthTrust into a new term note, the 2004 Consolidation Note. The 2004 Consolidation Note was governed by the provisions of the Third Amendment to Third Amended and Restated Credit Agreement. The original principal amount of the note was \$2,193,000, which included an advance in the principal amount of \$454,659. The note accrued interest at the Company's option at either the LIBOR rate plus 155 to 250 basis points as determined by the Company's ratio of total liabilities to tangible net worth or the prime rate of SouthTrust. At December 31, 2004, the loan bore interest at 4.7% and was to be repaid in equal monthly installments of \$12,183. The loan was to mature on October 28, 2009 and was secured by real property with a Negative Pledge Agreement on all shrimp trawlers of the Company. The outstanding balance at December 31, 2004 was \$2,168,333.

In 2005, the SouthTrust loan was paid off. SBM took out a loan with Fifth Third Bank on December 28, 2005 in the amount of \$4,000,000. The loan accrues interest at the LIBOR rate plus 250 basis points and is due when principal payments are due. The loan matures on July 15, 2007 and is collateralized by substantially all of the assets of SBM and the rights of SBM to its sales-type lease agreement (see Note 7).

The loan agreements contain certain restrictive covenants requiring the Company to meet certain financial ratios and other matters. At December 31, 2005, the Company was in compliance with these covenants.

Other long-term debt in the amount of \$150,000 originated in 2003, with an additional \$150,000 in 2004, in connection with one of the wholly-owned subsidiaries, Sahlman Seafoods of Nicaragua, S.A. (SSN). The note matures on December 11, 2006 and is payable in 36 monthly installments bearing an annual interest rate of 9.55%. The loan is guaranteed by equipment and a mortgage on land and facilities of SSN. An additional note with SSN originated in 2005, which matures in May 2009 and is payable in 48 monthly installments bearing an annual interest rate of 10.75%. The loan is guaranteed by certain property, plant and equipment of SSN. In addition, a car loan was taken out in October 2001 in the amount of \$17,386 payable in 36 monthly installments of \$483 beginning on November 30, 2001 at 0% interest.

Aggregate maturities of long-term debt are as follows:

2006	\$ 1,362,250
2007	2,765,690
2008	4,661
2009	4,660
	\$ 4,137,261

NOTE 7 - NET INVESTMENT IN SALES-TYPE LEASE

In accordance with an agreement dated May 12, 2005, the Company entered into a sales-type lease as a lessor of certain assets of SBM. The lease is for the period May 12, 2005 through June 30, 2008. Following is a summary of the components of the Company's net investment in the sales-type lease at December 31, 2005:

Total minimum lease payments to be received	\$ 7,256,363
Unearned income	(727,613)
Net investment	\$ 6,528,750

The future minimum lease payments to be received on the life of the lease are as follows:

2006	\$ 2,601,138
2007	2,943,104
2008	1,712,121
	\$ 7,256,363

NOTE 8 - INCOME TAXES

For the years ended December 31, 2005 and 2004, the benefit from income taxes consists of the following:

	2005	2004
<u>Current</u>		
Federal	\$ 1,228,502	\$ (46,900)
State	131,161	-
Foreign	381,416	49,377
Total current	1,741,079	2,477
<u>Deferred</u>		
Federal	(2,246,977)	(212,720)
State	(239,847)	(10,020)
Foreign	-	(19,437)
Total deferred	(2,486,824)	(242,177)

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Total benefit from income taxes	\$	(745,745)	\$	(239,700)
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The Company's effective income tax rate is lower than what would be expected if the federal statutory rate were applied to income from continuing operations primarily because of repatriation of foreign earnings as described below.

On October 22, 2004, the President signed the American Jobs Creation Act of 2004 (the Jobs Act). The Jobs Act created a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85 percent dividends received deduction for certain dividends from controlled foreign corporations. This provided the Company the opportunity to tax effectively repatriate foreign earnings for U.S. qualifying investments specified by the Company's domestic reinvestment plan. During 2005, the Company completed its evaluation of the repatriation provisions and, in the fourth quarter of 2005, the Company repatriated approximately \$6 million of foreign earnings in the United States pursuant to the provisions of the Jobs Act. In 2005, the Company recorded \$1.6 million of income tax benefit, net of available foreign tax credits, related to the Jobs Act, which effectively taxed earnings at 5.25 percent. The Company previously provided for income taxes on these foreign earnings at 34 percent. As this provision is only effective for the tax year 2005, the Company will not reduce its effective tax rate on future foreign earnings and profits.

Deferred income taxes resulting from the tax effects of temporary differences consist of book depreciation in excess of tax depreciation, fixed asset sales, reserves and accrued expenses, intercompany profit, and unremitted earnings of foreign subsidiaries. Other differences between income taxes computed using the statutory federal and state income tax rates and the provision for income taxes are attributed primarily to foreign income being subject only to federal income tax. Net deferred tax liabilities and assets are \$175,010 and \$2,571,401 at December 31, 2005 and 2004, respectively.

