

JACUZZI BRANDS INC
Form 10-Q
August 10, 2006

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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 July 1, 2006
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: **1-14557**

JACUZZI BRANDS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

22-3568449

(I.R.S. Employer
Identification No.)

777 S. Flagler Drive; Suite 1100W

West Palm Beach, FL 33401

(Address of principal executive offices)

(561) 514-3838

(Registrant's telephone number, including area code)

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

Yes No

Indicate by check mark whether the registrant 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 Exchange Act):

Yes No

As of July 31, 2006, Jacuzzi Brands, Inc. had one class of common stock, of which 77,653,322 shares were outstanding.

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****JACUZZI BRANDS, INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(in millions, except per share data)**

| | Three Months Ended | | Nine Months Ended | |
|--|---------------------------|-------------|--------------------------|-------------|
| | June 30, | | June 30, | |
| | 2006 | 2005 | 2006 | 2005 |
| Net sales | \$332.6 | \$334.2 | \$888.9 | \$916.7 |
| Operating costs and expenses: | | | | |
| Cost of products sold | 225.6 | 223.5 | 608.9 | 621.2 |
| Selling, general and administrative expenses | 72.7 | 75.3 | 200.4 | 214.6 |
| Restructuring charges | 0.7 | 1.4 | 3.3 | 3.6 |
| Operating income | 33.6 | 34.0 | 76.3 | 77.3 |
| Interest expense | (10.5) | (12.4) | (31.5) | (36.9) |
| Interest income | 1.2 | 0.3 | 3.8 | 1.5 |
| Gain on sale of business | | 25.8 | | 25.8 |
| Rexair equity earnings | 0.8 | | 2.5 | |
| Other (expense) income, net | (0.7) | (5.9) | 8.4 | (5.9) |
| Earnings before income taxes | 24.4 | 41.8 | 59.5 | 61.8 |
| Provision for income taxes | (25.4) | (3.9) | (41.3) | (8.7) |
| (Loss) Earnings from continuing operations | (1.0) | 37.9 | 18.2 | 53.1 |
| Discontinued operations: | | | | |
| Loss from operations (net of tax benefit of \$0.0, \$1.5, \$0.0 and \$2.4, respectively) | (1.6) | (2.7) | (3.8) | (4.7) |
| Loss from disposals (net of tax benefit of \$0.4 \$1.0, \$1.8 and \$1.2, respectively) | (1.3) | (56.0) | (3.5) | (56.3) |
| Net (loss) earnings | \$ (3.9) | \$ (20.8) | \$ 10.9 | \$ (7.9) |
| Basic (loss) earnings per share: | | | | |
| Continuing operations | \$ (0.01) | \$ 0.50 | \$ 0.24 | \$ 0.70 |
| Discontinued operations | (0.04) | (0.78) | (0.10) | (0.81) |
| | \$ (0.05) | \$ (0.28) | \$ 0.14 | \$ (0.11) |
| Diluted (loss) earnings per share: | | | | |
| Continuing operations | \$ (0.01) | \$ 0.50 | \$ 0.24 | \$ 0.69 |

| | | | | |
|-------------------------|-----------|-----------|---------|-----------|
| Discontinued operations | (0.04) | (0.77) | (0.10) | (0.79) |
| | \$ (0.05) | \$ (0.27) | \$ 0.14 | \$ (0.10) |

The accompanying notes are an integral part of these statements.

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JACUZZI BRANDS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in millions)

| | June 30, 2006 (unaudited) | September 30, 2005 |
|--|--|-----------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 108.9 | \$ 110.2 |
| Trade receivables, net | 219.3 | 200.5 |
| Inventories | 191.2 | 165.0 |
| Deferred income taxes | 28.6 | 27.9 |
| Assets held for sale | 69.4 | 69.7 |
| Prepaid expenses and other current assets | 23.4 | 22.6 |
| Total current assets | 640.8 | 595.9 |
| Restricted cash | | 12.4 |
| Property, plant and equipment, net | 99.0 | 103.7 |
| Pension assets | 149.8 | 147.8 |
| Insurance for asbestos claims | 153.0 | 153.0 |
| Goodwill | 230.7 | 228.2 |
| Other non-current assets | 49.5 | 48.5 |
| TOTAL ASSETS | \$1,322.8 | \$ 1,289.5 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Notes payable | \$ 18.6 | \$ 22.0 |
| Current maturities of long-term debt | 1.7 | 1.5 |
| Trade accounts payable | 109.9 | 105.7 |
| Income taxes payable | 34.6 | 24.7 |
| Liabilities associated with assets held for sale | 71.1 | 66.9 |
| Accrued expenses and other current liabilities | 104.8 | 114.4 |
| Total current liabilities | 340.7 | 335.2 |
| Long-term debt | 381.8 | 383.5 |
| Deferred income taxes | 17.6 | 5.6 |
| Asbestos claims | 153.0 | 153.0 |
| Other non-current liabilities | 120.8 | 127.0 |
| Total liabilities | 1,013.9 | 1,004.3 |
| Commitments and contingencies | | |
| Stockholders' equity | 308.9 | 285.2 |

| | | |
|--|-----------|------------|
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | \$1,322.8 | \$ 1,289.5 |
|--|-----------|------------|

The accompanying notes are an integral part of these statements.

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

| | Nine months ended June 30 | |
|--|------------------------------|-------------------|
| | 2006 | 2005 (Revised) |
| OPERATING ACTIVITIES: | | |
| Net cash (used in) provided by operating activities of continuing operations | \$ (0.6) | \$ 8.8 |
| Net cash used in operating activities of discontinued operations | (12.5) | (26.1) |
| NET CASH USED IN OPERATING ACTIVITIES | (13.1) | (17.3) |
| INVESTING ACTIVITIES: | | |
| Proceeds from sale of businesses, net | | 140.7 |
| Purchases of property, plant and equipment | (8.2) | (18.4) |
| Proceeds from sale of excess real estate and other non-operating assets | 10.9 | 7.2 |
| Proceeds from sale of fixed assets | 0.2 | 0.2 |
| Net cash provided by investing activities of continuing operations | 2.9 | 129.7 |
| Investing activities of discontinued operations | (1.4) | (0.4) |
| NET CASH PROVIDED BY INVESTING ACTIVITIES | 1.5 | 129.3 |
| FINANCING ACTIVITIES: | | |
| Proceeds from long-term debt | | 59.1 |
| Repayment of long-term debt | (1.5) | (124.8) |
| Excess tax benefits from share based payment agreements | 0.2 | |
| Payment of financing fees | | (1.0) |
| Proceeds from stock option exercises | 0.7 | 0.2 |
| Withdrawal from restricted cash collateral accounts | 12.8 | |
| Deposits into restricted cash collateral accounts | | (12.4) |
| Payments for stock option exchange | | (0.2) |
| Decrease in notes payable, net | (4.4) | (2.9) |
| Net cash provided by (used in) financing activities of continuing operations | 7.8 | (82.0) |
| Financing activities of discontinued operations | (0.2) | (0.1) |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | 7.6 | (82.1) |
| Effect of exchange rate changes on cash and cash equivalents | 2.7 | (0.3) |
| (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (1.3) | 29.6 |

| | | |
|--|----------|---------|
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 110.2 | 39.6 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 108.9 | \$ 69.2 |

The accompanying notes are an integral part of these statements.

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JACUZZI BRANDS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions unless otherwise noted)
(unaudited)

Note 1 Basis of Presentation

We manufacture and distribute a broad range of consumer and industrial products through our operating subsidiaries in two business segments – Bath Products and Plumbing Products. Please refer to **Note 13** regarding our business segments.

We operate on a 52- or 53-week fiscal year ending on the Saturday nearest to September 30. The three- and nine-month periods presented in our condensed consolidated financial statements reflect the 13-week and 39-week periods ending on the Saturday nearest June 30 of the respective year, but are presented as of June 30 for convenience. The fiscal periods presented in this report on Form 10-Q, which consist of the 13 weeks and 39 weeks ended June 30, 2006 (also referred to as the third quarter of 2006 and nine months ended 2006, respectively) and the 13 weeks and 39 weeks ended June 30, 2005 (also referred to as the third quarter of 2005 and nine months ended 2005, respectively), are unaudited. However, in our opinion, these financial statements reflect all normal, recurring adjustments necessary to provide a fair presentation of our financial position, results of operations and cash flows for the periods presented. These interim financial statements are condensed, and thus, do not include all of the information and footnotes required by United States generally accepted accounting principles (GAAP) for presentation of a complete set of financial statements. The balance sheet as of October 1, 2005 (referred to as September 30, 2005 for convenience) has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for a complete set of financial statements. Our results are impacted by weather and other seasonal influences affecting construction. These interim results are not necessarily indicative of the results that should be expected for the full year. For a better understanding of Jacuzzi Brands, Inc. and our financial statements, the condensed interim financial statements should be read in conjunction with our audited consolidated financial statements for the year ended October 1, 2005, which are included in our 2005 Annual Report on Form 10-K, filed on December 15, 2005.

Tax expense for the third quarter of fiscal 2006 includes a \$14.4 million valuation allowance related to our U.K. deferred tax assets (see **Note 12** for further details).

Operating income in the third quarter of fiscal 2006 included \$4.5 million of expense related to our retiree benefit liabilities for several key executives. Approximately \$1.0 million of this amount should have been recorded in the first and second quarters of fiscal 2006 and \$2.9 million should have been recorded during the period beginning with the Company's 1995 spin off from Hanson plc through fiscal 2005, and \$0.6 million relates to the current quarter. No single fiscal year was materially misstated so the entire \$4.5 million was recorded in the current period as follows: \$2.9 million in corporate expenses; \$1.1 million in the Bath Products segment; and \$0.5 million in the Plumbing Products segment. We also adjusted paid-in capital by \$0.5 million to reflect the additional retiree benefit liability associated with these contracts, which should have been recorded at the time of the Company's 1995 spin off.

Net cash provided by investing activities in the nine months ended 2006 included \$9.3 million collected on a non-operating note that had previously been fully reserved. We had obtained the note in October 2002 upon the sale of a piece of property to a property developer, Woodlands Ventures, LLC. The gain of \$9.3 million, which had been deferred until collection of the note, was recorded in other income, net, in the first quarter of 2006.

Revision of Statements of Cash Flows

In 2006 we have separately disclosed the operating, investing and financing portion of the cash flows attributable to our discontinued operations, which in prior periods were reported on a combined basis as a single amount. The annual Statements of Cash Flows in the fiscal 2006 annual report will be revised to reflect this change. The revision will have the following impact on the past three fiscal years ended:

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JACUZZI BRANDS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions unless otherwise noted)
(unaudited)

Note 1 Basis of Presentation (continued)

| | 2005 | September 30, 2004 | 2003 |
|---|-------------|-------------------------------|-------------|
| Net cash used in discontinued operations, as reported | \$(31.2) | \$(14.6) | \$(8.9) |
| Adjustments | | 0.3 | 1.5 |
| Net cash used in operating activities of discontinued operations, revised | (31.2) | (14.3) | (7.4) |
| Net cash used in investing activities of discontinued operations, as reported | | | |
| Adjustments | (0.7) | (0.3) | (1.5) |
| Net cash used in investing activities of discontinued operations, revised | (0.7) | (0.3) | (1.5) |
| Net cash provided by financing activities of discontinued operations, as reported | | | |
| Adjustments | 0.7 | | |
| Net cash provided by financing activities of discontinued operations, revised | 0.7 | | |

Note 2 New Accounting Pronouncement

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with Statement of Financial Accounting Standard No. 109, Accounting for Income Taxes. This interpretation clarifies the accounting for income taxes by prescribing the recognition threshold a tax position is required to meet before being recognized in the financial statements. This interpretation also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the impact of FIN 48 on our consolidated results of operations and financial position.

Note 3 Inventories

Inventories consist of the following:

| | June 30, 2006 | September 30, 2005 |
|---------------------|--------------------------|-----------------------------------|
| Finished products | \$ 130.0 | \$ 108.7 |
| In-process products | 14.1 | 12.9 |
| Raw materials | 47.1 | 43.4 |
| | \$ 191.2 | \$ 165.0 |

Note 4 Long-Term Debt

Long-term debt consists of the following:

| | June 30, 2006 | September 30, 2005 |
|--------------------------|--------------------------|-----------------------------------|
| Senior Notes | \$380.0 | \$ 380.0 |
| Other long-term debt | 3.5 | 5.0 |
| | 383.5 | 385.0 |
| Less: current maturities | (1.7) | (1.5) |
| Long-term debt | \$381.8 | \$ 383.5 |

The 9.625% senior secured notes (Senior Notes) are due on July 1, 2010 and require the payment of interest of \$18.3 million on January 1 and July 1 of each year. We are restricted in the redemption of the Senior Notes per the terms of the agreement with the note holders.

