

APPLICA INC
Form 10-Q
May 07, 2004

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

FORM 10-Q

**þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2004**

OR

**o 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 1-10177

APPLICA INCORPORATED

(Exact Name of Registrant as Specified in its Charter)

Florida

59-1028301

(State or Other Jurisdiction of Incorporation or
Organization)

(I.R.S. Employer Identification Number)

**5980 Miami Lakes Drive, Miami Lakes,
Florida**

33014

(Address Of Principal Executive Offices)

(Zip Code)

(305) 362-2611

(Registrant's Telephone Number, Including Area Code)

Former Name, If Changed Since Last Report:

Not Applicable

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 requirement for the past 90 days. Yes No

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

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

| <u>Class</u> | <u>Number of shares outstanding on May 3, 2004</u> |
|-----------------------------------|--|
| Common Stock, \$0.10 par value | 24,032,329 |
| <hr/> | |
| <hr/> | |
| <hr/> | |

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****Applica Incorporated and Subsidiaries****CONSOLIDATED BALANCE SHEETS****Assets**

| | March 31, | December |
|--|-----------------------|------------------|
| | 2004 | 31, |
| | (Unaudited) | 2003 |
| | <hr/> | <hr/> |
| | (In thousands) | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 6,099 | \$ 12,735 |
| Accounts and other receivables, less allowances of \$12,303 in 2004 and \$12,543 in 2003 | 97,173 | 131,021 |
| Notes receivable - officers | 1,637 | 1,615 |
| Inventories | 108,637 | 106,326 |
| Prepaid expenses and other | 12,648 | 13,593 |
| Refundable income taxes | 2,790 | 4,823 |
| Future income tax benefits | 11,616 | 11,616 |
| | <hr/> | <hr/> |
| Total current assets | 240,600 | 281,729 |
| Investment in Joint Venture | 4,201 | 5,389 |
| Property, Plant and Equipment - at cost, less accumulated depreciation of \$106,435 in 2004 and \$103,894 in 2003 | 71,183 | 70,389 |
| Future Income Tax Benefits, Non-Current | 52,721 | 49,695 |
| Goodwill | 62,812 | 62,812 |
| Other Intangibles, Net | 5,724 | 6,146 |
| Other Assets | 2,419 | 2,676 |
| | <hr/> | <hr/> |
| Total Assets | \$439,660 | \$478,836 |
| | <hr/> | <hr/> |
| Liabilities and Shareholders' Equity | | |
| Current Liabilities: | | |
| Accounts payable | \$ 45,456 | \$ 39,273 |
| Accrued expenses | 53,681 | 61,362 |
| Current maturities of long-term debt | 158 | 151 |

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| | | |
|---|-------------------|-------------------|
| Current taxes payable | 1,884 | 2,172 |
| Deferred rent | 284 | 301 |
| | <u> </u> | <u> </u> |
| Total current liabilities | 101,463 | 103,259 |
| Other Long-Term Liabilities | 1,350 | 1,327 |
| Long-Term Debt, Less Current Maturities | 103,008 | 136,637 |
| Shareholders Equity: | | |
| Common stock authorized:75,000 shares of \$.10 par value; issued and outstanding: 23,873 shares in 2004 and 23,687 shares in 2003 | 2,387 | 2,369 |
| Paid-in capital | 157,385 | 156,604 |
| Retained earnings | 81,995 | 86,474 |
| Note receivable officer | (1,496) | (1,496) |
| Accumulated other comprehensive earnings (loss) | (6,432) | (6,338) |
| | <u> </u> | <u> </u> |
| Total shareholders equity | 233,839 | 237,613 |
| | <u> </u> | <u> </u> |
| Total Liabilities and Shareholders Equity | \$439,660 | \$478,836 |
| | <u> </u> | <u> </u> |

The accompanying notes are an integral part of these financial statements.

Table of Contents**Applica Incorporated and Subsidiaries****CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)****Three Months Ended March 31,**

| | 2004 | | 2003 | |
|--|--|---------------|------------------|--------------|
| | (In thousands, except per share data) | | | |
| Net sales | \$ 132,493 | 100.0% | \$ 121,239 | 100.0% |
| Cost of goods sold | <u>95,022</u> | <u>71.7</u> | <u>84,217</u> | <u>69.5</u> |
| Gross profit | 37,471 | 28.3 | 37,022 | 30.5 |
| Selling, general and administrative expenses: | | | | |
| Operating expenses | 43,544 | 32.9 | 38,337 | 31.6 |
| Repositioning and other charges | <u>(563)</u> | <u>(0.4)</u> | | |
| Operating earnings (loss) | (5,510) | (4.2) | (1,315) | (1.1) |
| Other expense (income): | | | | |
| Interest expense | 2,115 | 1.6 | 3,887 | 3.2 |
| Interest and other income | (347) | (0.3) | (404) | (0.3) |
| Loss on early extinguishment of debt | <u>187</u> | <u>0.1</u> | | |
| | <u>1,955</u> | <u>1.4</u> | <u>3,483</u> | <u>2.9</u> |
| Earnings (loss) before equity in net earnings (loss) of joint venture and income taxes | (7,465) | (5.6) | (4,798) | (4.0) |
| Equity in net earnings (loss) of joint venture | | | <u>37,500</u> | <u>30.9</u> |
| Earnings (loss) before income taxes | (7,465) | (5.6) | 32,702 | 26.9 |
| Income tax expense (benefit) | <u>(2,986)</u> | <u>(2.2)</u> | <u>13,081</u> | <u>10.7</u> |
| Net earnings (loss) | <u>\$ (4,479)</u> | <u>(3.4)%</u> | <u>\$ 19,621</u> | <u>16.2%</u> |

Earnings (loss) per common share:

Earnings (loss) per common share
basic

\$ (0.19)

\$ 0.84

Earnings (loss) per common share
diluted.

\$ (0.19)

\$ 0.83

The accompanying notes are an integral part of these financial statements.

Table of Contents**Applica Incorporated and Subsidiaries****CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

| | Three Months Ended March 31, | |
|---|---|---------------|
| | 2004 | 2003 |
| | (In thousands) | |
| Cash flows from operating activities: | | |
| Net earnings (loss) | \$ (4,479) | \$ 19,621 |
| Reconciliation to net cash provided by (used in) operating activities: | | |
| Depreciation of property, plant and equipment | 3,531 | 4,689 |
| Provision for doubtful accounts | 391 | 898 |
| Amortization of intangible and other assets | 564 | 2,426 |
| Loss on early extinguishment of debt | 187 | |
| Deferred taxes | (3,026) | 16,354 |
| Repositioning charges | (563) | |
| Equity in net (earnings) loss of joint venture | | (37,500) |
| Changes in assets and liabilities: | | |
| Accounts and other receivables | 33,457 | 42,646 |
| Inventories | (2,671) | (6,538) |
| Prepaid expenses and other | 945 | 1,310 |
| Other assets | (26) | 240 |
| Accounts payable and accrued expenses | (672) | (19,438) |
| Current income taxes | 1,745 | (3,189) |
| Other liabilities | 6 | 108 |
| Net cash provided by (used in) operating activities | <u>29,389</u> | <u>21,627</u> |
| Cash flows from investing activities: | | |
| Additions to property, plant and equipment | (4,325) | (6,297) |
| Distributions from (investments in) joint ventures net | 1,188 | |
| Receivables from officers | (17) | 77 |
| | <u></u> | <u></u> |
| Net cash (used in) provided by investing activities | (3,154) | (6,220) |
| Cash flows from financing activities: | | |
| Net (payments) borrowings under lines of credit | (29,372) | (17,629) |
| Redemption of long-term debt | (4,390) | |
| Exercise of stock options and issuance of common stock under employee stock purchase plan | 799 | 12 |
| Interest receivable from officer | (5) | (10) |
| | <u></u> | <u></u> |
| Net cash (used in) provided by financing activities | (32,968) | (17,627) |

| | | |
|--|-------------------|-------------------|
| Effect of exchange rate changes on cash | 97 | 683 |
| Decrease in cash and cash equivalents | (6,636) | (1,537) |
| Cash and cash equivalents at beginning of period | 12,735 | 7,683 |
| | <u> </u> | <u> </u> |
| Cash and cash equivalents at end of period | <u>\$ 6,099</u> | <u>\$ 6,146</u> |
| Supplemental Disclosures of Cash Flow Information: | | |
| Cash paid during the three-month period ended March 31: | | |
| Interest | \$ 3,645 | \$ 6,797 |
| Income taxes | | |

The accompanying notes are an integral part of these financial statements.