NOTE 9 - CAPITAL STOCK

Common Stock - The Company has four classes of authorized common stock: Class A, B, C and D. Under the Company's Amended and Restated Certificate of Incorporation, the relative rights and preferences of each class of stock are as follows:

Voting Rights - The holders of Class A, B and C common stock will vote together as a single combined class on all matters submitted to a vote of the shareholders, with each holder of Class A, B and C common stock being entitled to one vote per share of such stock held. The holders of Class D common shares have no right to vote on any matters submitted to a vote of the shareholders.

Liquidation Preferences - Upon dissolution, liquidation, or winding up of the Corporation, holders of Class B common stock are entitled to a minimum liquidation value of \$100 per share. Holders of Class C and D common stock are then entitled to the remaining assets available for distribution after the distribution to holders of Class B based upon the number of shares of C and D shares over the total number of common shares outstanding. Remaining distributions shall be to all holders of Class A and B shares on the basis of the number of such shares outstanding.

Redeemable Stock - If any employee ceases to be employed, then such employee's Class A stock that was purchased through the exercise of options will be subject to repurchase by the Company. The Company has the right of first refusal to purchase any or all of such Class A common stock held, if such employee's termination was with or without cause or if termination is the result of death, disability, or achieving the age of 65. If the employee voluntarily terminates or is terminated for cause, the repurchase price for Class A common stock will be the lesser of the price the employee paid for the repurchased shares plus seven percent annual simple interest, or the value of such repurchased shares on the date 30 days prior to the date of termination. If the employee is terminated without cause or if the termination is a result of death, disability, or achieving the age of 65, the repurchase price of Class A common stock will be the value as defined in the Stock Options and Repurchase Agreement of such repurchased shares on the date 30 days prior to the date of termination.

Convertible Stock - Class D common stock is convertible into shares of Class C common stock. Such conversion will be effected by the surrender of the Class D common stock in exchange for the Class C common stock upon consummation of an initial public, Rule 144, or Regulation A offering or upon the sale of Class C common stock to those shares convertible to Class C shares equaling 2% or more of the outstanding common stock having voting rights.

Additional stock information is as follows:

	2005	2004
Class A common stock:		
Par value per share	.10	.10
Shares authorized	60,000	60,000
Shares outstanding, net of treasury stock	26,233	27,068
Class B common stock:		
Par value per share	.10	.10
Shares authorized	50,000	50,000
Shares outstanding, net of treasury stock	41,750	41,750
Class C common stock:		
Par value per share	.10	.10
Shares authorized	40,000	40,000
Shares outstanding, net of treasury stock	-	-
Class D common stock:		
Par value per share	.10	.10
Shares authorized	40,000	40,000
Shares outstanding, net of treasury stock	-	-

During 2005, the Company entered into a settlement agreement with a holder of 4,871 shares of Class A common stock. The agreement requires the Company, effectively as of September 1, 2001, to repurchase \$75,000 worth of the individual's common stock, calculated based on the book value per share of the Company's common stock as of the preceding December 31st, until all shares have been repurchased. As of December 31, 2005, the Company had repurchased 835 shares for a cost of \$217,090. The remaining 4,036 shares have been reflected as a stock buyback obligation on the accompanying consolidated balance sheets in the amount of \$1,047,229.

NOTE 10 - STOCK OPTION PLANS

During 2001, 1999, 1998 and 1997, the Company's stockholders approved the granting of incentive stock options for shares of Class A common stock to key executives and management. Under the Stock Option and Repurchase Agreements, all options were granted at a price of \$160.08, which is considered by management to be equal to market value on the date of grant. All options are exercisable immediately.

A summary of option transactions during the years ended December 31, 2005 and 2004 is shown below:

	Number of Shares	Weighted Average Option Price
Options (granted and unexercised) at January 1, 2005	4,117	\$ 160.08
Granted	-	-
Exercised	-	-
Forfeited	-	-
Options (granted and unexercised) at December 31, 2005	4,117	\$ 160.08
Options (granted and unexercised) at January 1, 2004	4,117	\$ 160.08
Granted	-	-
Exercised	-	-
Forfeited	-	-
Options (granted and unexercised) at December 31, 2004	4,117	\$ 160.08

The fair value of the options is determined by the management of the Company. The Company applies APB Opinion 25 and related interpretations in accounting for its plans. Accordingly, no compensation cost has been recognized for its stock option plans. Had compensation cost been determined based on the fair value at the grant date consistent with the method of FASB No. 123, "Accounting for Stock-Based Compensation," the net loss of the Company would not have been affected in 2005 and 2004.

NOTE 11 - EMPLOYEE BENEFIT PLAN

The subsidiary has a 401(k) Profit Sharing and Savings Plan (the Plan) covering nearly all employees of the domestic company. Under the provisions of the Plan, participants have the right to make employee contributions in whole percentages of not less than two percent or more than fifteen percent of their gross annual earnings, subject to limitations prescribed by law. Employees are eligible to participate in the Plan if they are age eighteen or older and have completed six months of service. Participants are immediately vested in their contributions and earnings thereon.