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JACUZZI BRANDS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions unless otherwise noted)
(unaudited)

Note 4 Long-Term Debt (continued)

On and after July 1, 2007, we can redeem the Senior Notes subject to a redemption premium of 104.8% for the first 12 months and 102.4% for the following 12 months. On and after July 1, 2009, the Senior Notes can be redeemed at face value.

As required by the Indenture governing the Senior Notes, on April 11, 2006 we commenced an offer to purchase up to \$47.7 million aggregate principal amount of our Senior Notes at par, plus accrued and unpaid interest. The amount of the offer was equivalent to the remaining proceeds from both the Rexair, Inc. (Rexair) and Eljer Plumbingware, Inc. (Eljer) dispositions, net of certain expenses and payments incurred in connection with the dispositions. None of the Senior Notes was tendered for purchase. At September 30, 2005, we had restricted cash accounts of \$12.4 million that were held for the benefit of the bondholders related to the proceeds from the Rexair and Eljer dispositions. As a result of the tender offer this restricted cash balance was reclassified to cash and cash equivalents.

We have an asset-based credit facility that matures on July 15, 2008. Under this facility, we can borrow up to \$200.0 million subject to a borrowing base consisting of eligible accounts receivable and eligible inventory. There were no balances outstanding under this facility during the nine months ended 2006. At June 30, 2006, we had approximately \$131.8 million available to be borrowed under the asset-based credit facility, of which we had utilized approximately \$32.4 million for letters of credit, leaving \$99.4 million available for borrowings. In addition, we have outstanding foreign commercial letters of credit of \$2.8 million which do not affect availability under the asset-based credit facility.

We paid \$20.8 million of interest on our borrowings during the nine months ended 2006 and \$44.5 million during the nine months ended 2005. The majority of the difference between the two years is the result of the timing of the semi-annual payment of our Senior Notes. The July payment was made in the third quarter of the prior year, whereas it was paid at the beginning of the fourth quarter of the current year. Additional information regarding our long-term debt can be found in our 2005 Annual Report on Form 10-K, filed on December 15, 2005.

Note 5 Commitments and Contingencies*Warranties*

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

Changes in our warranty reserves during the nine months ended 2006 are as follows:

| | |
|-----------------------|---------|
| At September 30, 2005 | \$ 24.3 |
| Warranty accrual | 13.6 |
| Cash payments | (12.1) |
| At June 30, 2006 | \$ 25.8 |

Contingencies

In the first quarter 2006, we reached a settlement with a state regarding past due taxes on property. As a result, we recorded a gain of \$1.7 million, reducing our liability to the state to \$0.3 million. This gain is included in corporate general and administrative expenses for the nine months ended 2006.

Guarantees & Indemnifications

In connection with the sale of Ames True Temper in January 2002, we continue to guarantee the lease payments of their master distribution center. The lease obligation will expire in 2015. The scheduled lease payments totaled \$3.8 million for fiscal 2005, and increase by 2.25% each year thereafter. We obtained a security interest and

indemnification from Ames True Temper on the lease that would enable us to exercise remedies in the event of default. We have not been called upon to make any payments under this guarantee.

We have sold a number of assets and businesses over the last several years and have, on occasion, provided indemnifications for liabilities relating to product liability, environmental, insurance, tax and other claims. We have recorded reserves, net of escrow deposits totaling approximately \$15.9 million as of June 30, 2006 for asserted and potential unasserted claims related to these liabilities. These amounts have not been discounted.

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JACUZZI BRANDS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions unless otherwise noted)
(unaudited)

Note 5 Commitments and Contingencies (continued)

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

Environmental Matters

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

Our subsidiaries have made capital and maintenance expenditures over time to comply with these laws and regulations. While the amount of expenditures in future years will depend on legal and technological developments which cannot be predicted at this time, these expenditures may progressively increase if regulations become more stringent. In addition, while future costs for compliance cannot be predicted with precision, no information currently available reasonably suggests that these expenditures will have a material adverse effect on our financial condition, results of operations or cash flows. We are investigating and remediating contamination at a number of present and former operating sites under the Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA or Superfund), the Federal Resource Conservation and Recovery Act or comparable state statutes or agreements with third parties. These proceedings are in various stages ranging from initial investigations to active settlement negotiations to the cleanup of sites. We have been named as a potentially responsible party at a number of Superfund sites under CERCLA or comparable state statutes. Under these statutes, responsibility for the entire cost of cleanup of a contaminated site can be imposed upon any current or former site owner or operator, or upon any party who sent waste to the site, regardless of the lawfulness of the original activities that led to the contamination. No information currently available reasonably suggests that projected expenditures associated with any of these proceedings or any remediation of these sites will have a material adverse effect on our financial condition, results of operations or cash flows.

As of June 30, 2006, we had accrued approximately \$8.5 million (\$0.6 million accrued as current liabilities and \$7.9 million as non-current liabilities), including \$5.9 million for discontinued operations, for environmental liabilities. These amounts have not been discounted. Other income in the nine months ended 2006 includes a \$3.5 million gain related to a reduction of environmental reserves resulting from a favorable court ruling. We have deposited \$10.5 million in escrow accounts pursuant to the terms of past asset sales to pay for almost all of the balance accrued for environmental liabilities. We accrue an amount for each case when the likelihood of an unfavorable outcome is probable and the amount of loss associated with such unfavorable outcome is reasonably estimable. We believe that the range of liability for these matters could reach \$8.7 million if it included cases where the likelihood of an unfavorable outcome is only reasonably possible. During the third quarter of 2006, we entered into a settlement agreement with Ames True Temper, Inc. regarding our environmental liabilities. We surrendered the cash that was deposited in escrow for these matters and paid \$2.5 million in return for our release from all pending claims and any future environmental liabilities associated with Ames True Temper, Inc. We cannot predict whether future developments in laws and regulations concerning environmental protection or unanticipated enforcement actions will require material capital expenditures or otherwise affect our financial condition, results of operations or cash flows in a materially adverse manner, or whether our businesses will be successful in meeting future demands of regulatory agencies in a manner which will not have a material adverse effect on our financial condition, results of operations or cash flows.

Litigation

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

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

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JACUZZI BRANDS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions unless otherwise noted)
(unaudited)

Note 5 Commitments and Contingencies (continued)

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

Federal legislation has been proposed that would remove asbestos claims from the current tort system and place them in a trust fund system. This trust would be funded by the insurers and defendant companies. There can be no assurance as to when or if this or any other legislation will be passed and become law or what, if any, the financial impact it could have on Zurn.

New claims filed against Zurn were lower period-over-period. During the third quarter and nine months ended 2006, approximately 1,600 and 5,000, respectively, new asbestos claims were filed against Zurn. During the third quarter and nine months ended 2005, approximately 2,600 and 9,200, respectively, new asbestos claims were filed against Zurn. As of June 30, 2006, the number of asbestos claims pending against Zurn was approximately 59,000 compared to 69,900 as of September 30, 2005. The pending claims against Zurn as of June 30, 2006 were included in approximately 4,700 lawsuits, in which Zurn and an average of 70 other companies are named as defendants, and which cumulatively allege damages of approximately \$10.9 billion against all defendants. The claims are handled pursuant to a defense strategy funded by Zurn's insurers. Defense costs currently do not erode the coverage amounts in the insurance policies, although a few policies that will be accessed in the future may count defense costs toward aggregate limits.

During the third quarter and nine months ended 2006 and as of the end of such periods, approximately 14,300 and 16,000 claims, respectively, were paid and/or pending payment and approximately 6,100 and 10,800 claims, respectively, were dismissed and/or pending dismissal. During the third quarter and nine months ended 2005 and as of the end of such period, approximately 12,800 and 16,000 claims, respectively, were paid and/or pending payment and approximately 5,100 and 11,800 claims, respectively, were dismissed and/or pending dismissal. Since Zurn received its first asbestos claim in the 1980s, Zurn has paid or dismissed or agreed to settle or dismiss approximately 131,800 asbestos claims including dismissals or agreements to dismiss of approximately 35,000 of such claims through June 30, 2006.

Zurn used an independent economic consulting firm with substantial experience in asbestos liability valuations to assist in the estimation of Zurn's potential asbestos liability. At September 30, 2005, that firm estimated that Zurn's potential liability for asbestos claims pending against it and for claims estimated to be filed through 2015 is approximately \$153 million. That firm estimated Zurn will pay approximately \$114 million through 2015 on such claims, with the balance of the estimated liability being paid in subsequent years. As discussed below in more detail, Zurn expects all such payments to be paid by its carriers.

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

Zurn's current estimate of its asbestos liability of \$153 million for claims filed through 2015 assumes that (i) its continuous vigorous defense strategy will remain effective; (ii) new asbestos claims filed annually against it will decline modestly through 2015; (iii) the values by disease will remain consistent with past experience; and (iv) its insurers will continue to pay defense costs without eroding the coverage amounts of its insurance policies. While Zurn

believes there is evidence, in recent claims settlements, for such an impact of a successful defense strategy, if the defense strategy ultimately is not successful to the extent assumed by Zurn, the severity and frequency of asbestos claims could increase substantially above Zurn's estimates. Further, while Zurn's current asbestos liability is based on an estimate of claims through 2015, such liability may continue beyond 2015, and such liability could be substantial. Zurn estimates that its available insurance to cover its potential asbestos liability as of June 30, 2006 is approximately \$287 million. Zurn believes, based on its experience in defending and dismissing such claims and the coverage available, that it has sufficient insurance to cover the pending and reasonably estimable future claims. This conclusion was reached after considering Zurn's experience in asbestos litigation, the insurance payments made to date by Zurn's insurance carriers, existing insurance policies, the industry ratings of the insurers and the advice of insurance coverage counsel with respect to applicable insurance coverage law relating to the terms and conditions of those policies.

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Note 5 Commitments and Contingencies (continued)

As of June 30, 2006 and September 30, 2005, Zurn recorded a receivable from its insurance carriers of \$153 million, which corresponds to the amount of Zurn's potential asbestos liability that is covered by available insurance and is probable of recovery. However, there is no assurance that \$287 million of insurance coverage will ultimately be available or that Zurn's asbestos liabilities will not ultimately exceed this amount. Factors that could cause a decrease in the amount of available coverage include changes in law governing the policies, potential disputes with the carriers on the scope of coverage, and insolvencies of one or more of Zurn's carriers.

Principally as a result of the past insolvency of certain of Zurn's insurance carriers, coverage analysis reveals that certain gaps exist in Zurn's insurance coverage, but only if and after Zurn uses approximately \$217 million of its remaining approximate \$287 million of insurance coverage. As noted above, the estimate of Zurn's potential liability for asbestos claims pending against it and for claims estimated to be filed through 2015 is \$153 million with the expected amount to be paid through 2015 being \$114 million. In order to use approximately \$262 million of the \$287 million of its insurance coverage from solvent carriers, Zurn estimates that it would need to satisfy approximately \$14 million of asbestos claims, with additional gaps of \$80 million layered within the final \$25 million of the \$287 million of coverage. We will pursue, if necessary, any available recoveries on our approximately \$148 million of coverage with insolvent carriers, which includes approximately \$83 million of coverage attributable to the gaps discussed above. These estimates are subject to the factors noted above.