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Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements

1. SUMMARY OF ACCOUNTING POLICIES**Interim Reporting**

The accompanying unaudited consolidated financial statements include the accounts of Applica Incorporated and its subsidiaries (Applica). All significant intercompany transactions and balances have been eliminated. The unaudited consolidated financial statements have been prepared in conformity with Rule 10-01 of Regulation S-X of the Securities and Exchange Commission and therefore do not include information or footnotes necessary for a complete presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. However, all adjustments (consisting of normal recurring accruals), which, in the opinion of management, are necessary for a fair presentation of the financial statements, have been included. Operating results for the period ended March 31, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004 due to seasonal fluctuations in Applica s business, changes in economic conditions and other factors. For further information, please refer to the Consolidated Financial Statements and Notes thereto contained in Applica s Annual Report on Form 10-K for the year ended December 31, 2003.

Reclassifications

Certain prior period amounts have been reclassified for comparability.

Inventories

Inventories are stated at the lower of cost or market; cost is determined by the first-in, first-out method. Inventories are comprised of the following:

| | March 31, 2004 | December 31, 2003 |
|-----------------|---------------------------|------------------------------|
| | (In thousands) | |
| Raw materials | \$ 3,315 | \$ 1,894 |
| Work in process | 4,970 | 3,029 |
| Finished goods. | 100,352 | 101,403 |
| | \$108,637 | \$106,326 |

Stock Based Compensation

At March 31, 2004, the Company had four active stock based compensation plans. The Company accounts for stock-based compensation using the intrinsic value method. Accordingly, compensation cost for stock options issued is measured as the excess, if any, of the fair value of the Company s common stock at the date of grant over the exercise price of the options. The Company s net earnings (loss) and earnings (loss) per share would have been changed to the pro forma amounts indicated below had compensation cost for the stock option plans and non-qualified

options issued to employees been determined based on the fair value of the options at the grant dates consistent with the method of SFAS 123.

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Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements Continued

| | March 31, 2004 | March 31, 2003 |
|---------------------------------------|---------------------------|---------------------------|
| (In thousands, except per share data) | | |
| Net earnings (loss): | | |
| As reported | \$ (4,479) | \$ 19,621 |
| Pro forma | \$ (4,581) | \$ 19,471 |
| Basic earnings (loss) per share: | | |
| As reported | \$ (0.19) | \$ 0.84 |
| Pro forma | \$ (0.19) | \$ 0.83 |
| Diluted earnings (loss) per share: | | |
| As reported | \$ (0.19) | \$ 0.83 |
| Pro forma | \$ (0.19) | \$ 0.82 |

There was no stock-based employee compensation expense included in net earnings (loss) in the quarters ending March 31, 2004 and 2003.

The above pro forma disclosures may not be representative of the effects on reported net earnings (loss) for future periods as options vest over several years and Applica may continue to grant options to employees.

In accordance with the requirements of SFAS 123, the fair value of each option grant was estimated on the date of grant using a binomial option-pricing model with the following weighted-average assumptions used for grants in 2004 and 2003, respectively: no dividend yield; expected volatility ranging from 64.1% to 82.7%; risk-free interest rates of 3.0%; and expected holding periods of four years.

Comprehensive Income

The components of other comprehensive income, net of tax, were as follows:

| | March 31, 2004 | March 31, 2003 |
|---|---------------------------|---------------------------|
| (In thousands) | | |
| Earnings (loss) | \$(4,479) | \$19,621 |
| Foreign currency translation adjustment | (200) | (397) |
| Change in market value of derivatives | 106 | 111 |
| | \$(4,573) | \$19,335 |

The components of accumulated other comprehensive income, net of tax, were as follows:

| | March 31, 2004 | March 31, 2003 |
|---|---------------------------|---------------------------|
| | (In thousands) | |
| Accumulated translation adjustment foreign currency | \$(5,725) | \$(7,192) |
| Accumulated net unrealized holding gain on derivatives | (707) | (1,466) |
| | <u>\$(6,432)</u> | <u>\$(8,658)</u> |

Table of Contents**Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements Continued****Recent Accounting Pronouncements**

In January 2003, the FASB issued Interpretation No. (FIN) 46, Consolidation of Variable Interest Entities, which establishes criteria to identify variable interest entities (VIE) and the primary beneficiary of such entities. An entity that qualifies as a VIE must be consolidated by its primary beneficiary. All other holders of interests in a VIE must disclose the nature, purpose, size and activity of the VIE as well as their maximum exposure to losses as a result of involvement with the VIE. FIN 46 was revised in December 2003 and is effective for financial statements of public entities that have special-purpose entities, as defined, for periods ending after December 15, 2003. For public entities without special-purpose entities, it is effective for financial statements for periods ending after March 15, 2004. Applica does not have any special-purpose entities, as defined. The adoption of FIN 46 did not have a material effect on Applica's financial statements.

On March 31, 2004, the Financial Accounting Standards Board (FASB) issued a proposed statement, *Share-Based Payment*, that addresses the accounting for share-based payment transactions (for example, stock options and awards of restricted stock) in which an employer receives employee-services in exchange for equity securities of the company or liabilities that are based on the fair value of the company's equity securities. This proposal, if finalized as proposed, would eliminate use of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and generally would require such transactions be accounted for using a fair-value-based method and recording compensation expense rather than optional pro forma disclosure of what expense amounts might be. The proposal, if approved, would substantially amend FASB Statement No. 123, *Accounting for Stock-Based Compensation*. Because of the timing of the proposal and the uncertainty of whether it will be adopted substantially as proposed, management has not completed its review of the proposal or assessed its potential impact on Applica.

A variety of proposed or otherwise potential accounting standards are currently under study by standard-setting organizations and various regulatory agencies. Because of the tentative and preliminary nature of these proposed standards, management has not determined whether implementation of such proposed standards would be material to Applica's consolidated financial statements.

Loss on Early Extinguishments of Debt

In February 2004, Applica redeemed \$4.25 million of its 10% Senior Subordinated Notes due 2008. The notes were redeemed at prices between 103.25% and 103.33% of the principal amount, plus accrued interest. The cost of the redemption of the notes includes \$187,000 in prepayment premiums and the write-off of deferred financing costs related to the redemption.

Vendor Consideration

Applica's supplier of vacuum packaging products has agreed to reimburse Applica \$4.0 million for a portion of the costs of litigating the Tilia matter. The reimbursement is evidenced by a note receivable bearing interest at a rate of 6% and is payable in equal quarterly installments of \$200,000, plus interest, over five years. As the reimbursement is coming from a vendor and the payment thereof is indirectly associated with future purchases from the vendor, the amount to be received has been offset by a related deferred credit to be recognized over the five-year period as a reduction of future product costs.