The Company may elect to match the employees' contributions, but not in excess of two percent of the participant's gross annual earnings. The Company contributions to this plan were \$9,460 and \$12,553 for the years 2005 and 2004, respectively.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

Litigation - In the ordinary course of business, the Company and its Subsidiary are involved in litigation primarily as a result of injuries sustained during shrimp boat operations. The Company is self-insured for these claims. Management believes that the reserves are adequate to cover unpaid losses that have been incurred as of December 31, 2005.

Insurance Coverage - The Company provides insurance for workers' compensation claims and boat reserve claims. The Company is fully insured for group health care claims. In the opinion of management, the boat reserve of \$0 and \$3,000 included in accrued expenses represents adequate provision for covering unpaid losses which have been incurred as of the years ended December 31, 2005 and 2004, respectively. The Company had a protection and indemnity insurance policy to cover the employees working on the shrimp boats. This policy expired on December 15, 2001, and the Company has decided not to renew it as all of the boats are now St. Vincent registry, which the Company feels will virtually eliminate the risk of future claims in the United States.

Rights and Concessions - SSN has entered into contracts for the construction of shrimp farming operations located in Nicaragua.

One contract entered into during 1997 and 1998, is for a 2,593 acre land lease for twenty years with the government of Nicaragua. Payments of \$52,606 have been made with additional payments of 1% of the gross sales due annually to the government once production begins. No additional amounts have been paid in connection with the requirements of the lease, nor has any been accrued, as construction has not begun as of December 31, 2005. Under the terms of the lease, construction was required to begin by October 1, 1998. The Company is undecided as to when, or if, they will begin construction.

In November 2000, SSN was granted the right to construct a shrimp farm in exchange for a fee of \$50,000 paid to a Nicaraguan government agency.

The payments made under these agreements are included with other assets and at December 31, 2005 and 2004, amounted to \$44,223 and \$66,897 net of amortization, respectively. Payments relating to these rights and concessions are being amortized over 20 years using the straight-line method.

NOTE 13 - SUBSEQUENT EVENT

Subsequent to December 31, 2005, the Company assigned all of its rights related to its foreclosed property in exchange for approximately \$232,000.

FINANCIAL STATEMENT SCHEDULES

Financial Statements of Sahlman Holding Company, Inc.

SAHLMAN HOLDING COMPANY, INC.

TAMPA, FLORIDA

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2003

INDEPENDENT AUDITORS' REPORT

February 20, 2004, except for Note 6
is as of March 18, 2004 and Note 12
is as of January 10, 2005

To the Board of Directors and Shareholders of
Sahlman Holding Company, Inc.
Tampa, Florida

We have audited the accompanying consolidated balance sheet of Sahlman Holding Company, Inc. and its subsidiary (Sahlman Seafoods, Inc.) as of December 31, 2003, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for the year ended December 31, 2003. 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 did not audit the financial statements of Sahlman Seafoods of Nicaragua, S.A., a wholly owned subsidiary of Sahlman Seafoods, Inc., which statements reflect total assets of \$6,409,000 as of December 31, 2003 and net loss of \$711,000 for the year ended December 31, 2003. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for Sahlman Seafoods of Nicaragua, S.A., is based solely on the report of the other auditors, except for the adjustment to building depreciation described further in note 12 which has not been reflected in such financial statements by the other auditors. This adjustment has been recorded in the consolidated financial statements of Sahlman Holding Company, Inc.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 audit, which includes the adjustment to building depreciation for Sahlman Seafoods of Nicaragua, S.A. described further in note 12, provides a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Sahlman Holding Company, Inc. and its subsidiary as of December 31, 2003, and the results of their operations and their cash flows for the year ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America.

/s/ Dwight, Darby, and Company
Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

January 10, 2005

To the Board of Directors and Stockholders of
Sahlman Seafoods of Nicaragua, S.A.:

We have audited the accompanying balance sheet of Sahlman Seafoods of Nicaragua, S.A. (the Company) as of December 31, 2003, and the related statement of operations and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on those statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sahlman Seafoods of Nicaragua, S.A., as of December 31, 2003, the results of its operations and cash flows for the year then ended, in conformity with accounting standards generally accepted in the United States of America.

/s/ Grant Thornton
Certified Public Accountants
Managua, Nicaragua

SAHLMAN HOLDING COMPANY, INC.CONSOLIDATED BALANCE SHEET

	DECEMBER 31, 2003
ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	\$ 235,628
Accounts receivable - net of allowance for doubtful accounts of \$9,000	1,578,551
Inventories	3,204,570
Note and other receivables, current portion	127,648
Prepaid expenses	456,883
Recoverable income taxes	225,626
Deferred income taxes	221,798
Total current assets	6,050,704
NOTE RECEIVABLE, LESS CURRENT PORTION	173,271
PROPERTY, PLANT AND EQUIPMENT, NET	18,512,798
OTHER ASSETS	
Goodwill, net	165,366
Other, net	115,420
	280,786
	\$ 25,017,559
LIABILITIES AND SHAREHOLDERS' EQUITY	
CURRENT LIABILITIES	
Accounts payable	\$ 942,401
Accrued expenses	475,538
Short-term debt	1,731,000
Current maturities of long-term debt	611,617
Income taxes payable	843,220
Total current liabilities	4,603,776
LONG-TERM DEBT	1,745,543
DEFERRED INCOME TAXES	3,145,702

Total liabilities	9,495,021
SHAREHOLDERS' EQUITY	15,522,538
	\$ 25,017,559

The accompanying Notes are an integral part of these Consolidated Financial Statements

SAHLMAN HOLDING COMPANY, INC.