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

Note 6 Comprehensive Earnings

The components of comprehensive earnings (loss) are as follows:

| | Third Quarter | | Nine Months Ended | |
|--|----------------------|-------------|--------------------------|-------------|
| | 2006 | 2005 | 2006 | 2005 |
| Net (loss) earnings | \$(3.9) | \$(20.8) | \$10.9 | \$ (7.9) |
| Foreign currency translation adjustments, net of tax | 9.7 | (9.9) | 9.9 | (1.7) |
| Minimum pension liability adjustment, net of tax | (1.1) | 0.7 | (0.8) | (0.7) |
| Net unrealized loss on investments, net of tax | (0.1) | | (0.1) | (0.2) |
| Comprehensive earnings (loss) | \$ 4.6 | \$(30.0) | \$19.9 | \$(10.5) |

Note 7 (Loss) Earnings Per Share

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

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Note 7 (Loss) Earnings Per Share (continued)

| | Third Quarter | | Nine Months Ended | |
|--|----------------------|-------------|--------------------------|-------------|
| | 2006 | 2005 | 2006 | 2005 |
| Basic weighted-average number of common shares outstanding | 76.4 | 75.5 | 76.2 | 75.3 |
| Effect of potentially dilutive securities: | | | | |
| Stock options | | 0.5 | 0.4 | 0.5 |
| Restricted stock and restricted stock units | | 0.6 | 0.8 | 0.8 |
| Diluted weighted-average number of common shares outstanding | 76.4 | 76.6 | 77.4 | 76.6 |

Options to purchase 0.1 million shares in both the nine months ended 2006 and 2005, were not included in the computation of diluted earnings per share because the exercise prices of these options exceeded the average market price of the common shares during the respective periods. Options to purchase 0.3 million shares as well as the effect of assuming 0.7 million shares of restricted stock vested in the third quarter of 2006 were excluded from the computation of diluted earnings per share because the effect would have been anti-dilutive. The effect of anti-dilutive options in the third quarter of 2005 was minimal.

Note 8 Stock-Based Compensation

We maintain incentive stock plans that provide for grants of stock options and restricted stock awards to our directors, officers and key employees. The stock plans are described more fully below.

Adoption of New Accounting Guidance and Transition

Prior to October 2, 2005, we accounted for these plans under the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations, (APB 25) as permitted by FASB Statement No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123). No compensation cost was recognized in the Statement of Earnings prior to October 2, 2005 related to stock option grants as they all had an exercise price equal to the market value of the underlying common stock on the date of grant. The restricted stock awards granted under those plans were measured at fair value, which was determined using the closing market value of the stock on the date of the grant, and amortized over the vesting period in tranches consistent with our previous accounting policy of recognizing expense for awards with graded vesting under the expense attribution method described in FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans* (FIN 28).

Effective October 2, 2005, we adopted the fair value recognition provisions of FASB Statement No. 123R, *Share-Based Payment*, and related interpretations (SFAS No. 123R) using the modified prospective transition method. Under that method, compensation cost recognized beginning in the first quarter of 2006 includes (a) compensation cost for all share-based payments granted prior to, but not yet vested as of, October 2, 2005 based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 and (b) compensation cost for all share-based payments granted on or subsequent to October 2, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R. Compensation cost related to stock awards granted prior to, but not vested as of, October 2, 2005 continues to be amortized using the expense attribution method described in FIN 28, while compensation cost associated with stock awards granted on or after October 2, 2005 is being recognized on a

straight-line basis over the requisite service period for the entire award in accordance with the provisions of SFAS No. 123R. Results for the prior periods have not been restated.

Prior to the adoption of SFAS No. 123R, we recognized compensation cost over the explicit service period for restricted stock awards subject to acceleration of vesting upon retirement. This policy has changed upon the adoption of SFAS No. 123R. For awards granted prior to the adoption of SFAS No. 123R, we continue to recognize compensation cost over the explicit service period and will accelerate any remaining unrecognized compensation cost when an employee actually retires. For awards granted or modified after the adoption of SFAS No. 123R and subject to acceleration of vesting upon retirement, compensation cost is recognized over a service period ending no later than the date the employee first becomes eligible for retirement. Had we recognized any remaining unrecognized compensation cost at the point when

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Note 8 Stock-Based Compensation (continued)

an employee became eligible for retirement, compensation cost would have decreased in the third quarter and nine months of 2006 by approximately \$0.2 million and \$0.7 million, respectively, and decreased by approximately \$0.3 million and increased by approximately \$0.4 million, respectively, in the third quarter and nine months of 2005. Prior to the adoption of SFAS No. 123R, we presented the tax benefit of deductions arising from the exercise of stock options as operating cash flows in the Condensed Consolidated Statement of Cash Flows. SFAS No. 123R requires that we classify the cash flows resulting from the tax benefit that arises when the tax deductions exceed the compensation cost recognized for those options (excess tax benefits) as financing cash flows. The excess tax benefits, which were less than \$0.1 million for the third quarter and approximately \$0.2 million for the nine months of 2006, would have been classified as an operating cash inflow if we had not adopted SFAS No. 123R.

Pro Forma Information Under SFAS No. 123 for Periods Prior to Fiscal 2006

The table below illustrates the effect on net earnings and earnings per share if we had applied the fair value recognition provisions of SFAS No. 123 to our stock-based compensation plans (Amounts are in millions, except shares and per share amounts):

| | Third Quarter 2005 | Nine Months Ended 2005 |
|--|-----------------------------------|---------------------------------------|
| Net loss, as reported: | \$ (20.8) | \$ (7.9) |
| Stock-based employee compensation expense, net of tax | 0.6 | 2.1 |
| Total stock-based employee compensation expense determined under the fair value method, net of tax | (0.8) | (2.6) |
| Pro forma net loss | \$ (21.0) | \$ (8.4) |
| Loss per share: | | |
| Basic as reported | \$ (0.28) | \$ (0.11) |
| Basic pro forma | (0.28) | (0.11) |
| Diluted as reported | \$ (0.27) | \$ (0.10) |
| Diluted pro forma | (0.27) | (0.11) |

For purposes of this disclosure, the fair value of the options is estimated using a Black-Scholes-Merton (BSM) option-pricing formula, applying the following assumptions:

The pro forma information above was determined using the Black-Scholes option-pricing model based on the following assumptions:

| | Third Quarter 2005 | Nine Months Ended 2005 |
|--------------------------|-----------------------------------|---------------------------------------|
| Expected term (in years) | 4.0 | 4.0 |
| Risk-free interest rate | 3.81% | 3.41% |
| Expected volatility | 58% | 58% |
| Expected dividend yield | 0% | 0% |

We estimated the expected term and expected volatility of the stock options based upon historical data of our share-based compensation plans. The weighted-average fair value of options granted during the third quarter and nine months of 2005 was \$4.36 and \$4.63, respectively. Forfeitures of share-based compensation were recognized as they occurred.

Valuation and Expense Information under SFAS No. 123R

The adoption of SFAS No. 123R had a negligible impact on our earnings before income taxes and net earnings for the third quarter and nine months of 2006. Accordingly, the adoption of SFAS No. 123R did not have an effect on earnings per share for the third quarter and nine months of 2006. We recorded compensation costs of \$1.2 million and \$3.5 million for the third quarter and nine months of 2006, respectively,

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Note 8 Stock-Based Compensation (continued)

and \$1.1 million and \$3.8 million for the third quarter and nine months of 2005, respectively. We recognized a tax benefit for share-based compensation arrangements of \$0.4 million and \$1.1 million in the third quarter and nine months of 2006, respectively, and \$0.4 million and \$1.2 million, respectively, for the third quarter and nine months of 2005, respectively.

As required by SFAS No. 123R, we now estimate forfeitures of employee stock options and recognize compensation cost only for those awards expected to vest. Forfeiture rates are determined for three groups of employees—directors, senior management and all other employees—based on historical experience. Estimated forfeitures are now adjusted to actual forfeiture experience as needed. The cumulative effect of adopting SFAS No. 123 of \$0.2 million, which represents estimated forfeitures for restricted stock awards outstanding at the date of adoption, was not material and therefore has been recorded as a reduction of our stock-based compensation costs in SG&A expense rather than displayed separately as a cumulative change in accounting principle in the Condensed Consolidated Statement of Earnings.

In connection with the adoption of SFAS No. 123R, we estimate the fair value of each stock option on the date of grant using a BSM option-pricing formula and amortize that value to expense over the option's vesting period using the straight-line attribution approach. The following are the weighted-average assumptions used to value grants for the nine months ended June 2006. There were no stock options issued in the third quarter of 2006.

| | Nine Months Ended 2006 |
|--------------------------|---------------------------------------|
| Expected term (in years) | 5.6 |
| Risk-free interest rate | 4.28% |
| Expected volatility | 72% |
| Expected dividend yield | 0% |

Expected Term: The expected term represents the period over which the share-based awards are expected to be outstanding. It has been determined using the shortcut method described in Staff Accounting Bulletin Topic 14.D.2, which is based on a calculation to arrive at the midpoint between the vesting date and the end of the contractual term.

Risk-Free Interest Rate: We based the risk-free interest rate used in our assumptions on the implied yield currently available on U.S. Treasury zero-coupon issues with a remaining term equivalent to the stock option award's expected term.

Expected Volatility: The volatility factor used in our assumptions is based on the historical price of our stock over the most recent period commensurate with the expected term of the stock option award.

Expected Dividend Yield: We do not intend to pay dividends on our common stock for the foreseeable future. Accordingly, we use a dividend yield of zero in our assumptions.

Incentive Stock Plans

We maintain incentive stock plans that provide for the grants of stock options and restricted stock awards to our directors, officers and key employees. As of June 30, 2006, there were 2,536,276 shares of common stock reserved for issuance under our stock plans. Under these stock plans, stock options must be granted at an option price equal to the closing market value of the stock on the date of the grant. Options granted under these plans, prior to October 2, 2005, become exercisable over four years in equal annual installments after the date of grant, with the exception of directors' options which cliff vest after six months, provided that the individual is continuously employed by our company. Options granted in the third quarter and nine months of 2006 become exercisable over three years in equal annual installments after the date of grant, with the exception of directors' options which cliff vest after six months, provided that the individual is continuously employed by our company. All options granted expire ten years from the date of

grant. We had authorization under our stock plans to grant 2,965,433 additional stock awards at June 30, 2006. At June 30, 2006 and 2005, respectively, we had 1,285,831 and 1,140,039 restricted shares of our common stock (restricted stock awards) outstanding. Restricted stock awards granted in the third quarter and nine months of 2006 vest ratably over three years. Restricted stock awards granted in fiscal 2005 either vest in annual increments over four years or at the end of three years. Restricted stock awards issued in prior years either vest in equal annual increments over four years or vest over seven years (either in thirds on the third year, fifth year and

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Note 8 Stock-Based Compensation (continued)

seventh year or solely at the end of the seventh year). There were no restricted stock awards granted during the third quarter of 2006. The weighted-average fair value of restricted stock awards granted during the nine months ended 2006 was \$8.25 per share. During the third quarter and nine months of 2005, the weighted-average fair value of restricted stock awards granted was \$8.75 and \$9.50 per share, respectively.

In order to better align our stock compensation plans with our human resource goals, we plan to rebalance future grant awards to favor restricted stock awards over stock option awards. We have a policy of issuing treasury shares to satisfy share option exercises as well as vesting of restricted stock awards.

A summary of option activity under our stock plans as of June 30, 2006 and the changes during the nine months of 2006 is presented below (Amounts are in millions, except shares and per share amounts):

| Options | Number of Options | Weighted- Average Exercise Price | Weighted- Average Remaining Contractual Term (years) | Aggregate Intrinsic Value |
|---|------------------------------|---|---|--|
| Outstanding at September 30, 2005 | 1,266,032 | \$5.37 | | |
| Granted | 53,250 | 8.31 | | |
| Exercised | (146,650) | 4.34 | | |
| Forfeited | (89,500) | 7.53 | | |
| Outstanding at June 30, 2006 | 1,083,132 | \$5.48 | 5.9 | \$3,702 |
| Vested or expected to vest at June 30, 2006 | 1,043,512 | \$5.47 | 5.9 | 3,580 |
| Exercisable at June 30, 2006 | 838,632 | \$5.35 | 5.5 | \$2,963 |

There were no stock options granted in the third quarter of 2006. The weighted-average fair value of stock options granted for the nine months ended 2006 was \$5.41. The total intrinsic value of stock options exercised was \$0.1 million and \$0.7 million during the third quarter and nine months ended 2006, respectively, and was less than \$0.1 million in the third quarter and \$0.1 million in the nine months ended 2005. As of June 30, 2006, there was \$0.5 million of total unrecognized compensation cost related to the stock options granted under our stock plans. That cost is expected to be recognized over a weighted-average period of 1.8 years.