2. SHAREHOLDERS EQUITY

Earnings Per Share

Basic shares for the three-month periods ended March 31, 2004 and 2003 were 23,718,256 and 23,500,555, respectively. Included in diluted shares for the three-month period ended March 31, 2003 are common stock equivalents relating to options of 165,312. All common stock equivalents have been excluded from the diluted per share calculations in the three-month period ended March 31, 2004 because their inclusion would have been anti-dilutive. Potential common stock equivalents for the three-month period ended March 31, 2003 were options to purchase 2,423,435 shares of common stock, with exercise prices ranging from \$4.90 to \$31.69.

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Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements Continued

3. COMMITMENTS AND CONTINGENCIES

Tilia Matters. In April 2004, Applica and its U.S. operating subsidiary, Applica Consumer Products, Inc., entered into a license and settlement agreement with Tilia, Inc. and Tilia International, Inc. to resolve patent infringement litigation. As part of the license and settlement agreement, Applica agreed to pay Tilia royalties for using its vacuum sealing technology.

Other Matters. Applica is subject to other legal proceedings, product liability claims and other claims that arise in the ordinary course of our business. In the opinion of management, the amount of ultimate liability with respect to such matters, if any, in excess of applicable insurance coverage, is not likely to have a material effect on our business, financial condition, results of operations or liquidity. However, as the outcome of litigation or other claims is difficult to predict, significant changes in the estimated exposures could occur.

4. REPOSITIONING, RECALL AND OTHER CHARGES

For the three months ended March 31, 2004, the activity in the accrued repositioning and other charges was as follows:

Accrued liabilities relating to the 2001 repositioning, recall and other charges were as follows:

| | Amount Accrued at | 2003 (Write-offs) | 2004 Payments | Amount Accrued at March 31, 2004 |
|---------------------------|----------------------------------|------------------------------|--------------------------|---|
| | Dec. 31, 2003 | | | |
| | | (In thousands) | | |
| Back-office consolidation | \$ 5,553 | \$(563) | \$ 724 | \$ 4,266 |

* Represents a reduction of the amount accrued.

In the fourth quarter of 2003, management determined that an accrual related to the product recall was no longer required and \$4.1 million of such accrual was reversed and was included as a reduction of cost of sales.

For the three months ended March 31, 2003, the activity in the accrued repositioning and other charges was as follows:

| | Amount Accrued at | 2003 | 2004 | Amount Accrued at March 31, |
|--|------------------------------|-------------|-------------|--|
| | Dec. 31, | | | |

| | <u>2002 (Write-offs)</u> | <u>Payments</u> | <u>2003</u> |
|---------------------------|--------------------------|-------------------|-------------------|
| | (In thousands) | | |
| Product recall | \$ 4,763 | \$ 159 | \$ 4,604 |
| Back-office consolidation | 5,956 | 756 | 5,200 |
| Shareholder litigation | 450 | 450 | |
| | <u> </u> | <u>-</u> | <u> </u> |
| | \$ 11,169 | \$ 1,365 | \$ 9,804 |
| | <u> </u> | <u> </u> | <u> </u> |

The amounts accrued in connection with the repositioning and other charges are reflected in accrued expenses in the accompanying balance sheets.

5. INVESTMENT IN JOINT VENTURE

Anasazi Partners, L.P. is a partnership owned 50% by Applica that invested in public and privately owned securities. In the fourth quarter of 2002, Anasazi Partners engaged an investment banker to pursue exit strategies for Anasazi's equity investment in ZonePerfect Nutrition Company. As part of this process, a valuation of the investment was performed. Based on this valuation, in the first quarter of 2003, Anasazi increased the fair value of

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Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements Continued

the investment by approximately \$75.0 million, resulting in equity in net earnings of unconsolidated joint venture of \$37.5 million in the first quarter 2003 statement of operations.

In July 2003, ZonePerfect was sold for approximately \$160.0 million in cash, \$20.0 million of which is being held in escrow as of March 31, 2004. Payment of \$10.0 million of the amount held in escrow is contingent on the performance of a negotiated matter and no portion thereof has been reflected in the net earnings of Anasazi. The funds held in escrow are to be released to the sellers, including Anasazi, at 18 and 24 months from date of closing, subject to any adjustments to the escrowed funds for breaches of representations and warranties. Management of Anasazi believes that Anasazi is entitled to receive additional amounts with respect to the contingent negotiated matter. Upon agreement with the purchaser of ZonePerfect, or release of the related funds from escrow, Applica expects to record additional earnings of approximately \$3.7 million.

In July 2003, the general partner of Anasazi Partners L.P. began the process of dissolving the partnership by distributing the remaining individual investments to the partners. In the first quarter of 2004, Applica received total cash distributions of \$1.2 million in connection with the planned liquidation of Anasazi. At March 31, 2004, Applica's interest in Anasazi represents its share of the escrow funds.

6. INTANGIBLE ASSETS

The components of Applica's intangible assets subject to amortization are as follows:

| | Average Life (Years) | March 31, 2004 | | December 31, 2003 | |
|----------------|--------------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| | | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Licenses | 4.3 | \$3,000 | \$ (508) | \$3,000 | \$ (333) |
| Contract-Based | 6.0 | 5,988 | (2,756) | 5,988 | (2,509) |
| | | <u>\$8,988</u> | <u>\$(3,264)</u> | <u>\$8,988</u> | <u>\$(2,842)</u> |

(In thousands)

Amortization expense for intangible assets during the three months ended March 31, 2004 and 2003 was \$0.4 million and \$2.2 million, respectively.

The following table provides information regarding estimated amortization expense for each of the following years ended December 31:

(In thousands)

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| | |
|------------|---------|
| 2004 | \$1,555 |
| 2005 | 1,454 |
| 2006 | 1,452 |
| 2007 | 569 |
| 2008 | 261 |
| Thereafter | 855 |

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Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements Continued

7. LEASES

On March 30, 2004, Applica entered into an operating lease for new corporate office space in South Florida totaling 110,000 square feet. The term of the lease commences on May 1, 2004 and is for 125 months. Rent is abated for the first five months of the lease term. Applica is also responsible for its pro rata share of the operating expenses, which are currently estimated at \$19,250 per month.

Future minimum payments under this lease are as follows:

| | (In thousands) |
|------------|---|
| 2004 | \$ 289 |
| 2005 | 1,161 |
| 2006 | 1,184 |
| 2007 | 1,208 |
| 2008 | 1,232 |
| Thereafter | 7,690 |
| | <hr style="width: 100%; border: 0.5px solid black;"/> |
| | \$12,764 |
| | <hr style="width: 100%; border: 0.5px solid black;"/> |

8. CONDENSED CONSOLIDATING FINANCIAL INFORMATION

Applica's domestic subsidiaries are guarantors of Applica's 10% Senior Subordinated Notes due 2008. The following condensed consolidating financial information presents the results of operations, financial position and cash flows of Applica Incorporated (on a stand alone basis), the guarantor subsidiaries (on a combined basis), the non-guarantor subsidiaries (on a combined basis) and the eliminations necessary to arrive at the consolidated results of Applica. The results of operations and cash flows presented below assume that the guarantor subsidiaries were in place for all periods presented. Applica and guarantor subsidiaries have accounted for investments in their respective subsidiaries on an unconsolidated basis using the equity method of accounting. The guarantor subsidiaries are wholly owned subsidiaries of Applica and have fully and unconditionally guaranteed the notes on a joint and several basis. The notes contain certain covenants which, among other things, restrict the ability of the guarantor subsidiaries to make distributions to Applica Incorporated. Applica has not presented separate financial statements and other disclosures concerning the guarantor subsidiaries and non-guarantor subsidiaries because it has determined they would not be material to investors.