CONSOLIDATED STATEMENT OF OPERATIONS

	YEAR ENDED DECEMBER 31, 2003
GROSS SALES	\$ 15,802,189
EXPENSES	
Cost of goods sold	15,200,241
Freight and other sales expense	349,161
General and administrative expense	2,063,111
Total expenses	17,612,513
GAIN ON SALE OF ASSETS, NET	233,671
LOSS FROM OPERATIONS	(1,576,653)
OTHER INCOME AND (EXPENSE)	
Interest expense	(131,578)
Other income	130,409
Other expense	(480,525)
LOSS BEFORE INCOME TAXES	(2,058,347)
BENEFIT FROM INCOME TAXES	(729,104)
NET LOSS	\$ (1,329,243)

The accompanying Notes are an integral part of these Consolidated Financial Statements

SAHLMAN HOLDING COMPANY, INC.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

YEAR ENDED DECEMBER 31, 2003

	TREASURY STOCK		COMMON STOCK		ADDITIONAL FOREIGN PAID-IN CAPITAL		CURRENCY TRANSLATION	RETAINED EARNINGS	TOTAL SHAREHOLDERS' EQUITY
	SHARES	AMOUNT	SHARES	AMOUNT					
BALANCE, JANUARY 1, 2003	(10,632)	\$ (1,717,067)	80,000	\$ 8,000	\$ 1,949,000	\$ (231,375)	\$ 16,931,267	\$ 16,939,825	
PURCHASE OF TREASURY STOCK	(550)	(88,044)	-	-	-	-	-	(88,044)	
NET LOSS	-	-	-	-	-	-	(1,329,243)	(1,329,243)	
BALANCE, DECEMBER 31, 2003	(11,182)	\$ (1,805,111)	80,000	\$ 8,000	\$ 1,949,000	\$ (231,375)	\$ 15,602,024	\$ 15,522,538	

The accompanying Notes are an integral part of these Consolidated Financial Statements

SAHLMAN HOLDING COMPANY, INC.CONSOLIDATED STATEMENT OF CASH FLOWS

	YEAR ENDED DECEMBER 31, 2003
CASH FLOWS FROM OPERATING ACTIVITIES	
Net loss	\$ (1,329,243)
Adjustments to reconcile net loss to net cash provided by operating activities -	
Depreciation and amortization	1,560,586
Gain on sale of assets	(233,671)
Deferred income taxes	(1,084,045)
(Increase) decrease in operating assets -	
Accounts receivable	(198,869)
Inventories	769,009
Other receivables	160,733
Prepaid expenses	(118,780)
Prepaid and recoverable income taxes	(225,626)
Other assets	(403)
(Decrease) increase in operating liabilities -	
Accounts payable	(193,165)
Accrued expenses	(15,597)
Income taxes payable	724,750
Net cash provided by operating activities	(184,321)
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of property, plant and equipment	(681,275)
Proceeds from sale of property, plant and equipment	1,102,319
Proceeds from note receivable	7,086
Net cash provided by investing activities	428,130
CASH FLOWS FROM FINANCING ACTIVITIES	
Finance costs	(16,122)
Proceeds from long-term debt	400,000
Payments on long-term debt	(799,228)
Net borrowings under line of credit	220,953
Purchase of treasury stock	(88,044)
Payments on short-term debt	-
Net cash used in financing activities	(282,441)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(38,632)

CASH AND CASH EQUIVALENTS - BEGINNING		274,260
CASH AND CASH EQUIVALENTS - ENDING	\$	235,628
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Income taxes refunded	\$	(190,131)
Interest paid	\$	134,045

The accompanying Notes are an integral part of these Consolidated Financial Statements

SAHLMAN HOLDING COMPANY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2003

NOTE 1 - DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business - Sahlman Holding Company, Inc. (Company), owns 100% of Sahlman Seafoods, Inc. (Sahlman or the Subsidiary), a wholesaler of shrimp and other seafood located in Tampa, Florida. Sahlman's customers are located throughout the United States. Sahlman has three wholly owned foreign subsidiaries. Two are located in Guyana and are involved in the harvesting and processing of shrimp and other seafood. The other foreign subsidiary is located in Nicaragua and is involved in the operation of a shrimp farm and processing plant.

Use of Estimates - The Company prepares its financial statements in conformity with accounting principles generally accepted in the United States of America. These principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosed contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Principles of Consolidation - The consolidated financial statements include the accounts of the Company and its subsidiaries after elimination of intercompany accounts and transactions.