A summary of the status of our restricted stock awards as of June 30, 2006 and changes during the first nine months of 2006 is presented below:

| | Number of Shares | Weighted- Average Fair Value at Grant Date |
|---------------------------------|-----------------------------|---|
| Nonvested at September 30, 2005 | 1,012,204 | \$ 9.41 |
| Granted | 479,571 | 8.25 |
| Vested | (154,204) | 9.79 |

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| | | |
|----------------------------|-----------|---------|
| Forfeited | (51,740) | 9.29 |
| Nonvested at June 30, 2006 | 1,285,831 | \$ 8.94 |

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Note 8 Stock-Based Compensation (continued)

As of June 30, 2006, there was \$5.4 million of total unrecognized compensation cost related to restricted stock awards granted under our stock plans. That cost is expected to be recognized over a weighted-average period of 2.1 years. The total fair value of restricted stock awards vested during the third quarter and nine months of 2006, based on the closing price on the vesting date, was \$0.2 million and \$1.4 million, respectively, and was \$0.5 million and \$1.6 million, respectively, during the third quarter and nine months of 2005. As announced on July 18, 2006, David H. Clarke will retire as Chief Executive Officer of the Company on August 31, 2006. He will also retire as Chairman and member of the Board of Directors effective September 30, 2006. We expect to record approximately \$2.0 million related to his separation agreement in the fourth quarter of fiscal 2006, of which approximately half is accelerated restricted stock vesting and the remainder is cash charges.

Note 9 Pension and Retirement Plans

We sponsor a number of non-contributory defined benefit pension plans and a number of defined contribution plans. Additionally, we provide other post-retirement benefits, such as health care and life insurance benefits, to certain groups of retirees, with most retirees contributing a portion of our costs.

The components of net periodic expense (income) for our defined benefit pension and other post-retirement benefit plans are as follows:

| | Pension Plans | | | |
|---|----------------------|-------------|--------------------------|-------------|
| | Third Quarter | | Nine Months Ended | |
| | 2006 | 2005 | 2006 | 2005 |
| Service cost | \$ 1.5 | \$ 2.1 | \$ 4.4 | \$ 6.2 |
| Interest cost | 6.0 | 5.8 | 17.8 | 17.3 |
| Expected return on plan assets | (9.0) | (8.9) | (27.1) | (26.5) |
| Amortization of prior service cost | 1.8 | 0.4 | 2.5 | 1.2 |
| Amortization of net actuarial loss | 2.0 | 1.5 | 6.2 | 4.3 |
| Curtailement/settlement | | 4.5 | 0.6 | 4.5 |
| Periodic expense of defined benefit plans including discontinued operations | 2.3 | 5.4 | 4.4 | 7.0 |
| Adjustment relating to prior years ⁽¹⁾ | 2.9 | | 2.9 | |
| Net reclassification adjustment for discontinued operations | | (2.9) | | (4.6) |
| Net periodic expense of: | | | | |
| Defined benefit plans | 5.2 | 2.5 | 7.3 | 2.4 |
| Defined contribution plans | 0.3 | 0.4 | 1.0 | 1.2 |
| Net periodic expense | \$ 5.5 | \$ 2.9 | \$ 8.3 | \$ 3.6 |

⁽¹⁾ As discussed in **Note 1**, we made an adjustment to pension expense

in the third
quarter of fiscal
2006 related to
several
employment
contracts, of
which
\$2.9 million
should have
been recorded in
prior years.

During the nine months ended 2006, we made an offer to certain retired or terminated vested participants in our defined benefit pension plans to pay them their future nonqualified benefits as a one-time lump sum payment, rather than in scheduled monthly payments. There were 27 participants who accepted the offer, resulting in a payment of \$3.0 million in benefits and a settlement charge of \$0.6 million, which is included in other income, net. Included in the third quarter and nine months ended 2005 are curtailment and settlement charges of \$4.5 million related to the sales of Rexair and Eljer.

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Note 9 Pension and Retirement Plans (continued)

| | Other Post-retirement Benefit Plans | | | |
|---|--|-------------|--------------------------|-------------|
| | Third Quarter | | Nine Months Ended | |
| | 2006 | 2005 | 2006 | 2005 |
| Service cost | \$ 0.1 | \$ 0.1 | \$ 0.3 | \$ 0.3 |
| Interest cost | 0.3 | 0.6 | 0.7 | 2.0 |
| Amortization of prior service cost | (0.3) | (0.8) | (0.8) | (2.4) |
| Amortization of net actuarial loss | | 0.8 | | 2.4 |
| Curtailment | | (0.4) | | (0.4) |
| Net periodic expense including discontinued operations | 0.1 | 0.3 | 0.2 | 1.9 |
| Net reclassification adjustment for discontinued operations | | (0.7) | | (2.1) |
| Net periodic expense (income) | \$ 0.1 | \$(0.4) | \$ 0.2 | \$(0.2) |

Included in the third quarter and nine months ended 2005 is a curtailment credit of \$0.4 million associated with the sale of Rexair.

Our funding policy is to contribute amounts to our pension plans sufficient to meet the minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974 or U.K. law and pension regulations, plus such additional amounts as we may determine to be appropriate from time to time. During the nine months ended fiscal 2006, we contributed \$2.8 million to our foreign pension plans and expect to contribute another \$1 million to our foreign pension plans during the remainder of fiscal 2006.

Note 10 Restructuring and Other Charges

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

| | Lease and Contract-Related Costs | Severance and Related Costs | Total Costs |
|-----------------------|---|--|------------------------|
| At September 30, 2005 | \$ 1.7 | \$ 2.1 | \$ 3.8 |
| Cash charges | 0.1 | 3.2 | 3.3 |
| Cash payments | (1.1) | (3.9) | (5.0) |
| Other | 0.5 | | 0.5 |
| At June 30, 2006 | \$ 1.2 | \$ 1.4 | \$ 2.6 |

We recorded restructuring and other charges of \$1.3 million during the third quarter which largely consisted of \$0.6 million in accelerated depreciation, recorded in cost of goods sold, and \$0.5 million in severance recorded in restructuring, related to the previously announced consolidation of the Bradford, U.K. ceramics plant and other U.K. staffing and overhead reductions. The remaining restructuring charges of \$0.2 million primarily related to staffing and overhead reductions in the domestic spa operations. We expect to record \$0.6 million in accelerated depreciation in cost of goods sold and \$0.6 million in cash restructuring charges over the remainder of fiscal 2006 related to the

Bradford ceramics plant consolidation. Approximately 100 employees will be affected by this action. We are reviewing a number of further U.K. and other profit improvement initiatives.

Restructuring and other charges for the nine months ended 2006 of \$4.5 million included charges for the plant consolidation and staff reductions in the U.K., the closure of our Asia office, and the continued implementation of other domestic overhead reductions. Restructuring and other charges related to the U.K. initiatives were \$2.7 million, of which \$1.2 million, related to inventory write-downs and accelerated depreciation and was recorded in cost of goods sold. The remaining \$1.5 million was recorded as restructuring and consisted of severance and other cash related charges. We incurred severance and lease related charges of \$0.6 million in the first quarter of 2006 with the closure of the Asia office and 11 employees were terminated.

Approximately \$2.3 million of the accrued restructuring costs at June 30, 2006 are included in the balance sheet caption Accrued expenses and other current liabilities, while the remaining \$0.3 million are recorded in the balance sheet caption Other non-current liabilities. We expect the remaining accruals to be paid with cash over the next two years as provided by the severance and lease agreements.

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Note 11 Discontinued Operations

On April 15, 2005, our Board of Directors adopted a plan to dispose of our investment in Spear & Jackson, (SJ), and on May 20, 2005, our Board of Directors approved a plan to dispose of Eljer. In the third quarter of fiscal 2005, we completed the sale of substantially all the assets, the current liabilities, the long-term retiree medical liability and certain other liabilities of Eljer. The sale of Eljer resulted in a loss of \$56.0 million, net of tax, recorded in the third quarter of 2005. Eljer's operations were included in our Bath Products segment prior to its sale being classified as a discontinued operation.

During the fourth quarter of 2006, we sold all of our shares of common stock of SJ to United Pacific Industries Limited for a purchase price of approximately \$5.0 million. We expect to record total income of approximately \$4.0 million in the fourth quarter of fiscal 2006 from the operation and sale of SJ. Two of our directors are also directors and significant stockholders of the purchaser. The transaction was considered and approved by a committee of independent directors, without participation by the interested directors. For further information, see our Reports on Form 8-K filed March 27, 2006 and July 28, 2006.

Both Eljer and SJ qualified for treatment as discontinued operations in accordance with FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS No. 144). Therefore, the operating results of these discontinued operations were not included in our results from continuing operations. Instead, the results were recorded as a loss from discontinued operations.

Summarized results of the discontinued operations are as follows:

| | Third Quarter | | Nine Months Ended | |
|-----------------------------------|----------------------|-------------|--------------------------|-------------|
| | 2006 | 2005 | 2006 | 2005 |
| Net sales | \$24.6 | \$ 35.7 | \$75.1 | \$104.9 |
| Operating loss | (2.7) | (5.4) | (6.9) | (8.4) |
| Loss from discontinued operations | (2.9) | (58.7) | (7.3) | (61.0) |

The assets and liabilities of discontinued operations are included in assets held for sale and liabilities associated with assets held for sale, respectively, until they are sold. The major classes of assets and liabilities classified as held for sale are as follows:

| | June 30, | September |
|------------------------------------|-----------------|------------------|
| | 2006 | 30, |
| Cash | \$ 6.3 | \$ 7.3 |
| Trade receivables, net | 17.1 | 16.4 |
| Inventories | 24.0 | 25.0 |
| Other current assets | 1.4 | 1.3 |
| Deferred taxes | 16.6 | 15.3 |
| Property, plant and equipment, net | 3.6 | 4.2 |
| Other non-current assets | 0.4 | 0.2 |
| Assets held for sale | \$69.4 | \$ 69.7 |
| Notes payable | \$ | \$ 0.8 |
| Trade accounts payable | 8.6 | 8.1 |
| Other current liabilities | 12.8 | 11.3 |

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| | | |
|--|--------|---------|
| Other non-current liabilities | 42.1 | 36.7 |
| Minority interest | 7.6 | 10.0 |
| Liabilities associated with assets held for sale | \$71.1 | \$ 66.9 |

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Note 11 Discontinued Operations (continued)

Also, included in assets held for sale under the classification of property, plant and equipment are properties held for sale of \$1.8 million at June 30, 2006 and \$2.8 million at September 30, 2005. These properties are currently being marketed for sale and meet all of the criteria for classification as held for sale at June 30, 2006 as required by SFAS No. 144. These properties are recorded at the lower of their carrying value or fair value less costs to sell.

Pension Plan

SJ operates a contributory defined benefit pension plan (The Plan) covering certain of its employees in its U.K. based subsidiaries. The benefits covered by the Plan are based on years of service and compensation history. Plan assets are primarily invested in equities, fixed income securities and government securities.

Pension costs amounted to \$2.1 million and \$6.2 million for the third quarter and nine months ended 2006, respectively, and \$1.0 million and \$3.0 million for the third quarter and nine months ended 2005, respectively. The net periodic costs include the following components:

| | Third Quarter | | Nine Months Ended | |
|--------------------------------|----------------------|-------------|--------------------------|-------------|
| | 2006 | 2005 | 2006 | 2005 |
| Service cost | \$ 0.6 | \$ 0.5 | \$ 1.6 | \$ 1.4 |
| Interest cost | 2.7 | 2.5 | 7.9 | 7.6 |
| Expected return on plan assets | (2.6) | (2.7) | (7.5) | (8.0) |
| Recognition of actuarial loss | 1.4 | 0.7 | 4.2 | 2.0 |
| Net periodic expense | \$ 2.1 | \$ 1.0 | \$ 6.2 | \$ 3.0 |

SJ's funding policy with respect to the Plan is to contribute annually not less than the minimum required by applicable U.K. law and pension regulations. Amounts payable are determined on the advice of the Plan's actuaries. SJ contributed \$2.6 million to the Plan in the nine months ended 2006 and anticipates that contributions will total \$3.3 million during fiscal 2006.

Our share of SJ's pension benefit cost is included in loss from discontinued operations, and our share of SJ's minimum pension liability is included in accumulated other comprehensive earnings.

Note 12 Income Taxes

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

| | Nine Months Ended | |
|--|--------------------------|-------------|
| | 2006 | 2005 |
| Federal Tax Provision computed at the statutory rate | 35.0% | 35.0% |
| Foreign tax differential | 2.7% | 2.5% |
| State income taxes (net of Federal benefit) | 3.1% | 3.0% |
| Valuation allowance for UK deferred tax assets | 24.2% | 0.0% |
| Resolution of tax contingencies | | -11.8% |
| Rexair Disposition | | -18.5% |
| Other valuation allowances | 2.1% | 2.1% |
| Other, net | 2.3% | 1.8% |
| | 69.4% | 14.1% |

The tax provision for the nine months ended 2006 includes a non-cash charge of \$14.4 million associated with the establishment of a valuation allowance for all the deferred tax assets of our U.K. operations. We recorded the valuation allowance for the UK deferred tax assets because of losses expected to be incurred in the two year period ended fiscal 2006. The nine months ended 2005 includes \$7.3 million in tax benefits as a result of favorable settlements of federal income tax audits. No taxes were recorded on the Rexair gain because it resulted in a capital loss for tax purposes.