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Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements Continued

Three months Ended March 31, 2004

| | Parent | Guarantors | Non- Guarantors | Eliminations | Consolidated |
|--|-----------------------|-------------------|----------------------------|---------------------|---------------------|
| | (In thousands) | | | | |
| Statement of Operations: | | | | | |
| Net sales | \$ | \$103,806 | \$ 76,114 | \$ (47,427) | \$132,493 |
| Cost of sales | | 72,501 | 69,948 | (47,427) | 95,022 |
| Gross profit | | 31,305 | 6,166 | | 37,471 |
| Operating (income) expenses | | 37,793 | 5,751 | | 43,544 |
| Repositioning and other charges | | (563) | | | (563) |
| Operating earnings (loss) | | (5,925) | 415 | | (5,510) |
| Other (income) expense, net | 5 | 2,073 | (310) | | 1,768 |
| Loss on early extinguishment of debt | | 187 | | | 187 |
| Earnings (loss) before equity in net earnings (loss) of joint venture and subsidiaries, and income taxes | (5) | (8,185) | 725 | | (7,465) |
| Equity in net earnings (loss) of joint venture | | | | | |
| Equity in net earnings (loss) of subsidiaries | (4,474) | | | 4,474 | |
| Income tax expense (benefit) | | (3,305) | 319 | | (2,986) |
| Net earnings (loss) | \$ (4,479) | \$ (4,880) | \$ 406 | \$ 4,474 | \$ (4,479) |
| Balance Sheet: | | | | | |
| Cash and cash equivalents | \$ | \$ 477 | \$ 5,622 | \$ | \$ 6,099 |
| Accounts and other receivables, net | | 67,462 | 29,711 | | 97,173 |
| Receivables from affiliates | (329,276) | 81,077 | 78,567 | 171,269 | 1,637 |
| Inventories | | 71,241 | 37,396 | | 108,637 |
| Future income tax benefits | | 13,723 | (2,107) | | 11,616 |
| Other current assets | | 5,123 | 10,315 | | 15,438 |
| Total current assets | (329,276) | 239,103 | 159,504 | 171,269 | 240,600 |

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| | | | | | |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|
| Investment in joint venture | 4,201 | | | | 4,201 |
| Investment in subsidiaries | 660,545 | 113,503 | 70,430 | (844,478) | |
| Property, plant and equipment, net | | 21,872 | 49,311 | | 71,183 |
| Long-term future income tax benefits | | 49,651 | 3,070 | | 52,721 |
| Other assets | 2,089 | 99,513 | 11,382 | (42,029) | 70,955 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total assets | \$ 337,559 | \$523,642 | \$293,697 | \$(715,238) | \$439,660 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Accounts payable and accrued expenses | \$ | \$ 40,733 | \$ 58,404 | \$ | \$ 99,137 |
| Current maturities of long-term debt | 158 | | | | 158 |
| Deferred rent | | 284 | | | 284 |
| Current taxes payable | | 470 | 1,414 | | 1,884 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total current liabilities | 158 | 41,487 | 59,818 | | 101,463 |
| Long-term debt | 103,008 | 41,550 | 13,143 | (54,693) | 103,008 |
| Future income tax liabilities | | 65 | (65) | | |
| Other long-term liabilities | 554 | 796 | | | 1,350 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total liabilities | 103,720 | 83,898 | 72,896 | (54,693) | 205,821 |
| Shareholders' equity | 233,839 | 439,744 | 220,801 | (660,545) | 233,839 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total liabilities and shareholders' equity | \$ 337,559 | \$523,642 | \$293,697 | \$(715,238) | \$439,660 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Cash Flow Information: | | | | | |
| Net cash provided by (used in) operating activities | \$ (21,307) | \$ 8,532 | \$ 20,812 | \$ 21,352 | \$ 29,389 |
| Net cash provided by (used in) investing activities | (2,268) | (11,491) | (13,104) | 23,709 | (3,154) |
| Net cash provided by (used in) financing activities | 23,478 | 2,312 | (13,697) | (45,061) | (32,968) |
| Effect of exchange rate changes on cash | 97 | | | | 97 |
| Cash at beginning | | 1,124 | 11,611 | | 12,735 |
| Cash at end | \$ | \$ 477 | \$ 5,622 | \$ | \$ 6,099 |

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Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements Continued

Three months Ended March 31, 2003

| | Parent | Guarantors | Non- Guarantors | Eliminations | Consolidated |
|--|----------------|-------------|--------------------|--------------|--------------|
| | (In thousands) | | | | |
| Statement of Operations: | | | | | |
| Net sales | \$ | \$ 94,002 | \$ 76,775 | \$ (49,538) | \$ 121,239 |
| Cost of sales | | 64,728 | 69,027 | (49,538) | 84,217 |
| | | | | | |
| Gross profit | | 29,274 | 7,748 | | 37,022 |
| Operating (income) expenses | 10 | 31,693 | 6,634 | | 38,337 |
| | | | | | |
| Operating earnings (loss) | (10) | (2,419) | 1,114 | | (1,315) |
| Other (income) expense, net | (26) | 3,840 | (331) | | 3,483 |
| Gain on litigation settlement | | | | | |
| | | | | | |
| Earnings (loss) before equity in net earnings (loss) of joint venture and subsidiaries, and income taxes | 16 | (6,259) | 1,445 | | (4,798) |
| Equity in net earnings (loss) of joint venture | 37,500 | | | | 37,500 |
| Equity in net earnings (loss) of subsidiaries | (17,895) | | | 17,895 | |
| Income tax expense (benefit) | | 19,441 | (6,360) | | 13,081 |
| | | | | | |
| Net earnings (loss) | \$ 19,621 | \$ (25,700) | \$ 7,805 | \$ 17,895 | \$ 19,621 |
| | | | | | |
| Balance Sheet: | | | | | |
| Cash and cash equivalents | \$ | \$ 578 | \$ 5,568 | \$ | \$ 6,146 |
| Accounts and other receivables, net | | 74,039 | 28,984 | | 103,023 |
| Receivables from affiliates | (324,645) | 104,485 | 48,771 | 173,382 | 1,993 |
| Inventories | | 80,653 | 36,655 | | 117,308 |
| Future income tax benefits | | 14,906 | (252) | | 14,654 |
| Other current assets | | 2,941 | 14,765 | | 17,706 |
| | | | | | |
| Total current assets | (324,645) | 277,602 | 134,491 | 173,382 | 260,830 |
| Investments in joint venture | 38,749 | | | | 38,749 |

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| | | | | | |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|
| Investment in subsidiaries | 699,921 | 113,482 | 70,430 | (883,833) | |
| Property, plant and equipment, net | | 17,349 | 61,222 | | 78,571 |
| Long-term future income tax benefits | | 36,983 | 5,041 | | 42,024 |
| Other assets | 2,499 | 114,305 | 20,341 | (50,964) | 86,181 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total assets | \$ 416,524 | \$559,721 | \$291,525 | \$(761,415) | \$506,355 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Accounts payable and accrued expenses | \$ | \$ 36,689 | \$ 50,005 | \$ | \$ 86,694 |
| Current maturities of long-term debt | 144 | | | | 144 |
| Deferred rent | | 354 | | | 354 |
| Current taxes payable | | 629 | 2,191 | | 2,820 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total current liabilities | 144 | 37,672 | 52,196 | | 90,012 |
| Long-term debt | 176,209 | 44,351 | 17,143 | (61,494) | 176,209 |
| Future income tax liabilities | | (909) | 909 | | |
| Other long-term liabilities | 1,686 | (37) | | | 1,649 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total liabilities | 178,039 | 81,077 | 70,248 | (61,494) | 267,870 |
| Shareholders' equity | 238,485 | 478,644 | 221,277 | (699,921) | 238,485 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total liabilities and shareholders' equity | \$ 416,524 | \$559,721 | \$291,525 | \$(761,415) | \$506,355 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Cash Flow Information: | | | | | |
| Net cash provided by (used in) operating activities | \$ 38,491 | \$(71,263) | \$ 26,972 | \$ 27,427 | \$ 21,627 |
| Net cash provided by (used in) investing activities | (30,478) | (7,201) | (16,612) | 48,071 | (6,220) |
| Net cash provided by (used in) financing activities | (8,696) | 75,433 | (8,866) | (75,498) | (17,627) |
| Effect of exchange rate changes on cash | 683 | | | | 683 |
| Cash at beginning | | 3,609 | 4,074 | | 7,683 |
| Cash at end | \$ | \$ 578 | \$ 5,568 | \$ | \$ 6,146 |

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

As used in this Quarterly Report on Form 10-Q, we, our, us, the Company and Applica refer to Applica Incorporated and its subsidiaries, unless the context otherwise requires.