Cash and Cash Equivalents - The Company considers all short-term highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Accounts Receivable - Trade accounts receivable are carried at their estimated collectible amounts and trade credit is generally extended on a short-term basis; thus trade receivables do not bear interest. Trade accounts receivable are periodically evaluated for collectibility based on past credit history with customers and their current financial condition.

The Company uses the reserve method of accounting for bad debts for financial reporting purposes and the direct write-off method for income tax purposes. Trade accounts receivable are charged against the allowance account when such receivables are deemed to be uncollectible.

Inventories - Inventories of materials and supplies are stated at lower of cost or market, determined under the average cost method. Inventories of finished products are valued at production cost under the average cost method, which is not more than market value. Stock in ponds consists of the direct and indirect costs incurred in the cultivation and maintenance of shrimp.

Other Assets - Prior to 2002, the Company amortized goodwill over a twenty-year period using the straight-line method. However, in accordance with Financial Accounting Standards Board (FASB) Statement No. 142, "Goodwill and other Intangible Assets" (Statement No. 142), the Company discontinued the amortization of goodwill effective January 1, 2002 (see Note 4).

Costs of acquiring loans are capitalized and amortized over the term of the loan using the straight line method.

Property, Plant and Equipment - Property, plant and equipment are stated at cost, less accumulated depreciation. The Company computes depreciation using the straight-line method over the estimated useful lives of the assets as follows:

Land improvements	15 years
Building	5 - 30 years
Marine vessels	10 - 20 years
Machinery and equipment	5 - 20 years

For income tax purposes, buildings, marine vessels and machinery and equipment are depreciated under the lives and methods of the applicable income tax regulations in effect at the acquisition date. Effective January 1, 2003, the salvage value was changed on the marine vessels to more accurately reflect their depreciable value. (See Note 3)

Income Taxes - The Company accounts for its income taxes in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes," which requires the liability method of accounting for income taxes. Under this method, deferred taxes are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates.

Concentration of Credit Risk - The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents. The Company places its cash and temporary cash investments with high credit quality institutions. At times, such investments may be in excess of the FDIC insurance limit.

For the year ended December 31, 2003, three customers accounted for \$5,269,000 of the Company's sales.

Foreign Currency Translation - Financial statements for two of the foreign subsidiaries have been remeasured to U.S. dollars considering the dollar as the functional currency. Under this method, monetary assets and liabilities are remeasured at the exchange rate in effect as of the financial statement date; nonmonetary assets and liabilities at the date when they were acquired or incurred; property and equipment at its acquisition date; and capital stock at the exchange rate in effect when recorded. Income and expenses are recorded at an average rate for the year, except for depreciation and amortization whose remeasurement is made at the historical exchange rate. Under this method, gains and losses from remeasurement are recognized in net income of the period. For the year ended December 31, 2003, a net loss of \$385,000 on remeasurement is included in other expense. The 2003 loss on remeasurement net of income taxes is \$254,000. In years prior to 1998, the foreign currency was considered the functional currency and gains or losses on exchange were recorded as a separate component of shareholders' equity.

Advertising Costs - All of the Company's advertising costs are nondirect-response costs and are expensed as incurred. Total advertising costs for the year ended December 31, 2003 was \$92,654.

Shipping and Handling Costs - Included in "freight and other sales expense" on the statement of operations is shipping and handling costs of \$214,451 for 2003.

Impairment of Long-Lived Assets - The Company evaluates the recoverability of its long-lived assets whenever adverse events or changes in business climate indicate that the expected undiscounted future cash flows from the related assets may be less than previously anticipated. If the net book value of the related asset exceeds the undiscounted future cash flows of the asset, the carrying amount would be reduced to the present value of its expected future cash flows and an impairment loss would be recognized. As of December 31, 2003, management does not believe that an impairment reserve is required.

Asset Disposals - During 2003, the Company sold four shrimp trawlers for \$1,130,000. A portion of the total proceeds was used to pay down the term debt upon the bank's approval. The cost of the four vessels sold totaled \$1,768,000 with accumulated depreciation of \$900,000 leaving a net book value of \$868,000. After expenses to ready the boats for sale, the Company recognized a gain on the sale in the amount of \$234,355.

The sale of the vessels will reduce the high repair expense incurred in previous years on the vessels as well as reduce interest on the loan, enabling the Company to improve its loan service position.

NOTE 2 - INVENTORIES

Inventories consist of the following:

	2003
Seafood products	\$ 1,474,220

Supplies	1,635,113
Stock in ponds	95,237
Total inventories	\$ 3,204,570

NOTE 3 - PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	2003
Land	\$ 561,854
Land improvements	1,542,668
Buildings	4,383,481
Marine vessels	15,990,078
Machinery and equipment	5,802,766
Furniture and fixtures	750,841
Construction in progress	223,950
Total property, plant and equipment	29,255,638
Less accumulated depreciation	(10,742,840)
Property, plant and equipment, net	\$ 18,512,798

Effective January 1, 2003, the Company changed the salvage value of their shrimp trawlers from \$100,000 to \$200,000. This change was made to more accurately reflect the value expected to be received by the Company upon the sale of their used boats and was based on used shrimp trawler sales by the Company in recent years. For 2003, this change resulted in a \$443,000 reduction in depreciation expense and a reduction in the net loss after income taxes of \$276,000.