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JACUZZI BRANDS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions unless otherwise noted)
(unaudited)

Note 12 Income Taxes (continued)

We have appealed various issues relating to the Federal audit of our U.S. consolidated returns for 1998 through 2002. We have recorded reserves that are adequate to cover any assessment if our appeals are rejected. In addition, several states and various other countries have examinations either in the planning stages or currently underway.

Note 13 Segment Data

We manufacture and distribute a broad range of consumer and industrial products through our operating subsidiaries in two business segments Bath Products and Plumbing Products. Our Bath Products segment manufactures whirlpool baths, spas, showers, sanitary ware, including sinks and toilets, and bathtubs for the construction and remodeling markets. Our Plumbing Products segment manufactures professional grade drainage, water control, commercial brass and PEX piping products primarily for the commercial and institutional construction, renovation and facilities maintenance markets. Our results in fiscal 2005 included the Rexair segment, which was sold on June 30, 2005. The following is a summary of the significant accounts and balances by segment, reconciled to the consolidated totals.

| | | Bath Products | Plumbing Products | Rexair | Corporate and Other | Consolidated Total |
|---|------|--------------------------|------------------------------|---------------|--------------------------------|-------------------------------|
| Net Sales | | | | | | |
| Third Quarter | 2006 | \$210.6 | \$122.0 | \$ | \$ | \$ 332.6 |
| | 2005 | 213.3 | 96.2 | 24.7 | | 334.2 |
| Nine Months | 2006 | \$573.0 | \$315.9 | \$ | \$ | \$ 888.9 |
| | 2005 | 585.5 | 255.1 | 76.1 | | 916.7 |
| Total Operating Income (Loss) | | | | | | |
| Third Quarter | 2006 | \$ 14.8 | \$ 27.4 | \$ | \$ (8.6) | \$ 33.6 |
| | 2005 | 12.4 | 20.7 | 6.5 | (5.6) | 34.0 |
| Nine Months | 2006 | \$ 28.7 | \$ 65.5 | \$ | \$ (17.9) | \$ 76.3 |
| | 2005 | 23.2 | 51.2 | 19.0 | (16.1) | 77.3 |
| Capital Expenditures | | | | | | |
| Third Quarter | 2006 | \$ 2.4 | \$ 0.6 | \$ | \$ | \$ 3.0 |
| | 2005 | 6.1 | 0.7 | 0.2 | 0.1 | 7.1 |
| Nine Months | 2006 | \$ 5.1 | \$ 3.1 | \$ | \$ | \$ 8.2 |
| | 2005 | 14.8 | 2.9 | 0.4 | 0.3 | 18.4 |
| Depreciation and Amortization | | | | | | |
| Third Quarter | 2006 | \$ 4.4 | \$ 1.0 | \$ | \$ 0.5 | \$ 5.9 |
| | 2005 | 3.6 | 1.2 | 0.7 | 0.7 | 6.2 |
| Nine Months | 2006 | \$ 13.0 | \$ 3.3 | \$ | \$ 1.4 | \$ 17.7 |
| | 2005 | 10.8 | 3.9 | 2.3 | 2.6 | 19.6 |
| Restructuring and Other Charges Included in Operating Income (Loss) ⁽¹⁾ | | | | | | |
| Third Quarter | 2006 | \$ 1.3 | \$ | \$ | \$ | \$ 1.3 |
| | 2005 | 1.4 | | | | 1.4 |
| Nine Months | 2006 | \$ 4.3 | \$ | \$ | \$ 0.2 | \$ 4.5 |
| | 2005 | 3.6 | | | | 3.6 |

Assets

| | | | | | |
|--------------------------|---------|---------|----|---------|-----------|
| As of June 30, 2006 | \$477.8 | \$326.1 | \$ | \$518.9 | \$1,322.8 |
| As of September 30, 2005 | 480.9 | 295.6 | | 513.0 | 1,289.5 |

(1) The third quarter and year to date period of fiscal 2006 includes \$0.6 million and \$1.2 million, respectively, of inventory write-downs and accelerated depreciation in cost of goods sold associated with the Bradford, U.K. consolidation.

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JACUZZI BRANDS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions unless otherwise noted)
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Note 14 Supplemental Joint Issuer and Guarantor Financial Information

The following represents the supplemental consolidating condensed financial statements of Jacuzzi Brands, Inc. (JBI), which is the issuer of our Senior Notes, the subsidiaries which are guarantors of the Senior Notes and our subsidiaries which are not guarantors of the Senior Notes as of June 30, 2006 and September 30, 2005 and for each of the three and nine months ended June 30, 2006 and 2005. Certain of our existing and future domestic restricted subsidiaries guarantee the Senior Notes, jointly and severally, on a senior basis. The Senior Notes are secured by a first-priority lien on and security interest in substantially all of our domestic real property, plant and equipment (referred to as Notes Collateral). The Senior Notes are also secured by a second-priority lien on and security interest in the Bank Collateral (see our 2005 Annual Report on Form 10-K, filed on December 15, 2005). Separate consolidated financial statements of each guarantor are not presented, as we have determined that they would not be material to investors.

| | JBI | For the Three Months Ended June 30, 2006 | | Eliminations | Consolidated |
|---|------------|---|--|---------------------|---------------------|
| | | Combined Guarantor Subsidiaries | Combined Non-Guarantor Subsidiaries | | |
| Net sales | \$ | \$248.7 | \$ 88.4 | \$ (4.5) | \$ 332.6 |
| Operating costs and expenses: | | | | | |
| Cost of products sold | | 166.9 | 63.2 | (4.5) | 225.6 |
| Selling, general and administrative expenses | 8.5 | 43.2 | 21.0 | | 72.7 |
| Restructuring charges | (0.1) | 0.2 | 0.6 | | 0.7 |
| Operating income (loss) | (8.4) | 38.4 | 3.6 | | 33.6 |
| Interest expense | (10.3) | (0.1) | (0.1) | | (10.5) |
| Interest income | 1.0 | 0.1 | 0.1 | | 1.2 |
| Intercompany interest (expense) income, net | (8.8) | 7.5 | 1.3 | | |
| Equity in earnings (losses) of investees, net | 9.3 | 2.3 | | (11.6) | |
| Rexair equity earnings | | 0.8 | | | 0.8 |
| Other (expense) income, net | (0.4) | (0.5) | 0.2 | | (0.7) |
| Other intercompany income (expense), net | 6.6 | (5.4) | (1.2) | | |
| (Loss) earnings before income taxes and discontinued operations | (11.0) | 43.1 | 3.9 | (11.6) | 24.4 |
| Benefit from (provision for) income taxes | 10.0 | (33.8) | (1.6) | | (25.4) |
| (Loss) income from continuing operations | (1.0) | 9.3 | 2.3 | (11.6) | (1.0) |
| (Loss) income from discontinued operations | (2.9) | (2.9) | | 2.9 | (2.9) |
| Net (loss) earnings | \$ (3.9) | \$ 6.4 | \$ 2.3 | \$ (8.7) | \$ (3.9) |

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JACUZZI BRANDS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions unless otherwise noted)
(unaudited)

Note 14 Supplemental Joint Issuer and Guarantor Financial Information (continued)

| | JBI | For the Three Months Ended June 30, 2005 | | | Consolidated |
|---|------------|---|--|---------------------|---------------------|
| | | Combined Guarantor Subsidiaries | Combined Non-Guarantor Subsidiaries | Eliminations | |
| Net sales | \$ | \$244.0 | \$ 94.1 | \$ (3.9) | \$ 334.2 |
| Operating costs and expenses: | | | | | |
| Cost of products sold | | 161.1 | 66.3 | (3.9) | 223.5 |
| Selling, general and administrative expenses | 5.5 | 47.3 | 22.5 | | 75.3 |
| Restructuring charges | | 0.8 | 0.6 | | 1.4 |
| Operating (loss) income | (5.5) | 34.8 | 4.7 | | 34.0 |
| Interest expense | (11.9) | (0.2) | (0.3) | | (12.4) |
| Interest income | 0.1 | | 0.2 | | 0.3 |
| Intercompany interest (expense) income, net | (4.0) | 3.7 | 0.3 | | |
| Equity in earnings (losses) of investees, net | 76.2 | 2.9 | | (79.1) | |
| Gain on sale of business | | 25.8 | | | 25.8 |
| Other (expense) income, net | (4.3) | (0.8) | (0.8) | | (5.9) |
| Other intercompany (expense) income, net | (35.2) | 34.4 | 0.8 | | |
| Earnings (loss) before income taxes and discontinued operations | 15.4 | 100.6 | 4.9 | (79.1) | 41.8 |
| Benefit from (provision for) income taxes | 22.5 | (24.4) | (2.0) | | (3.9) |
| Earnings (loss) from continuing operations | 37.9 | 76.2 | 2.9 | (79.1) | 37.9 |
| (Loss) income from discontinued operations | (58.7) | (58.7) | | 58.7 | (58.7) |
| Net (loss) earnings | \$(20.8) | \$ 17.5 | \$ 2.9 | \$ (20.4) | \$ (20.8) |

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JACUZZI BRANDS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions unless otherwise noted)
(unaudited)

Note 14 Supplemental Joint Issuer and Guarantor Financial Information (continued)

| | For the Nine Months Ended June 30, 2006 | | | | |
|---|--|--|--|---------------------|---------------------|
| | JBI | Combined Guarantor Subsidiaries | Combined Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| Net sales | \$ | \$ 648.7 | \$ 249.9 | \$ (9.7) | \$ 888.9 |
| Operating costs and expenses: | | | | | |
| Cost of products sold | | 439.0 | 179.6 | (9.7) | 608.9 |
| Selling, general and administrative expenses | 17.2 | 123.3 | 59.9 | | 200.4 |
| Restructuring charges | 0.2 | 0.7 | 2.4 | | 3.3 |
| Operating (loss) income | (17.4) | 85.7 | 8.0 | | 76.3 |
| Interest expense | (30.4) | (0.4) | (0.7) | | (31.5) |
| Interest income | 2.8 | 0.3 | 0.7 | | 3.8 |
| Intercompany interest (expense) income, net | (23.6) | 21.5 | 2.1 | | |
| Equity in earnings (losses) of investees, net | 45.1 | 4.8 | | (49.9) | |
| Rexair equity earnings | | 2.5 | | | 2.5 |
| Other (expense) income, net | (1.0) | 10.8 | (1.4) | | 8.4 |
| Other intercompany income (expense), net | 20.4 | (19.7) | (0.7) | | |
| (Loss) earnings before income taxes and discontinued operations | (4.1) | 105.5 | 8.0 | (49.9) | 59.5 |
| Benefit from (provision for) income taxes | 22.3 | (60.4) | (3.2) | | (41.3) |
| Earnings (loss) from continuing operations | 18.2 | 45.1 | 4.8 | (49.9) | 18.2 |
| (Loss) earnings from discontinued operations | (7.3) | (7.4) | | 7.4 | (7.3) |
| Net earnings (loss) | \$ 10.9 | \$ 37.7 | \$ 4.8 | \$ (42.5) | \$ 10.9 |

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JACUZZI BRANDS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions unless otherwise noted)
(unaudited)