The following discussion and analysis and the related financial data present a review of the consolidated operating results and financial condition of Applica for the three-month periods ended March 31, 2004 and 2003. This discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto contained in Applica's Annual Report on Form 10-K for the year ended December 31, 2003.

General

Applica is a marketer, distributor and manufacturer of a broad range of branded and private-label small electric consumer goods. Applica markets, distributes and manufactures kitchen products, home products, pest control products, pet care products and personal care products. Applica markets products under licensed brand names, such as Black & Decker®, its own brand names, such as Windmere®, LitterMaid® and Applica®, and other private-label brand names. Applica's customers include mass merchandisers, specialty retailers and appliance distributors primarily in North America, Latin America and the Caribbean.

We operate manufacturing facilities in China and Mexico. In 2003 and 2002, approximately 63% and 76%, respectively, of the products sold by Applica were manufactured in such facilities. In addition, we manufacture products for other consumer products companies, which we refer to as contract manufacturing. Management is currently focused on restructuring our manufacturing facilities to focus on more innovative, proprietary products. We are outsourcing more commodity-type products to strategic sourcing partners in China, which will significantly decrease the percentage of products manufactured at our own facilities.

Forward Looking Statement Disclosure

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Such statements are indicated by words or phrases such as anticipates, projects, management believes, Applica believes, intends, expects, and similar words or phrases. forward-looking statements are subject to certain risks, uncertainties or assumptions and may be affected by certain other factors, including the specific factors set forth below.

You should carefully consider the following risk factors, together with the other information contained in our annual report on Form 10-K for the year ended December 31, 2003, in evaluating us and our business before making an investment decision regarding our securities:

Increases in cost and unavailability of raw materials and components will reduce our profitability.

The failure of our growth strategy could have a material adverse effect on our business.

Our business could be adversely affected by complications resulting from our implementation of the new ERP system or other new computer technologies we install.

We depend on purchases from several large customers and any significant decline in these purchases or pressure from these customers to reduce prices could have a negative effect on our business.

If we are unable to renew the Black & Decker® trademark license agreement, our business could be adversely affected.

Our business is very sensitive to the strength of the U.S. retail market and weakness in this market could adversely affect our business.

Our business could be adversely affected by currency fluctuations in our international operations. Additionally, if the Chinese renminbi and Hong Kong dollar are allowed to float freely, it could result in significant fluctuations in our product costs.

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Our business involves the potential for product recalls and product liability claims against us.

The bankruptcy or financial difficulty of any major customer or fluctuations in the financial condition of the retail industry could adversely affect our business.

We operate a significant portion of our business outside of the United States which subjects us to additional risks.

Our business could be adversely affected by changes in trade relations with China.

Our business could be adversely affected by retailer inventory management.

Our future success requires us to develop new and innovative products on a consistent basis in order to increase revenues and we may not be able to do so or the start-up costs related to such products could be significant.

We rely heavily on our manufacturing facilities to manufacture and assemble our products. An extended interruption in the operation of any facility could have an adverse impact on our operating results.

We are subject to several production-related risks which could jeopardize our ability to realize anticipated sales and profits.

The infringement or loss of our proprietary rights could have an adverse effect on our business.

Our operating results can be affected by seasonality.

We compete with other large companies that produce similar products.

Our debt agreements contain covenants that restrict our ability to take certain actions.

Our business can be adversely affected by newly acquired businesses or product lines.

Government regulations could adversely impact our operations.

Should one or more of these risks, uncertainties or other factors materialize, or should underlying assumptions prove incorrect, actual results, performance, or achievements of Applica may vary materially from any future results, performance or achievements expressed or implied by the forward-looking statements. All subsequent written and oral forward-looking statements attributable to Applica or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements in this paragraph. You are cautioned not to place undue reliance on forward-looking statements. Applica undertakes no obligation to publicly revise any forward-looking statements to reflect events or circumstances that arise after the filing of this Quarterly Report on Form 10-Q.

Outlook

We intend to update this Outlook section in our Quarterly Reports on Form 10-Q and Annual Reports on Form 10-K subsequently filed with the SEC; however, Applica disclaims any intention or obligation to publicly announce the results of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

Management anticipates that sales for the year ended December 31, 2004 will be between \$740.0 million and \$765.0 million. The increased sales volume is expected to result from:

the introduction of the Home Café single-cup brewing system and the Tide™ Buzz™ ultrasonic stain removal system, both of which were co-developed with The Procter & Gamble Company;

the continued success of Lids Off Jar Openers and the Gizmo sub-brand of products; and

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increases in sales of other new Black & Decker® branded products.

Management expects gross margins for the full year to expand in 2004 as a result of:

cost reductions resulting from the movement of the production of certain products from Mexico to third party suppliers in China;

the retrenchment work undertaken in 2003 and the first quarter of 2004 in the U.S. and in our factories in Mexico and China;

a greater proportion of higher margin, new products to be launched in 2004; and

the implementation of raw materials cost reduction programs.

This improvement will be partly offset by expected higher costs of raw materials, such as copper, steel, aluminum and plastic, and inbound freight costs compared to 2003. Management anticipates that gross margins will be between 34% and 35% in 2004.

Management expects that selling, general and administrative operating expenses will increase in amount in 2004, but will remain flat as a percentage of sales at approximately 29%. Variable cost categories will increase because of higher sales volume. Additionally, royalties on Black and Decker® branded products will increase and management is planning to increase advertising and promotional spending. We experienced higher outbound freight costs in the first quarter, which we expect to continue during the remainder of 2004. These expenses will be partially offset by lower amortization expense related to the Black & Decker® tradename.

Management anticipates that interest expense will continue to decrease to approximately \$9.0 million for 2004.

Capital expenditures are planned to be approximately \$21.0 million, driven by new products and our information technology initiative. Management expects that capital expenditures for our manufacturing operations will decrease in 2004.

Earnings per diluted share for 2004 is expected to be between \$0.80 and \$0.90.

For the three months ended June 30, 2004, we believe that sales will be between \$155.0 million and \$165.0 million and earnings per diluted share will range between zero and a loss of \$0.05 per share. April 2004 sales increased 29% over sales in April 2003.

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Results of Operations

Three Months Ended March 31, 2004 Compared To Three Months Ended March 31, 2003

Net Sales. Sales for Applica increased by \$11.3 million to \$132.5 million, an increase of 9.3% over the first quarter of 2003. The increase was largely the result of growth in sales of Black & Decker® branded products, which benefited from better point-of-sale, as well as retailers that began the year with lower inventory levels. For the quarter:

sales of Black & Decker® branded products increased \$20.6 million to \$88.7 million; and

total sales of Littermaid®, Weitech (pest control), Belson® (personal care) and Jerdon® (hospitality) branded products increased \$.3 million to \$25.7 million.