Construction in progress consists of costs incurred for expanding the shrimp processing plant in Nicaragua.

NOTE 4 - OTHER ASSETS

Other assets consist of the following:

	2003
Goodwill	\$ 566,880
Less accumulated amortization	(401,514)
Goodwill, net	\$ 165,366
Deferred financing costs	\$ 51,994
Less accumulated amortization	(29,676)
Deferred financing costs, net	22,318
Other assets (see Note 11)	93,102
Total other assets, net	\$ 115,420

In June 2001, FASB issued Statement No. 142, which includes requirements to test goodwill and indefinite lived intangible assets for impairment rather than amortize them. The provisions of Statement No. 142 require an annual impairment test. In accordance with the provisions of Statement No. 142, the Company performed the annual impairment test during fiscal 2003. The results of this test indicated that the Company's goodwill was not impaired, as the fair value of the asset did exceed its carrying value.

As of December 31, 2003, the gross carrying amount of deferred financing costs is \$51,994. During 2003, new loan costs were incurred in the amount of \$16,122 that are to be amortized over three years. Amortization expense related to deferred financing costs included in other expense for the year ended December 31, 2003.

The future estimated amortization expense is as follows:

2004	\$ 9,224
2005	8,674
2006	4,420
	\$ 22,318

NOTE 5 - SHORT-TERM DEBT

In 1997, the Company entered into the Second Amended and Restated Credit Agreement (Second Amended Credit Agreement) (see Note 6) with SouthTrust Bank, (SouthTrust), which provided financing under a line of credit facility of up to \$2,000,000. During 2003, the line of credit was amended and restated by the Third Amended and Restated Credit Agreement and the First Amendment to the Third Amended and Restated Credit Agreement (Third Amended Credit Agreement) with SouthTrust. The Company and the bank desired to amend and restate the Second Amended Credit Agreement to concisely and accurately reflect the current agreements of the parties. The Third Amended Credit Agreement consolidates two term notes outstanding with SouthTrust (see Note 6) and the line of credit was amended to allow for advances not to exceed \$2,250,000. Advances are limited based on a formula applied to assets and less any issued letters of credit. Advances accrue interest at the Company's option at either LIBOR plus 130 to 225 basis points as determined by the Company's ratio of total liabilities to tangible net worth or the prime rate of SouthTrust. At December 31, 2003, advances of \$1,731,000 were outstanding. The line of credit is secured by the Company's accounts receivable, inventory and certain equipment. The line of credit matures on July 31, 2004 and is subject to annual renewal at SouthTrust's discretion.

NOTE 6 - LONG-TERM DEBT

Long-term debt consists of the following:

	2003
SouthTrust term loans	\$ 2,202,330
Sahlman Seafoods of Nicaragua, SA bank loan	150,000
Other	4,830
Total long-term debt	2,357,160
Less current maturities of long-term debt	611,617
Total long-term debt	\$ 1,745,543

SouthTrust - During 1997, the Company paid off its revolving loan and consolidated the remaining debt balances of the original term loan and Vessel Acquisition Facility Note into one consolidated term loan governed by the provisions of the SouthTrust Second Amended Credit Agreement. On January 23, 2001, the Company refinanced the remaining balance due on this note as of that date into a new 2001 Consolidation Note. The total amount advanced under the agreement was \$1,200,000. Advances under the note accrue interest at the LIBOR rate plus 130 to 225 basis points as determined by the Company's ratio of total liabilities to tangible net worth. The loan bore interest at 2.619% at December 31, 2003, and is to be repaid in equal monthly installments of \$6,667 with a final payment of \$800,000 due January 23, 2006. The note is secured by real property with a Negative Pledge Agreement on all shrimp trawlers of the Company. The outstanding balance at December 31, 2003 was \$966,667.

In 2003, the 1999 term note and the 1999 Vessel Acquisition Facility were consolidated and refinanced with SouthTrust into a new term note, the 2003 Term Loan. The 2003 Term Loan is governed by the provisions of the Third Amended Credit Agreement. The original principal amount of the note was \$1,287,667. The note was renewed in August 2003 to increase the principal amount by \$250,000 for a note balance of \$1,430,362. The note accrues interest at the Company's option at either the LIBOR rate plus 155 to 250 basis points as determined by the Company's ratio of total liabilities to tangible net worth or the prime rate of SouthTrust. At December 31, 2003, the loan bore interest at 2.7% and is to be repaid in equal monthly installments of \$39,732. The loan matures on August 15, 2006 and is unsecured; however, SouthTrust has required a Negative Pledge Agreement on all shrimp trawlers of the Company as a condition of, and as partial consideration for, entering into the credit agreement. At December 31, 2003, the outstanding loan balance was \$1,235,663.