Note 14 Supplemental Joint Issuer and Guarantor Financial Information (continued)

| | For the Nine Months Ended June 30, 2005 | | | | |
|---|--|--|--|---------------------|---------------------|
| | JBI | Combined Guarantor Subsidiaries | Combined Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| Net sales | \$ | \$ 645.1 | \$ 282.3 | \$ (10.7) | \$ 916.7 |
| Operating costs and expenses: | | | | | |
| Cost of products sold | | 431.8 | 200.1 | (10.7) | 621.2 |
| Selling, general and administrative expenses | 15.5 | 136.2 | 62.9 | | 214.6 |
| Restructuring charges | | 3.0 | 0.6 | | 3.6 |
| Operating (loss) income | (15.5) | 74.1 | 18.7 | | 77.3 |
| Interest expense | (35.6) | (0.5) | (0.8) | | (36.9) |
| Interest income | 0.1 | 0.4 | 1.0 | | 1.5 |
| Intercompany interest (expense) income, net | (11.5) | 11.0 | 0.5 | | |
| Equity in earnings (losses) of investees, net | 108.6 | 11.8 | | (120.4) | |
| Gain on sale of Rexair | | 25.8 | | | 25.8 |
| Other (expense) income, net | (4.9) | (1.4) | 0.4 | | (5.9) |
| Other intercompany (expense) income, net | (20.7) | 20.6 | 0.1 | | |
| Earnings (loss) before income taxes and discontinued operations | 20.5 | 141.8 | 19.9 | (120.4) | 61.8 |
| Benefit from (provision for) income taxes | 32.6 | (33.2) | (8.1) | | (8.7) |
| Earnings (loss) from continuing operations | 53.1 | 108.6 | 11.8 | (120.4) | 53.1 |
| (Loss) earnings from discontinued operations | (61.0) | (61.0) | | 61.0 | (61.0) |
| Net (loss) earnings | \$ (7.9) | \$ 47.6 | \$ 11.8 | \$ (59.4) | \$ (7.9) |

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JACUZZI BRANDS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions unless otherwise noted)
(unaudited)

Note 14 Supplemental Joint Issuer and Guarantor Financial Information (continued)

| | At June 30, 2006 | | | | |
|--|------------------|---------------------------------------|---|--------------|--------------|
| | JBI | Combined Guarantor Subsidiaries | Combined Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| ASSETS | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | \$ 84.0 | \$ (8.0) | \$ 32.9 | \$ | \$ 108.9 |
| Trade receivables, net | | 132.0 | 87.3 | | 219.3 |
| Inventories | | 134.3 | 56.9 | | 191.2 |
| Deferred income taxes | 3.0 | 19.7 | 5.9 | | 28.6 |
| Assets held for sale | | 0.8 | 68.6 | | 69.4 |
| Prepaid expenses and other current assets | 5.6 | 7.0 | 10.8 | | 23.4 |
| Total current assets | 92.6 | 285.8 | 262.4 | | 640.8 |
| Restricted cash | | | | | |
| Property, plant and equipment, net | 1.0 | 45.5 | 52.5 | | 99.0 |
| Pension assets | 148.8 | 1.0 | | | 149.8 |
| Insurance for asbestos claims | | 153.0 | | | 153.0 |
| Goodwill | | 176.7 | 54.0 | | 230.7 |
| Other non-current assets | 29.1 | 20.1 | 0.3 | | 49.5 |
| Investment in subsidiaries/ Intercompany receivable (payable), net | 546.6 | 962.8 | 185.3 | (1,694.7) | |
| Total assets | \$818.1 | \$1,644.9 | \$ 554.5 | \$(1,694.7) | \$1,322.8 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | | |
| Current liabilities: | | | | | |
| Notes payable | \$ | \$ | \$ 18.6 | \$ | \$ 18.6 |
| Current maturities of long-term debt | | 1.7 | | | 1.7 |
| Trade accounts payable | | 56.9 | 53.0 | | 109.9 |
| Income taxes payable | 28.1 | 3.6 | 2.9 | | 34.6 |
| Liabilities associated with assets held for sale | | | 71.1 | | 71.1 |
| Accrued expenses and other current liabilities | 21.2 | 53.9 | 29.7 | | 104.8 |

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| | | | | | |
|--|---------|-----------|----------|-------------|-----------|
| Total current liabilities | 49.3 | 116.1 | 175.3 | | 340.7 |
| Long-term debt | 380.0 | 1.8 | | | 381.8 |
| Deferred income taxes | 36.9 | (15.0) | (4.3) | | 17.6 |
| Asbestos claims | | 153.0 | | | 153.0 |
| Other non-current liabilities | 43.0 | 47.7 | 30.1 | | 120.8 |
| | | | | | |
| Total liabilities | 509.2 | 303.6 | 201.1 | | 1,013.9 |
| Stockholders' equity | 308.9 | 1,341.3 | 353.4 | (1,694.7) | 308.9 |
| | | | | | |
| Total liabilities and stockholders' equity | \$818.1 | \$1,644.9 | \$ 554.5 | \$(1,694.7) | \$1,322.8 |

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JACUZZI BRANDS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions unless otherwise noted)
(unaudited)

Note 14 Supplemental Joint Issuer and Guarantor Financial Information (continued)

| | At September 30, 2005 | | | | Consolidated |
|--|-----------------------|---------------------------------------|---|--------------|--------------|
| | JBI | Combined Guarantor Subsidiaries | Combined Non-Guarantor Subsidiaries | Eliminations | |
| ASSETS | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | \$ 84.1 | \$ (7.0) | \$ 33.1 | \$ | \$ 110.2 |
| Trade receivables, net | | 118.9 | 81.6 | | 200.5 |
| Inventories | | 116.9 | 48.1 | | 165.0 |
| Deferred income taxes | 7.9 | 19.4 | 0.6 | | 27.9 |
| Assets held for sale | | 1.8 | 67.9 | | 69.7 |
| Prepaid expenses and other current assets | 4.4 | 5.9 | 12.3 | | 22.6 |
| Total current assets | 96.4 | 255.9 | 243.6 | | 595.9 |
| Restricted cash | 12.4 | | | | 12.4 |
| Property, plant and equipment, net | 1.2 | 50.5 | 52.0 | | 103.7 |
| Pension assets | 146.8 | 1.0 | | | 147.8 |
| Insurance for asbestos claims | | 153.0 | | | 153.0 |
| Goodwill | | 176.7 | 51.5 | | 228.2 |
| Other non-current assets | 30.6 | 17.6 | 0.3 | | 48.5 |
| Investment in subsidiaries/ Intercompany receivable (payable), net | 475.7 | 985.2 | 180.7 | (1,641.6) | |
| Total assets | \$763.1 | \$1,639.9 | \$ 528.1 | \$(1,641.6) | \$1,289.5 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | | |
| Current liabilities: | | | | | |
| Notes payable | \$ | \$ | \$ 22.0 | \$ | \$ 22.0 |
| Current maturities of long-term debt | | 1.5 | | | 1.5 |
| Trade accounts payable | 0.3 | 58.0 | 47.4 | | 105.7 |
| Income taxes payable | 19.3 | 6.0 | (0.6) | | 24.7 |
| Liabilities associated with assets held for sale | | | 66.9 | | 66.9 |
| Accrued expenses and other current liabilities | 17.9 | 63.9 | 32.6 | | 114.4 |
| Total current liabilities | 37.5 | 129.4 | 168.3 | | 335.2 |

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| | | | | | |
|--|---------|-----------|----------|-------------|-----------|
| Long-term debt | 380.0 | 3.5 | | | 383.5 |
| Deferred income taxes | 17.4 | (1.2) | (10.6) | | 5.6 |
| Asbestos claims | | 153.0 | | | 153.0 |
| Other non-current liabilities | 43.0 | 55.8 | 28.2 | | 127.0 |
| Total liabilities | 477.9 | 340.5 | 185.9 | | 1,004.3 |
| Stockholders' equity | 285.2 | 1,299.4 | 342.2 | (1,641.6) | 285.2 |
| Total liabilities and stockholders' equity | \$763.1 | \$1,639.9 | \$ 528.1 | \$(1,641.6) | \$1,289.5 |

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JACUZZI BRANDS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions unless otherwise noted)
(unaudited)

Note 14 Supplemental Joint Issuer and Guarantor Financial Information (continued)

| | For the Nine Months Ended June, 2006 | | | | Consolidated |
|--|---|--|--|---------------------|---------------------|
| | JBI | Combined Guarantor Subsidiaries | Combined Non-Guarantor Subsidiaries | Eliminations | |
| NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES | \$(12.3) | \$(19.9) | \$ 19.1 | \$ | \$ (13.1) |
| INVESTING ACTIVITIES: | | | | | |
| Purchases of property, plant and equipment | | (4.8) | (3.4) | | (8.2) |
| Proceeds from sale of fixed assets | | 0.2 | | | 0.2 |
| Proceeds from sale of excess real estate | | 10.9 | | | 10.9 |
| Net transfers with subsidiaries | (4.2) | 12.4 | | (8.2) | |
| Net cash (used in) provided by investing activities of continuing operations | (4.2) | 18.7 | (3.4) | (8.2) | 2.9 |
| Investing activities of discontinued operations | | | (1.4) | | (1.4) |
| NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES | (4.2) | 18.7 | (4.8) | (8.2) | 1.5 |
| FINANCING ACTIVITIES: | | | | | |
| Repayment of long-term debt | | (1.5) | | | (1.5) |
| Excess Tax Benefits from Share based payment | 0.2 | | | | 0.2 |
| Deposits into restricted cash collateral accounts | 12.8 | | | | 12.8 |
| Proceeds from stock option exercises | 0.7 | | | | 0.7 |
| (Decrease) increase in notes payable, net | | | (4.4) | | (4.4) |
| Net transfers with parent | | 4.2 | (12.4) | 8.2 | |
| Net cash provided by (used in) financing activities of continuing operations | 13.7 | 2.7 | (16.8) | 8.2 | 7.8 |
| Financing activities of discontinued operations | | (0.1) | (0.1) | | (0.2) |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | 13.7 | 2.6 | (16.9) | 8.2 | 7.6 |

| | | | | |
|--|---------|----------|---------|----------|
| Effect of exchange rate changes on cash and cash equivalents | 2.7 | (2.4) | 2.4 | 2.7 |
| DECREASE IN CASH AND CASH EQUIVALENTS | (0.1) | (1.0) | (0.2) | (1.3) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 84.1 | (7.0) | 33.1 | 110.2 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 84.0 | \$ (8.0) | \$ 32.9 | \$ 108.9 |

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JACUZZI BRANDS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in millions unless otherwise noted)
(unaudited)

Note 14 Supplemental Joint Issuer and Guarantor Financial Information (continued)

| | For the Nine Months Ended June, 2005 | | | | |
|--|---|--|--|---------------------|---------------------|
| | JBI | Combined Guarantor Subsidiaries | Combined Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES | \$ (59.7) | \$ 33.2 | \$ 9.1 | \$ | \$ (17.4) |
| INVESTING ACTIVITIES: | | | | | |
| Proceeds from sale of businesses, net | | 140.7 | | | 140.7 |
| Purchases of property, plant and equipment | (0.3) | (11.2) | (6.8) | | (18.3) |
| Proceeds from sale of excess real estate and other non-operating assets | | 7.1 | | | 7.1 |
| Proceeds from sale of fixed assets | | 0.2 | | | 0.2 |
| Net transfers with subsidiaries | 190.3 | 15.5 | | (205.8) | |
| Net cash (used in) provided by investing activities of continuing operations | 190.0 | 152.3 | (6.8) | (205.8) | 129.7 |
| Investing activities of discontinued operations | | (0.1) | (0.3) | | (0.4) |
| NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES | 190.0 | 152.2 | (7.1) | (205.8) | 129.3 |
| FINANCING ACTIVITIES: | | | | | |
| Proceeds from long-term debt | 59.1 | | | | 59.1 |
| Repayment of long-term debt | (123.4) | (1.4) | | | (124.8) |
| Payment of financing fees | (1.0) | | | | (1.0) |
| Deposits into restricted cash collateral accounts | (12.4) | | | | (12.4) |
| Payments for stock option exchange | (0.2) | | | | (0.2) |
| Proceeds from stock option exercises | 0.2 | | | | 0.2 |
| Decrease in notes payable, net | | | (2.9) | | (2.9) |
| Net transfers with parent | | (190.3) | (15.5) | 205.8 | |
| Net cash (used in) provided by financing activities of continuing | (77.7) | (191.7) | (18.4) | 205.8 | (82.0) |

| | | | | | |
|--|---------|----------|---------|-------|---------|
| operations | | | | | |
| Financing activities of discontinued operations | | | (0.1) | | (0.1) |
| NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES | (77.7) | (191.7) | (18.5) | 205.8 | (82.1) |
| Effect of exchange rate changes on cash and cash equivalents | (1.7) | 0.8 | 0.7 | | (0.2) |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 50.9 | (5.5) | (15.8) | | 29.6 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 0.9 | 1.0 | 37.7 | | 39.6 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 51.8 | \$ (4.5) | \$ 21.9 | \$ | \$ 69.2 |

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
(Tabular amounts in millions)****Disclosure Concerning Forward-Looking Statements**

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

This Quarterly Report on Form 10-Q contains both historical information and other information. While we have specifically identified certain information as being forward-looking in the context of its presentation, we caution the reader that, with the exception of information that is clearly historical, all the information contained in this Quarterly Report on Form 10-Q should be considered to be forward-looking statements as referred to in the Reform Act. Without limitation, when we use the words believe, estimate, plan, expect, intend, anticipate, continue, probably, should, will and similar expressions, we intend to clearly express that the information deals with possible future events and is forward-looking in nature.