These increases were partially offset by:

decreases in sales of Windmere and other branded products of \$6.5 million to \$12.6 million; and

decreases in contract manufacturing sales of \$3.1 million to \$5.5 million.

We expect sales of Black & Decker® branded products to continue to increase for the remainder of 2004 as the result of the introduction of several new products, including the Home Café single-cup brewing system and the Tide™ Buzz™ ultrasonic stain removal system, both of which were co-developed with The Procter & Gamble Company and launched in the second quarter of 2004. Additionally, in the second quarter of 2004, the majority of the pest control products will be marketed under the Black & Decker® brand name and we will introduce new items under the Gizmo sub brand.

Gross Profit. Applica's gross profit margin decreased to 28.3% for the three months ended March 31, 2004 as compared to 30.5% for the same period in 2003. The gross profit margin decrease was primarily attributed to:

\$900,000 in manufacturing retrenchment costs, which relate to expenses that did not qualify for accrual at December 31, 2003;

higher inbound freight costs;

higher raw material costs; and

start-up costs related to the Home Café single-cup brewing system.

Recently, we have experienced significant increases in prices for raw materials, including plastic, steel, aluminum and copper, as well as in inbound freight costs. Management expects this trend to continue in 2004 and to continue to negatively affect gross profit margins.

Selling, General and Administrative Expenses.

Operating Expenses. Operating expenses increased \$5.2 million, or 13.6%, for the three months ended March 31, 2004 to \$43.5 million as compared to the first quarter in 2003. Such expenses increased as a percentage of sales to 32.9% from 31.6% in the 2003 period primarily as the result of:

increases of \$2.6 million in legal and settlement expenses related to the Tilia matter;

increases of \$1.9 million in royalty expenses; and

increases of \$1.3 million in outbound freight expenses.

Management expects increased royalties and outbound freight expenses to continue throughout 2004.

These increases in operating expenses were partially offset by lower amortization of intangible assets of \$1.9 million related to the write-off of the unamortized book value of an intangible asset related to the Black & Decker tradename in the fourth quarter of 2003.

Repositioning and Other Charges. In the first quarter of 2004, Applica settled an outstanding litigation matter for \$125,000 and reversed the remaining accrual of \$563,000 related to such litigation.

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Interest Expense. Interest expense decreased by \$1.8 million, or 45.6%, to \$2.1 million for the three months ended March 31, 2004, as compared to \$3.9 million for the first quarter of 2003, as the result of lower debt levels. Management expects interest expense for the remainder of 2004 will continue to be lower than 2003.

Loss On Early Extinguishment of Debt. In February 2004, Applica redeemed \$4.25 million of its 10% Senior Subordinated Notes due 2008. The notes were redeemed at prices between 103.25 and 103.33% of the principal amount, plus accrued interest. The cost of the redemption of the notes also included \$187,000 in prepayment premiums and write-off of deferred financing costs related to the redemption.

Taxes. Applica's tax expense is based on an estimated annual aggregation of the taxes on earnings of each of its foreign and domestic operations. For the first quarter of 2004, Applica used an effective tax rate of 40% and reflected a tax benefit based upon the expectation of taxable income for the year.

The earnings of subsidiaries in Canada, Mexico and Latin America (other than Chile) are generally taxed at rates comparable to or higher than 35%, the United States statutory rate. In addition, commencing on January 1, 2002, the earnings of Applica's Hong Kong subsidiary are also taxed at the United States statutory rate of 35% due to Applica's intent not to permanently reinvest the earnings outside of the United States. Applica does not make tax provisions for the undistributed earnings of its foreign subsidiaries that it expects will be permanently reinvested in its operations outside of the United States.

Earnings Per Share. Basic shares for the three-month periods ended March 31, 2004 and 2003 were 23,718,256 and 23,500,555, respectively. Included in diluted shares for the three-month period ended March 31, 2003 are common stock equivalents relating to options of 165,312. All common stock equivalents have been excluded from the diluted per share calculations in the three-month period ended March 31, 2004 because their inclusion would have been anti-dilutive. Potential common stock equivalents for the three-month period ended March 31, 2003 were options to purchase 2,423,435 shares of common stock, with exercise prices ranging from \$4.90 to \$31.69.

Liquidity and Capital Resources

Liquidity

Applica's financial condition and liquidity remained adequate as of March 31, 2004. Cash and cash equivalents were \$6.1 million at March 31, 2004 and March 31, 2003. Any excess cash in the United States is typically used to pay down Applica's borrowings under its domestic credit facility on the next business day.

Operating Activities. Operations generated cash of \$29.4 million for the quarter ended March 31, 2004, as compared to \$21.6 million net cash provided in the quarter ended March 31, 2003. The cash generated in the quarter was primarily the result of seasonal decreases in accounts receivable.

Investing Activities. For the quarter ended March 31, 2004, investing activities used cash of \$3.1 million compared to \$6.2 million of cash used in the same period in 2003. Cash flow from investing activities benefited from lower capital expenditures of \$2.0 million and cash proceeds of \$1.2 million received from Anasazi Partners L.P., our 50% joint venture.

Applica makes capital expenditures primarily for new product development and maintenance of its manufacturing facilities. In addition, Applica is undergoing a major upgrade of its information technology infrastructure, including the installation of a new enterprise resource planning system. Capital expenditures for 2004 are expected to be approximately \$21.0 million. Applica plans to fund such capital expenditures from cash flow from operations and, if necessary, borrowings under its credit facilities.

Financing Activities. Net cash used in financing activities was \$32.9 million in the first quarter of 2004, compared to cash used of \$17.6 million in the 2003 period. The cash used in financing reflects the pay down of borrowings under our lines of credit, as well as the redemption of \$4.25 million of our 10% notes at a redemption price of \$4.4 million.

We will continue to have cash requirements to support seasonal working capital needs and capital expenditures, to pay interest and to service debt.

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Management continues to review its opportunities to repurchase additional 10% notes depending on several factors, including availability under Applica's credit facility, the market price of the 10% notes and projected cash flow.

Capital Resources

Applica's primary sources of short-term capital are its cash flow from operations and borrowings under its credit facilities. Applica's current domestic credit facility is a \$205 million asset-based senior secured revolving credit facility maturing December 28, 2005. As of May 5, 2004, Applica was borrowing approximately \$39.7 million under the facility and had approximately \$59.4 million available for future cash borrowings, based on Applica's collateral value. Advances under the facility are primarily based upon percentages of outstanding eligible accounts receivable and inventories. The credit facility includes a \$10.0 million sublimit for the issuance of letters of credit, with approximately \$500,000 outstanding under the limit as of May 5, 2004.

At Applica's option, interest accrues on the loans made under the credit facility at either:

LIBOR (adjusted for any reserves), plus a specified margin (determined by Applica's leverage ratio and set at 2.35% at March 31, 2004 and 2.35% at May 5, 2004), which was 3.44% at March 31, 2004 and 3.45% at May 5, 2004; or

the Base Rate (which is Bank of America's prime rate), plus a specified margin (determined based upon Applica's leverage ratio and was 0.35% at March 31, 2004 and May 5, 2004), which was 4.35% at March 31, 2004 and 4.35% at May 5, 2004.

Management expects its borrowing margins to decrease to 2.00% (for LIBOR loans) and zero percent (for Base Rate loans) during May 2004. This decrease is a result of a decrease in our leverage ratio.