The loan agreements contain certain restrictive covenants requiring the Company to meet certain ratios and other matters. At December 31, 2003, the Company was not in compliance with one of these covenants. On March 18, 2004, the bank has agreed to waive compliance with this covenant.

Other long-term debt in the amount of \$150,000 originated in 2003 in connection with one of the wholly-owned subsidiaries, Sahlman Seafoods of Nicaragua, S.A. (SSN). The note matures on December 11, 2006 and is payable in 36 monthly installments bearing an annual interest rate of 9.55%. The loan is guaranteed by equipment and a mortgage on land and facilities of SSN. In addition, a new car loan was taken out in October 2001 in the amount of \$17,386 payable in 36 monthly installments of \$483 beginning on November 30, 2001 at 0% interest.

Aggregate maturities of long-term debt during the three years ending in 2006 are as follows:

2004	\$ 611,617
2005	606,787
2006	1,138,756
	\$ 2,357,160

NOTE 7 - INCOME TAXES

For the years ended December 31, 2003, the provision for (benefit from) income taxes consists of the following:

	2003
<u>Current</u>	
Federal	\$ 354,941
Foreign	-
Total current	354,941
<u>Deferred</u>	
Federal	(1,038,397)
State	(45,648)
Foreign	-
Total deferred	(1,084,045)
Total provision for (benefit from) income taxes	\$ (729,104)

Deferred income taxes resulting from the tax effects of temporary differences consist of book depreciation in excess of tax depreciation, fixed asset sales, reserves and accrued expenses, intercompany profit and unremitted earnings of foreign subsidiaries. Other differences between income taxes computed using the statutory federal and state income tax rates and the provision for income taxes are attributed primarily to foreign income being subject only to federal income tax. Net deferred tax liabilities and assets are \$2,923,904 at December 31, 2003.

During 2003, the Company's 2000, 2001 and 2002 income tax returns were examined by the IRS. As a result of the examination, taxable income will be recognized in 2003 in the amount of \$932,400 from unremitted earnings of a foreign subsidiary. The effect of this change on the balance sheet is to reclassify deferred income taxes - long term liability in the amount of \$317,000 to income taxes currently payable.

For the year ended December 31, 2003, the Company had a federal tax loss of approximately \$664,000. This loss will be carried back to recover federal income taxes of \$225,626 paid in 2002. For state income tax purposes, this loss will be carried forward to offset taxable income of future years. A valuation allowance for the cumulative state loss carryforward of \$1,930,000, resulting in a deferred tax asset of \$106,000, is not considered necessary, as it is anticipated that future income will absorb the losses. The state loss carryforward expires from 2021 to 2024.

NOTE 8 - CAPITAL STOCK

Common Stock - The Company has four classes of authorized common stock: Class A, B, C and D. Under the Company's Amended and Restated Certificate of Incorporation, the relative rights and preferences of each class of stock are as follows:

Voting Rights - The holders of Class A, B and C common stock will vote together as a single combined class on all matters submitted to a vote of the shareholders, with each holder of Class A, B and C common stock being entitled to one vote per share of such stock held. The holders of Class D common shares have no right to vote on any matters submitted to a vote of the shareholders.

Liquidation Preferences - Upon dissolution, liquidation, or winding up of the Corporation, holders of Class B common stock are entitled to a minimum liquidation value of \$100 per share. Holders of Class C and D common stock are then entitled to the remaining assets available for distribution after the distribution to holders of Class B based upon the number of shares of C and D shares over the total number of common shares outstanding. Remaining distributions shall be to all holders of Class A and B shares on the basis of the number of such shares outstanding.

Redeemable Stock - If any employee ceases to be employed, then such employee's Class A stock that was purchased through the exercise of options will be subject to repurchase by the Company. The Company has the right of first refusal to purchase any or all of such Class A common stock held, if such employee's termination was with or without cause or if termination is the result of death, disability, or achieving the age of 65. If the employee voluntarily terminates or is terminated for cause, the repurchase price for Class A common stock will be the lesser of the price the employee paid for the repurchased shares plus seven percent annual simple interest, or the value of such repurchased shares on the date 30 days prior to the date of termination. If the employee is terminated without cause or if the termination is a result of death, disability, or achieving the age of 65, the repurchase price of Class A common stock will be the value as defined in the Stock Options and Repurchase Agreement of such repurchased shares on the date 30 days prior to the date of termination.

Convertible Stock - Class D common stock is convertible into shares of Class C common stock. Such conversion will be effected by the surrender of the Class D common stock in exchange for the Class C common stock upon consummation of an initial public, Rule 144, or Regulation A offering or upon the sale of Class C common stock to those shares convertible to Class C shares equaling 2% or more of the outstanding common stock having voting rights.