Forward-looking information involves risks and uncertainties. This information is based on various factors and assumptions about future events that may or may not actually come true. As a result, our operations and financial results in the future could differ substantially from those we have discussed in the forward-looking statements in this Quarterly Report and other documents that have been filed or furnished with the Securities and Exchange Commission. In particular, various economic and competitive factors, including those outside our control, such as interest rates, foreign currency exchange rates, inflation rates, instability in domestic and foreign financial markets, acts of war, terrorist acts, outbreak of new diseases, consumer spending patterns, energy costs and availability, freight costs, availability of consumer and commercial credit, adverse weather, levels of residential and commercial construction, changes in raw material and component costs and the creditworthiness of our customers, insurers and investees, could cause our actual results during the remainder of fiscal 2006 and in future years to differ materially from those expressed in any forward-looking statement made in this Quarterly Report on Form 10-Q. In addition, under the heading Critical Accounting Policies and Estimates in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K, we describe various estimates and assumptions that we make that affect the reported amounts of assets, liabilities, sales and expenses as well as the disclosure of contingent assets and liabilities. Future revisions to these estimates and assumptions may cause these amounts, when reported, to differ materially from those expressed in any forward-looking statement made in this Quarterly Report on Form 10-Q, particularly with respect to statements relating to pension and other post-retirement benefits, asbestos liabilities, self-insurance reserves, inventories and trade receivables. All subsequent written and oral forward-looking statements attributable to Jacuzzi Brands, Inc. and our subsidiaries are expressly qualified in their entirety by the foregoing factors.

Overview

We are a leading global producer of branded bath and plumbing products for the residential, commercial and institutional markets. We manufacture and distribute a broad range of products through our operating subsidiaries in two business segments Bath Products and Plumbing Products. Our Bath Products segment manufactures whirlpool baths, spas, showers, sanitary ware, including sinks and toilets, and bathtubs for the construction and remodeling markets. Our Plumbing Products segment manufactures professional grade drainage, water control, commercial brass and PEX piping products primarily for the commercial and institutional construction, renovation and facilities maintenance markets. In fiscal 2005, results of operations were reported in three business segments, consisting of the Bath Products segment, the Plumbing Products segment and the Rexair segment, which was sold on June 30, 2005. Demand for our products is primarily driven by remodeling, new home starts, and commercial construction activity. Accordingly, many external factors affect our business including weather and the impact of the broader economy on our end markets. Weather is an important variable for us as it significantly impacts construction. Spring and summer months in the U.S. and Europe represent the main construction season for remodeling and new housing starts as well as increased construction in the commercial and institutional markets. As a result, sales in our Bath Products and

Plumbing Products segments are generally higher in the third and fourth fiscal quarters as compared to the first two quarters of our fiscal year. The autumn and winter months generally impede construction and installation activity. Remodeling expenditures, housing starts, residential re-sales and consumer spending have a major impact on the consumer-focused bath and spa businesses of our Bath Products segment. The Bath Products segment generates the majority of its sales in the remodeling markets and residential construction. We believe that worldwide macro-economic and demographic factors such as population growth and household formation will continue to drive demand in these markets over the long-term.

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

On April 15, 2005, our Board of Directors adopted a plan to dispose of our investment in SJ, and on May 20, 2005, the Board of Directors approved a plan to dispose of Eljer. In the third quarter of fiscal 2005, we completed the sale of substantially all the assets, the current liabilities, the long-term retiree medical liability and certain other liabilities of Eljer. Eljer's operations were included in our Bath Products segment prior to its sale.

During the fourth quarter of fiscal 2006, we sold all of our shares of common stock of SJ to United Pacific Industries Limited for a purchase price of approximately \$5.0 million. We expect to record total income of approximately \$4.0 million in the fourth quarter of fiscal 2006 from the operation and sale of SJ. Two of our directors are also directors and significant stockholders of the purchaser. The transaction was considered and approved by a committee of independent directors, without participation by the interested directors. For further information, see our Reports on Form 8-K filed March 27, 2006 and July 28, 2006.

Both Eljer and SJ qualified for treatment as discontinued operations in accordance with SFAS No. 144. Therefore, the operating results of these discontinued operations were not included in our results from continuing operations. Instead, the results were recorded as a loss from discontinued operations.

Summarized results of these discontinued operations are as follows:

| | Third Quarter | | Nine Months Ended | |
|-----------------------------------|----------------------|-------------|--------------------------|-------------|
| | 2006 | 2005 | 2006 | 2005 |
| Net sales | \$24.6 | \$ 35.7 | \$75.1 | \$104.9 |
| Operating loss | (2.7) | (5.4) | (6.9) | (8.4) |
| Loss from discontinued operations | (2.9) | (58.7) | (7.3) | (61.0) |

These results are excluded from the following discussion of **Results of Operations**.

Results of Operations**Overall**

| | Third Quarter | | Nine Months Ended | |
|-------------------------|----------------------|----------------|--------------------------|----------------|
| | 2006 | 2005 | 2006 | 2005 |
| Net sales | | | | |
| Bath Products | \$210.6 | \$213.3 | \$573.0 | \$585.5 |
| Plumbing Products | 122.0 | 96.2 | 315.9 | 255.1 |
| Rexair | | 24.7 | | 76.1 |
| Total net sales | \$332.6 | \$334.2 | \$888.9 | \$916.7 |
| Operating income | | | | |
| Bath Products | \$ 14.8 | \$ 12.4 | \$ 28.7 | \$ 23.2 |
| Plumbing Products | 27.4 | 20.7 | 65.5 | 51.2 |
| Rexair | | 6.5 | | 19.0 |
| | 42.2 | 39.6 | 94.2 | 93.4 |
| Corporate expenses | (8.6) | (5.6) | (17.9) | (16.1) |

| | | | | |
|-------------------------------|---------|---------|---------|---------|
| Total operating income | \$ 33.6 | \$ 34.0 | \$ 76.3 | \$ 77.3 |
|-------------------------------|---------|---------|---------|---------|

Net sales decreased in the third quarter and nine months ended 2006 compared to the third quarter and nine months ended 2005, primarily due to the absence of Rexair sales in fiscal 2006 as a result of the June 30, 2005 disposition. This was largely offset by an increase in Plumbing product sales. Bath Products sales in the third quarter and nine months ended 2006 were negatively impacted by \$0.4 million and \$10.7 million of unfavorable foreign currency exchange rate fluctuations.

Operating income decreased by \$0.4 million and \$1.0 million in the third quarter and nine months ended 2006, respectively, compared to the same periods of the prior year largely due to the sale of Rexair. The Bath Products and Plumbing Products segments reported increases in operating income for both the third quarter and year to date periods.

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Operating income in the third quarter of fiscal 2006 included \$4.5 million of expense related to our retiree benefit liabilities for several key executives. Approximately \$1.0 million of this amount should have been recorded in the first and second quarters of fiscal 2006 and \$2.9 million should have been recorded during the period beginning with the Company's 1995 spin off from Hanson plc through fiscal 2005, and \$0.6 million relates to the current quarter. No single fiscal year was materially misstated so the entire \$4.5 million was recorded in the current period as follows: \$2.9 million in corporate expenses; \$1.1 million in the Bath Products segment; and \$0.5 million in the Plumbing Products segment.

In addition, operating income included restructuring and other charges of \$1.3 million and \$4.5 million in the third quarter and nine months ended 2006, respectively, compared to restructuring charges of \$1.4 million and \$3.6 million, in the third quarter and nine months ended 2005, respectively. The nine months ended 2006 also included a \$1.7 million gain from the settlement of a property tax liability.

Bath Products

Improved worldwide sales of U.K. sink products and spas partially offset declines in sales of U.K. bath products. Sales in the Bath Products segment decreased 1.3% and 2.1% in the third quarter and nine months ended 2006, respectively, from the same periods in 2005. The comparison to prior year included the impact of unfavorable currency exchange rate fluctuations of \$0.4 million and \$10.7 million for the third quarter and year to date periods, respectively. Sales of our U.K. sink products improved over last year, largely as a result of increased export sales to the U.S. Worldwide spa sales increased as a result of improved pricing, mix, and the continued expansion into European markets, which offset continued softness in the U.S. spa market.

Operating income increased 19.4% and 23.7% in the third quarter and nine months ended 2006, respectively, over the prior year periods primarily due to cost control measures and other improvement performance measures at the U.S. bath and spa businesses. Price increases throughout the Bath Products segment mitigated higher raw material costs, including oil-based and metal commodities. Operating income in the Bath Products segment included restructuring and other charges of \$1.3 million and \$4.3 million for the third quarter and year to date periods of fiscal 2006, compared to restructuring charges of \$1.4 million and \$3.6 million in the third quarter and year to date periods of fiscal 2005 (see the Restructuring Costs section below for further discussion on these charges). The Bath Products segment results in the third quarter of fiscal 2006 included \$1.1 million of the previously mentioned adjustment to retirement benefits, of which \$1.0 related to prior years and the remaining \$0.1 million largely related to the first and second quarters of fiscal 2006. The third quarter of 2005 included costs related to the opening of the Zhuhai China Engineering and Sourcing Center of \$0.5 million. Results in the nine months ended 2005 included a reduction in warranty costs of \$2.2 million resulting from the favorable settlement of a dispute with the previous owners of the Sundance Spas business as well as costs related to the opening of the Zhuhai, China Engineering and Sourcing Center of \$1.3 million.

Plumbing Products

Sales in the Plumbing Products segment increased 26.8% to \$122.0 million in the third quarter of 2006 and increased 23.8% to \$315.9 million for the nine months ended 2006 compared to the same periods last year. The higher sales were driven by sales of new products, market penetration and industry growth. Net sales for PEX products increased largely due to the continued conversion from copper to PEX. Higher sales for Wilkins and Commercial Brass products were a result of increased market penetration, new product innovation and reputation of outstanding customer service. Operating income for the third quarter and nine months ended 2006 increased by 32.4% and 27.9% over the same periods last year. The increase was principally due to strong sales volume. In addition, price increases initiated in prior periods offset the continued rise of raw material costs, primarily increases in metal and oil-based commodities.

Rexair

We sold our investment in Rexair on June 30, 2005. In conjunction with the sale, we obtained a 30% equity interest in Rexair's new parent company, which is accounted for under the equity method.

Corporate Expenses

Corporate expenses increased to \$8.6 million in the third quarter of fiscal 2006 from \$5.6 million in the same period last year. Corporate expenses for the current period included a \$2.9 million increase in retirement benefit expenses as previously discussed. The current quarter also included less pension income due to a lower discount rate and increased

pension costs (\$0.7 million), largely offset by lower professional fees (\$0.4 million) principally due to a reduction in Sarbanes Oxley compliance costs. For the year to date period the increase in corporate expense (\$1.8 million) was largely due to increases in retirement benefit expenses (\$2.9 million) and less pension income (\$2.0 million), partially offset by lower professional fees (\$1.2 million) and a gain recorded from a property tax settlement (\$1.7 million) in the first quarter of 2006.

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As previously announced, David H. Clarke will retire as Chief Executive Officer of the Company on August 31, 2006. He will also retire as Chairman and member of the Board of Directors effective September 30, 2006. We will record approximately \$2.0 million related to his separation agreement in the fourth quarter of fiscal 2006, of which approximately half is accelerated restricted stock vesting while the remainder is cash charges.

Interest Income and Expense

The decrease in interest expense and increase in interest income from the prior year periods are the result of lower debt levels and higher cash and cash equivalents, resulting primarily from the proceeds on the sale of Rexair in June 2005.

Other Expenses/Income

The decrease in other expense net, of \$5.2 million was largely because the third quarter of the prior year included debt retirement costs of \$3.2 million, as well as foreign currency transaction losses of \$0.9 million. Other income in the nine months ended 2006 includes a \$3.5 million gain as a result of a reduction of environmental reserves due to a favorable court ruling as well as a \$9.3 million gain that resulted from the recognition of deferred profit on the sale of real estate.