Swing loans up to \$15.0 million bear interest at the Base Rate plus a specified margin (determined based on Applica's leverage ratio and was 0.35% at March 31, 2004 and at May 5, 2004), which was 4.35% at March 31, 2004 and 4.35% at May 5, 2004.

Certain of Applica's foreign subsidiaries have approximately \$14.5 million in trade finance lines of credit, payable on demand, which are secured by the subsidiaries' tangible and intangible property, and in some cases, a guarantee by the parent company, Applica Incorporated. As of March 31, 2004, there were no amounts outstanding under the working capital lines and \$179,000 outstanding under the letter of credit lines. As of May 5, 2004, there were \$7.8 million outstanding under the working capital lines and approximately \$400,000 under the letter of credit lines.

In addition, Applica has senior subordinated notes bearing interest at a rate of 10%, payable semiannually, and mature on July 31, 2008. The notes are general unsecured obligations of Applica Incorporated and rank subordinate in right of payment to all senior debt of Applica and rank pari passu in right of payment to all future subordinated indebtedness of Applica. The notes may be redeemed at the option of Applica, in whole or in part, at various redemption prices. During 2003, we repurchased \$65.0 million of these notes. In February 2004, we repurchased an additional \$4.25 million of 10% notes. As of March 31, 2004, the outstanding principal balance was \$60.7 million.

On September 28, 2002, Applica entered into credit approved receivables purchasing agreements with CIT Group/Commercial Services, Inc. The agreements allow Applica to transfer to CIT, without recourse, approved receivables of specified customers under certain circumstances, including the bankruptcy of covered customers. Applica remains the servicer of the approved receivables and pays fees based upon a percentage of the gross face amount of each approved receivable. These arrangements are strictly for the purpose of insuring selected receivables. At March 31, 2004 and 2003, \$9.4 million and \$10.0 million of accounts receivable were insured under this

arrangement.

In April 2002, Applica Consumer Products, Inc. entered into a five-year \$6.0 million mortgage loan on Applica's executive offices located in Miami Lakes, Florida. The loan bears interest at an annual rate of 7.25%, with monthly principal and interest payments based on a 20-year amortization. A final balloon payment is due at the end of the term. The loan is secured by a mortgage on the property and the building located thereon. In November 2003, Applica entered into an agreement to sell its executive offices located in Miami Lakes for \$9.3 million,

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resulting in an estimated gain before taxes of approximately \$1.5 million. The sale is scheduled to close in October 2004. At the time of closing, approximately \$6.0 million of these proceeds will be used to repay the outstanding mortgage on the property. On March 30, 2004, Applica entered into a ten-year operating lease for new corporate office space in South Florida. The lease contains provisions for annual rental escalations of 2% beginning in October 2005.

At March 31, 2004, debt as a percent of total capitalization was 30.6%, as compared to 42.5% at March 31, 2003. The improvement was primarily the result of a \$73.2 million decrease in debt year-over-year.

Applica's ability to make scheduled payments of principal of, or to pay the interest on, or to refinance, its indebtedness, or to fund planned capital expenditures, and marketing expenses will depend on its future performance. Based upon the current level of operations and anticipated margin improvements and revenue growth, we believe that cash flow from operations and available cash, together with available borrowings under its credit facility and other facilities, will be adequate to meet our future liquidity needs for at least the next several years. However, business may not generate sufficient cash flow from operations, our anticipated revenue growth and operating improvements may not be realized and future borrowings may not be available under the credit facility in an amount sufficient to enable us to service our indebtedness, including the outstanding 10% notes, or to fund our other liquidity needs. In addition, we may not be able to effect any needed refinancing on commercially reasonable terms or at all.

Applica is also involved in certain ongoing litigation. See Part II. Item 1 Legal Proceedings.

Use of Estimates and Critical Accounting Policies

The preparation of Applica's financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and revenues and expenses during the period. Future events and their effects cannot be determined with absolute certainty; therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to our financial statements. Management continually evaluates its estimates and assumptions, which are based on historical experience and other factors that are believed to be reasonable under the circumstances. These estimates and Applica's actual results are subject to the risk factors listed in Forward Looking Statement Disclosure above.

Management believes that the following may involve a higher degree of judgment or complexity:

Collectibility of Accounts Receivable. Applica's allowance for doubtful accounts is based on management's estimates of the creditworthiness of its customers, current economic conditions and historical information, and, in the opinion of management, is believed to be an amount sufficient to respond to normal business conditions. Management sets specific allowances for customers in bankruptcy and other allowances for the remaining customers based upon historical collection experience. Should business conditions deteriorate or any major customer default on its obligations to Applica, this allowance may need to be significantly increased, which would have a negative impact upon Applica's results of operations. Applica reviews its accounts receivable aging on a regular basis to determine if any of the receivables are past due. Applica writes off all uncollectible trade receivables against its allowance for doubtful accounts.

Inventory Allowances. Applica establishes an allowance based on historical experience and specific allowances when it is apparent that the expected realizable value of an inventory item falls below its original cost. A charge to operations results when the estimated net realizable value of inventory items declines below cost. Management regularly reviews Applica's investment in inventories for declines in value.

Income Taxes. Significant management judgment is required in developing Applica's provision for income taxes, including the determination of foreign tax liabilities, deferred tax assets and liabilities and any valuation allowances that might be required to be applied against the deferred tax assets. At March 31, 2004 and 2003, Applica had deferred tax assets in excess of deferred tax liabilities of \$71.7 million and \$66.9 million, respectively. Applica determined that it was more likely than not that \$64.3 million and \$56.7 million of such assets will be realized, resulting in a valuation allowance of \$7.4 million and \$10.2 million as of March 31, 2004 and 2003, respectively. Applica evaluates its ability to realize its deferred tax assets on a quarterly basis and adjusts the amount of its valuation allowance, if necessary. Applica operates within multiple taxing jurisdictions and is subject to audit in those jurisdictions. Because of the complex issues involved, any claims can require an extended period to resolve.

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Goodwill. On an annual basis, management assesses the composition of Applica's assets and liabilities, as well as the events that have occurred and the circumstances that have changed since the most recent fair value determination. If events occur or circumstances change that would more likely than not reduce the fair value of goodwill below its carrying amount, goodwill will be tested for impairment. Applica selected June 30th as the annual impairment test date and will recognize an impairment loss if the carrying value of the asset exceeds the fair value determination as of June 30th of each year.

Long-Lived Assets. Applica reviews long-lived assets and certain identifiable intangibles held and used for possible impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In evaluating the fair value and future benefits of its intangible assets, management performs an analysis of the anticipated undiscounted future net cash flows of the individual assets over the remaining amortization period. Applica recognizes an impairment loss if the carrying value of the asset exceeds the expected future cash flows.

Accruals for Product Liability Claims and Litigation. Applica is subject to various legal proceedings, product liability claims and other claims in the ordinary course of its business. Management estimates the amount of ultimate liability, if any, with respect to such matters in excess of applicable insurance coverage based on historical claims experience and current claim amounts, as well as other available facts and circumstances. As the outcome of litigation is difficult to predict and significant estimates are made with regard to future events, significant changes from estimated amounts could occur.

Other Estimates. During the years, Applica has made significant estimates in connection with specific events affecting its expectations. These have included accruals relating to the consolidation of its operations, plant closings, reduction in employees and product recalls. Applica makes a number of other estimates in the ordinary course of business relating to sales returns and allowances, warranty accruals, and accruals for promotional incentives. Historically, past changes to these estimates have not had a material impact on our financial condition but have significantly affected results of operations from time to time. However, circumstances could change which may alter future expectations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk Management

Applica is exposed to the impact of interest rate changes. Applica's objective is to manage the impact of interest rate changes on earnings and cash flows and on the market value of its borrowings. Applica maintains fixed rate debt as a percentage of its net debt between a minimum and maximum percentage, which is set by policy.