Additional stock information is as follows:

	2003
Class A common stock:	
Par value per share	.10
Shares authorized	60,000
Shares outstanding, net of treasury stock	27,068
Class B common stock:	
Par value per share	.10
Shares authorized	50,000
Shares outstanding, net of treasury stock	41,750
Class C common stock:	
Par value per share	.10
Shares authorized	40,000
Shares outstanding, net of treasury stock	-
Class D common stock:	
Par value per share	.10
Shares authorized	40,000
Shares outstanding, net of treasury stock	-

NOTE 9 - STOCK OPTION PLANS

During 2001, 1999, 1998 and 1997, the Company's stockholders approved the granting of incentive stock options for shares of Class A common stock to key executives and management. Under the Stock Option and Repurchase Agreements, all options were granted at a price of \$160.08, which is considered by management to be equal to market value on the date of grant. All options are exercisable immediately.

A summary of option transactions during the years ended December 31, 2003 is shown below:

	Number of Shares	Weighted Average Option Price
Options (granted and unexercised) at January 1, 2003	4,117	\$ 160.08
Granted	-	-
Exercised	-	-
Forfeited	-	-
Options (granted and unexercised) at December 31, 2003	4,117	\$ 160.08

The fair value of the options is determined by the management of the Company. The Company applies APB Opinion 25 and related interpretations in accounting for its plans. Accordingly, no compensation cost has been recognized for its stock option plans. Had compensation cost been determined based on the fair value at the grant date consistent with the method of FASB No. 123, "Accounting for Stock-Based Compensation," the net loss of the Company would not have been affected in 2003.

NOTE 10 - EMPLOYEE BENEFIT PLAN

The subsidiary has a 401(k) Profit Sharing and Savings Plan (the Plan) covering nearly all employees of the domestic company. Under the provisions of the Plan, participants have the right to make employee contributions in whole percentages of not less than two percent or more than fifteen percent of their gross annual earnings, subject to limitations prescribed by law. Employees are eligible to participate in the Plan if they are age eighteen or older and have completed six months of service. Participants are immediately vested in their contributions and earnings thereon.

The Company may elect to match the employees' contributions, but not in excess of two percent of the participant's gross annual earnings. The Company contributions to this plan was \$14,151 for the year 2003.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

Litigation - In the ordinary course of business, the Company and its Subsidiary are involved in litigation primarily as a result of injuries sustained during shrimp boat operations. The Company is self-insured for these claims. Management believes that the reserves are adequate to cover unpaid losses that have been incurred as of December 31, 2003.

Insurance Coverage - The Company provides insurance for workers' compensation claims and boat reserve claims. The Company is fully insured for group health care claims. In the opinion of management, the reserve for workers' compensation claims of approximately \$180,000 and the boat reserve of \$9,000 included in accrued expenses represent adequate provision for covering unpaid losses which have been incurred as of the year ended December 31, 2003. The Company had a protection and indemnity insurance policy to cover the employees working on the shrimp boats. This policy expired on December 15, 2001, and the Company has decided not to renew it as all of the boats are now St. Vincent registry, which the Company feels will virtually eliminate the risk of future claims in the United States.

Letters of Credit - The Company was contingently liable as of December 31, 2003 for \$175,000 related to letters of credit which guarantee workers' compensation claims.

Rights and Concessions - SSN has entered into contracts for the construction of shrimp farming operations located in Nicaragua.

One contract entered into during 1997 and 1998, is for a 1,787.5 acre land lease for twenty years with the government of Nicaragua. Payments of \$52,606 have been made with additional payments of 1% of the gross sales due annually to the government once production begins. No additional amounts have been paid in connection with the requirements of the lease, nor has any been accrued, as construction has not begun as of December 31, 2003. Under the terms of the lease, construction was required to begin by October 1, 1998. The Company is undecided as to when, or if, they will begin construction.

In November 2000, SSN was granted the right to construct a shrimp farm in exchange for a fee of \$50,000 paid to a Nicaraguan government agency.

The payments made under these agreements are included with other assets and at December 31, 2003, amounted to \$74,112 net of amortization. Payments relating to these rights and concessions are being amortized over 20 years using the straight-line method.

NOTE 12 - RECONCILIATION OF SSN FINANCIAL STATEMENTS

The financial statements of SSN were audited by other auditors in accordance with accounting principles generally accepted in the United States of America. Included in the financial statements of SSN is the recognition and recording of depreciation of buildings on the basis of an estimated useful life of ten years. Management of the Company is of the opinion that the proper estimated useful life for the buildings of SSN is twenty-five years. Following is a reconciliation of the significant differences in amounts reported in the financial statements of SSN of the other auditors to the amounts reported in the accompanying consolidated financial statements as a result of recording the depreciation of the buildings of SSN based on an estimated life of twenty-five years.

	Amount Reported By Other Auditors	Adjustment Due to Change to Twenty-Five Year Life for SSN Buildings	Amount Reported in the Accompanying Consolidated Financial Statements
Accumulated depreciation	\$ 5,135,910	\$ 1,294,314	\$ 3,841,596

EXHIBIT INDEX

Exhibit Number	Exhibit Title	
23.1	Consent of Independent Public Accounting Firm	**
23.2	Consent of Independent Public Accounting Firm	**
31.1	CEO Certification pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	**
31.2	CFO Certification pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	**
32.1	CEO Certification required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	**#
32.2	CFO Certification required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	**#

** Indicates filed herewith.

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