Taxes

The tax provision for the nine months ended 2006 includes a non-cash charge of \$14.4 million associated with the establishment of a valuation allowance for all the deferred tax assets of our U.K. operations. We recorded the valuation allowance for the UK deferred tax assets due to losses expected to be incurred in the two year period ended fiscal 2006. We expect that our previously announced U.K. restructuring initiatives and plant closing, which caused a significant portion of these losses, will return our U.K. operations to profitability in fiscal 2007. Any reversal of the valuation allowance which would result from the return to profitability of our U.K. operations will be included as a reduction in income tax expense in future periods. The nine months ended 2005 includes \$7.3 million in tax benefits as a result of favorable settlements of federal income tax audits. No taxes were recorded on the Rexair gain because it resulted in a capital loss for tax purposes.

We have appealed various issues relating to the Federal audit of our U.S. consolidated returns for 1998 through 2002. We have recorded reserves that are adequate to cover any assessment if our appeals are rejected. In addition, several states and various other countries have examinations either in the planning stages or currently underway.

Restructuring Costs

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

| | Lease and Contract-Related Costs | Severance and Related Costs | Total Costs |
|-----------------------|---|--|------------------------|
| At September 30, 2005 | \$ 1.7 | \$ 2.1 | \$ 3.8 |
| Cash charges | 0.1 | 3.2 | 3.3 |
| Cash payments | (1.1) | (3.9) | (5.0) |
| Other | 0.5 | | 0.5 |
| At June 30, 2006 | \$ 1.2 | \$ 1.4 | \$ 2.6 |

We recorded restructuring and other charges of \$1.3 million during the third quarter which largely consisted of \$0.6 million in accelerated depreciation, recorded in cost of goods sold, and \$0.5 million in severance recorded in restructuring, related to the previously announced consolidation of the Bradford, U.K. ceramics plant and other U.K. staffing and overhead reductions. The remaining restructuring charges of \$0.2 million primarily related to staffing and overhead reductions in the domestic spa operations. We expect to record \$0.6 million in accelerated depreciation in cost of goods sold and \$0.6 million in cash restructuring charges over the remainder of fiscal 2006 related to the Bradford consolidation. Approximately 100 employees will be affected by this action. We are reviewing a number of further U.K. and other profit improvement initiatives.

Restructuring and other charges for the nine months ended 2006 of \$4.5 million included charges for the plant consolidation and staff reductions in the U.K., the closure of our Asia office, and the continued implementation of other domestic overhead reductions. Restructuring and other charges related to the U.K. initiatives were \$2.7 million, of which \$1.2 million, related to inventory write-downs and accelerated depreciation and was recorded in cost of goods sold. The remaining \$1.5 million was recorded as restructuring and consisted of

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severance and other cash related charges. In the first quarter of 2006, management approved a plan to close our Asia sales and administration office. Asia's operations are being absorbed into our domestic and European subsidiaries. We incurred severance and lease related charges of \$0.6 million associated with this closure, and 11 employees were terminated.

Approximately \$2.3 million of the accrued restructuring costs at June 30, 2006 are included in the balance sheet caption Accrued expenses and other current liabilities, while the remaining \$0.3 million are recorded in the balance sheet caption Other non-current liabilities. We expect the remaining accruals to be paid with cash over the next two years as provided by the severance and lease agreements.

Liquidity and Capital Resources

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

Net cash used by operating activities of continuing operations was \$0.6 million in the nine months ended 2006 compared to \$8.8 million provided in the nine months ended 2005. The comparison was impacted by the sale of Rexair, which contributed \$17.0 million of cash during the nine months of fiscal 2005. This was more than offset by the timing of the semi-annual interest payment of the Senior Notes. The July payment was made in the third quarter of fiscal 2005, whereas it was paid at the beginning of the fourth quarter of the current year. Investments in primary working capital (trade receivables, inventory and trade payables) increased by \$11.6 million in the nine months ended 2006 over the nine months ended 2005 primarily as a result of the growth in our Plumbing segment. In the first quarter of 2006, we paid \$3.0 million to buyout certain vested post-retirement benefit plan liabilities owed to participants who were retired or terminated.

Cash is used by operating activities in the first half of the year due to the seasonality of most of our businesses. Weather can significantly impact construction and installation, which ultimately impacts sales in our Bath Products and Plumbing Products segments. Sales of outdoor jetted spas and other products are also sensitive to weather conditions and tend to decrease during the fall and winter months (predominantly the first and second quarters). During the nine months ended 2006, we paid \$5.0 million related to our restructuring plans. We expect to pay approximately \$2.0 million over the next quarter (see **Restructuring Costs** for additional information on restructuring).

Net cash used in discontinued operations in the nine months ended 2006 was \$12.5 million compared to \$26.1 million in the nine months ended 2005. The decrease in net cash used was due to the sale of Eljer in the third quarter of fiscal 2005. Net cash used in the current period was primarily associated with liabilities we assumed in conjunction with the Eljer sale and our settlement related to Ames True Temper liabilities (see **Note 5**).

Net cash provided by investing activities of \$1.5 million in the nine months ended 2006 consisted primarily of \$10.9 million collected from the sale of excess real estate and other non-operating assets, offset by capital expenditures of \$8.2 million. Net cash provided in the nine months ended 2005 consisted mainly of net proceeds of \$149.2 million from the sale of Rexair, net of \$8.5 million of costs associated with the sale of Eljer, as well as net proceeds of \$7.2 million from the sale of excess property. Cash provided from these proceeds was partially offset by cash used for capital expenditures of \$18.4 million.

We expect total capital expenditures for the full year of fiscal 2006 to be in the range of \$10 million to \$13 million for new business requirements, system upgrades and implementations, initiatives involving the consolidation of workflows and improvement of manufacturing efficiencies and other capital requirements in the ordinary course of business.

Net cash provided by financing activities was \$7.6 million during the nine months ended 2006, which consisted mainly of \$12.8 million received from restricted cash collateral accounts offset by \$5.9 million used for repayment of notes and long-term debt. As a result of the tender offer mentioned in **Note 4**, we are no longer required to hold \$12.8 million for the benefit of the bondholders related to the proceeds from the Rexair and Eljer dispositions. Net cash used in financing activities was \$82.1 million during the nine months ended 2005. During the nine months ended 2005, we reduced our total debt borrowings by \$68.6 million. In addition, we paid \$1.0 million in fees associated with

our debt retirement, and we deposited \$12.4 million into restricted cash collateral accounts in conjunction with the sales of Rexair and Eljer.

The outstanding debt balances and the maximum availability under our debt instruments at June 30, 2006 were as follows:

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| | Maximum Availability | Amount Outstanding | Applicable Interest Rate |
|--|-------------------------|-----------------------|--------------------------------------|
| Senior Notes | \$380.0 | \$380.0 | 9.625% |
| Asset-based credit facility ⁽¹⁾ | 131.8 | | 2.25% over LIBOR or 0.25% over Prime |
| US Brass note | 3.5 | 3.5 | Interest imputed at 9.5% |
| Total | \$515.3 | \$383.5 | |

⁽¹⁾ \$32.4 million of the facility is utilized for letters of credit, which were outstanding at June 30, 2006.

The Senior Notes are due on July 1, 2010 and require the payment of interest of \$18.3 million on January 1 and July 1 of each year. We are restricted in the redemption of the Senior Notes per the terms of the agreement with the note holders. On and after July 1, 2007, we can redeem the Senior Notes subject to a redemption premium of 104.8% for the first 12 months and 102.4% for the following 12 months. On and after July 1, 2009, the Senior Notes can be redeemed at face value. The indentures to the Senior Notes limit our ability to pay dividends, repurchase stock and make other restricted payments as defined therein.

We also have an asset-based revolving credit facility that matures on July 15, 2008. Under this facility, we can borrow up to \$200.0 million subject to a borrowing base consisting of eligible accounts receivable and eligible inventory. There are several fees associated with the asset-based credit facility including an unused commitment fee of 0.5%, a letter of credit fee equal to the applicable LIBOR margin and a fronting fee of 0.125% on all outstanding letters of credit. There were no outstanding balances under this facility at June 30, 2006 or September 30, 2005.

The asset-based credit facility requires us to maintain a minimum consolidated fixed charge coverage ratio, which is only applicable if our availability under the asset-based credit facility falls below \$20.0 million. We were not subject to this debt covenant at June 30, 2006 because our availability exceeded the required threshold. However, if it were applicable, we would have been in compliance. We expect to maintain availability in excess of \$20.0 million for the foreseeable future. This credit facility also includes a restriction on the payment of dividends.

We paid \$20.8 million of interest on our borrowings during the nine months ended 2006 and \$44.5 million during the nine months ended 2005. The majority of the difference between the two years is the result of the timing of the semi-annual payment of our Senior Notes. The July payment was made in the third quarter of the prior year, whereas it was paid at the beginning of the fourth quarter of the current year. Additional information regarding our long-term debt can be found in our 2005 Annual Report on Form 10-K, filed on December 15, 2005.

Commitments

At June 30, 2006, we had approximately \$131.8 million available to be borrowed under the asset-based credit facility, of which we had utilized approximately \$32.4 million for letters of credit, leaving \$99.4 million available for borrowings. In addition, we have outstanding foreign commercial letters of credit of \$2.8 million which do not affect availability under the asset-based credit facility.

Guarantees and Indemnifications

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

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

We have sold a number of assets and businesses over the last several years and have, on occasion, provided indemnifications for liabilities relating to product liability, environmental, insurance, tax and other claims. We have recorded reserves, net of escrow deposits totaling approximately \$15.9 million as of June 30, 2006 for asserted and potential unasserted claims related to these liabilities. These amounts have not been discounted.

New Accounting Pronouncement

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with Statement of Financial Accounting Standard No. 109, Accounting for

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Income Taxes. This interpretation clarifies the accounting for income taxes by prescribing the recognition threshold a tax position is required to meet before being recognized in the financial statements. This interpretation also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the impact of FIN 48 on our consolidated results of operations and financial position.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to foreign currency exchange risk related to our international operations as well as our U.S. businesses, which import or export goods. We have made limited use of financial instruments to manage this risk and have no such instruments outstanding as of June 30, 2006. A hypothetical unfavorable movement of 10% across each of the foreign exchange rates that we have exposure would have decreased our estimated income from continuing operations by approximately \$1.8 million, before taxes, in fiscal 2005. This calculation assumes that each exchange rate would change in the same direction relative to the U.S. dollar. In addition to the direct effects of changes in exchange rates, which are a changed dollar value of the resulting sales, changes in exchange rates also affect the volume of sales or the foreign currency sales price as competitors' products become more or less attractive. Our sensitivity analysis of the effects of changes in foreign currency exchange rates does not factor potential changes in sales levels or local currency prices.

We did not have any significant variable rate interest debt outstanding at June 30, 2006, and we do not anticipate incurring substantial amounts of such debt during the remainder of fiscal 2006. Therefore, market risks associated with interest rate changes are expected to be minimal for fiscal 2006.

Item 4. Controls and Procedures

We carried out an evaluation under the supervision and with the participation of our management, including the Chief Executive Officer and the Chief Financial Officer of the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective. Our management necessarily applied its judgment in assessing the costs and benefits of such controls and procedures, which by their nature can provide only reasonable assurance regarding management's control objectives. During the nine months ended 2006, we implemented new information technology systems at two sites. As a result, certain changes have been made to our internal control over financial reporting. There were no other significant changes in our internal control over financial reporting during the third quarter of 2006 identified in connection with the evaluation referred to above, that have materially affected, or are reasonably likely to materially effect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 6. Exhibits

- 10.1 Amendment No. 2 to the Stock Purchase Agreement dated as of July 10, 2006 entered into by and among the registrant, USI American Holdings, Inc. and United Pacific Industries Limited (filed as Exhibit 2.1 to our Current Report on Form 8-K filed on July 12, 2006).

- 31.1 Certification of principal executive officer required by Rule 13a-14(a) of the Exchange Act.

- 31.2 Certification of principal financial officer required by Rule 13a-14(a) of the Exchange Act.

- 32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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.

JACUZZI BRANDS, INC.

Date: August 10, 2006

By: /s/ Jeffrey B. Park
Jeffrey B. Park
Senior Vice President,
Chief Financial Officer and Treasurer
(Principal Financial Officer)

/s/ Francisco V. Puñal
Francisco V. Puñal
Vice President and Controller
(Principal Accounting Officer)

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