It is Applica's policy to enter into interest rate risk management transactions only to the extent considered necessary to meet its objectives as set forth above. Applica does not enter into interest rate risk management transactions for speculative purposes.

Outstanding as of March 31, 2004 were interest rate management contracts on approximately \$80 million notional principal amount with a fair value of \$975,849. The market value represents the amount Applica would receive upon exiting the contracts at March 31, 2004 and was determined based on quotes obtained from Applica's financial institutions. The market value related to the fair value of interest rate risk management contract is included as prepaid asset and an increase the bonds. The market value related to the cash flow interest rate risk management contracts is included as an offset to prepaid asset and other comprehensive income. Applica does not intend to exit these contracts at this time.

Significant interest rate risk management instruments held by Applica as of March 31, 2004 included pay-fixed and pay-floating swaps. The pay-fixed swaps effectively convert floating rate obligations to fixed-rate instruments. The pay-floating swap effectively converts medium term fixed-rate obligations to LIBOR-rate indexed variable-rate instruments. All swaps have maturity dates that mirror the maturity date of the underlying hedged transaction. For the period ending March 31, 2004, Applica did not discontinue any hedges due to the probability that the original underlying forecasted transaction would not occur.

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The impact of interest rate risk management activities on pre-tax income during the quarter ended March 31, 2004 was not material.

Foreign Exchange Risk Management

Applica transacts business globally and is subject to risks associated with changing foreign exchange rates. Applica's objective is to reduce earnings and cash flow volatility associated with foreign exchange rate changes to allow management to focus attention on core business issues and challenges. By policy, Applica maintains hedge coverage between minimum and maximum percentages of its forecasted foreign exchange exposures for periods not to exceed 18 months. The gains and losses on these contracts offset changes in the value of the related exposures.

It is Applica's policy to enter into foreign currency transactions only to the extent considered necessary to meet its objectives as set forth above. Applica does not enter into foreign currency transactions for speculative purposes.

Outstanding as of March 31, 2004 were \$22.8 million notional of contracts to purchase and/or sell foreign currency forward with a negative fair market value of \$553,828. The market value represents the amount Applica would pay upon exiting the contracts at March 31, 2004 and was determined based on quotes obtained from Applica's financial institutions. This amount is included in long-term liabilities and other comprehensive income as of March 31, 2004. Applica does not intend to exit these contracts at this time.

Applica enters into various contracts that change in value as foreign exchange rates change to protect the value of its existing foreign currency assets and liabilities, commitments and forecasted foreign currency revenues. Applica uses option strategies and forward contracts that provide for the sale of foreign currencies to hedge forecasted revenues and expenses. Applica also uses forward contracts to hedge foreign currency assets and liabilities. While these hedging instruments are subject to fluctuations in value, such fluctuations are offset by changes in the value of the underlying exposures being hedged. The principal currencies hedged are the Mexican peso and Canadian dollar.

Additional Information

For additional information, see Item 7A. Quantitative and Qualitative Disclosures About Market Risk in Applica's Annual Report on Form 10-K for the year ended December 31, 2003.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures. Applica has carried out an evaluation under the supervision of management, including the President and Chief Executive Officer and the Senior Vice President and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures. Based on that evaluation, Applica's Chief Executive Officer and Chief Financial Officer have concluded that, as of March 31, 2004, Applica's disclosure controls and procedures were effective to ensure that information required to be disclosed by the company in the reports filed or submitted by it under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and include controls and procedures designed to ensure that information required to be disclosed by Applica in such reports is accumulated and communicated to management, including the President and Chief Executive Officer and the Senior Vice President and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

Changes in Internal Controls. Applica is committed to continuously improving its internal controls and financial reporting. Beginning in 2003, Applica retained a consulting firm with experience in internal controls to assist management and the Audit Committee in reviewing Applica's current internal controls structure with a view towards

meeting the formalized requirements of Section 404 of the Sarbanes-Oxley Act. As a result of such review and the evaluation discussed above, management has determined that certain matters could be considered deficiencies in its internal control systems, including the following:

Many of the controls that are currently in place, including our policies and procedures, are informal and not standardized. As such, the reliability and effectiveness of these control processes are dependent on interpretation and execution by our employees. As part of our ongoing efforts,

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many of our procedures have already been formalized and documented. Also, a process has been instituted to perform timely reviews and evaluations of account balances.

Our legacy information technology systems are not fully integrated and do not, by themselves, provide for proper controls over access and change management. However, we are addressing access issues and have formalized and enhanced a number of our mitigating controls.

These potential issues have been discussed in detail among management, the Audit Committee and Grant Thornton LLP, our independent accountants. Management has assigned the highest priority to completion of the resolution of these matters. We are continuing to devote significant resources, both internal and external, to update, formalize and standardize our internal controls. Additionally, we are in the process of implementing a new enterprise resource planning system that includes financial applications. As a result of the steps we have taken and will continue to take to improve our systems and controls, changes in internal controls were undertaken in the first quarter of 2004 and will be ongoing throughout the remainder of the year. Despite the issues identified above, management believes that our financial statements and related disclosures as filed to date present fairly, in all material respects, our financial condition and results of operations for the respective periods.

Limitations on the Effectiveness of Controls. Applica's management does not expect that our disclosure or internal controls will prevent all errors or fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Tilia Matters. In April 2004, Applica and its U.S. operating subsidiary, Applica Consumer Products, Inc., entered into a license and settlement agreement with Tilia, Inc. and Tilia International, Inc. to resolve patent infringement litigation pending in federal court in Miami and before the International Trade Commission in Washington, D.C. As part of the license and settlement agreement, Applica agreed to pay Tilia royalties for using its vacuum sealing technology. In addition, Applica agreed to not contest the validity of Tilia's previously disputed patents and to settle any future disputes over product infringement by arbitration.

Other Matters. Applica is subject to other legal proceedings, product liability claims and other claims that arise in the ordinary course of our business. In the opinion of management, the amount of ultimate liability with respect to such matters, if any, in excess of applicable insurance coverage, is not likely to have a material effect on our business, financial condition, results of operations or liquidity of Applica. However, as the outcome of litigation or other claims is difficult to predict, significant changes in the estimated exposures could occur.

Item 5. Other Information

Frederick E. Fair, a director of Applica Incorporated since 1999, retired effective May 1, 2004.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits:

31.1 Certification of Principal Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a)

31.2 Certification of Principal Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a)

32.1 Certification of Principal Executive Officer Pursuant to 18 U.S.C. 1350

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. 1350

(b) Reports on Form 8-K:

Form 8-K dated April 8, 2004 reporting under Item 5. Other Events and Required FD Disclosure that Applica issued a press release announcing that it and its U.S. operating subsidiary, Applica Consumer Products, Inc., have entered into a license and settlement agreement with Tilia, Inc. and Tilia International, Inc. to resolve patent infringement litigation pending in federal court in Miami and before the International Trade Commission in Washington, D.C. The applicable press release was attached.

Form 8-K dated May 6, 2004 reporting under Item 12. Results of Operations and Financial Condition that Applica issued a press release describing its results of operations for the quarter ended March 31, 2004 and attaching such press release.

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SIGNATURES

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

APPLICA INCORPORATED
(Registrant)

May 6, 2004

By: /s/ Harry D. Schulman
Harry D. Schulman
President and Chief Executive Officer

May 6, 2004

By: /s/ Terry L. Polistina

Terry L. Polistina Senior Vice President
and Chief Financial Officer (Chief
Financial and Accounting Officer)

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