

APPLICA INC
Form 10-Q
November 03, 2003

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2003

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER 1-10177

APPLICA INCORPORATED

(Exact Name of Registrant as Specified in its Charter)

Florida

(State or Other Jurisdiction of Incorporation or Organization)

5980 Miami Lakes Drive, Miami Lakes, Florida

(Address Of Principal Executive Offices)

59-1028301

(I.R.S. Employer Identification Number)

33014

(Zip Code)

(305) 362-2611

(Registrant's Telephone Number, Including Area Code)

Former Name, If Changed Since Last Report:

Not Applicable

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirement for the past 90 days. Yes No

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

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

| Class | Number of shares outstanding on October 28, 2003 |
|--------------------------------|---|
| Common Stock, \$0.10 par value | 23,657,084 |

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Applica Incorporated and Subsidiaries

CONSOLIDATED BALANCE SHEETS

| | September 30, 2003 (Unaudited) | December 31, 2002 |
|---|--------------------------------------|----------------------|
| | (In thousands) | |
| Assets | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 6,974 | \$ 7,683 |
| Accounts and other receivables, less allowances of \$17,408 in 2003 and \$15,830 in 2002 | 133,912 | 146,567 |
| Receivables from affiliates | 1,587 | 2,060 |
| Inventories | 150,181 | 111,453 |
| Prepaid expenses and other | 13,975 | 11,862 |
| Refundable income taxes | 3,939 | 1,663 |
| Future income tax benefits | 14,654 | 18,654 |
| | <hr/> | <hr/> |
| Total current assets | 325,222 | 299,942 |
| Investment in Joint Venture | 5,038 | 1,249 |
| Property, Plant and Equipment - at cost, less accumulated depreciation of \$125,488 in 2003 and \$109,949 in 2002 | 71,315 | 76,963 |
| Future Income Tax Benefits, Non-Current | 43,070 | 54,378 |
| Goodwill | 62,812 | 62,812 |
| Other Intangibles, Net | 14,528 | 20,860 |
| Other Assets | 3,990 | 5,461 |
| | <hr/> | <hr/> |
| Total Assets | \$525,975 | \$521,665 |
| | <hr/> | <hr/> |
| Liabilities and Shareholders Equity | | |
| Current Liabilities: | | |
| Accounts payable | \$ 52,641 | \$ 31,446 |
| Accrued expenses | 65,789 | 74,686 |
| Current maturities of long-term debt | 151 | 144 |
| Current taxes payable | 4,613 | 518 |
| Deferred rent | 319 | 372 |
| | <hr/> | <hr/> |
| Total current liabilities | 123,513 | 107,166 |
| Other Long-Term Liabilities | 2,077 | 1,533 |
| Long-Term Debt, Less Current Maturities | 155,931 | 193,838 |
| Shareholders Equity: | | |
| Common stock authorized:75,000 shares of \$.10 par value; issued and outstanding: 23,657 shares in 2003 and 23,497 shares in 2002 | 2,366 | 2,350 |
| Paid-in capital | 156,432 | 155,395 |

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| | | |
|--|-------------------|-------------------|
| Retained earnings | 92,942 | 71,251 |
| Note receivable officer | (1,496) | (1,496) |
| Accumulated other comprehensive earnings (loss) | (5,790) | (8,372) |
| | <u> </u> | <u> </u> |
| Total shareholders equity | 244,454 | 219,128 |
| | <u> </u> | <u> </u> |
| Total liabilities and shareholders equity | \$ 525,975 | \$ 521,665 |
| | <u> </u> | <u> </u> |

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

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

| | Three Months Ended September 30, | | | |
|--|---------------------------------------|--------|------------|--------|
| | 2003 | | 2002 | |
| | (In thousands, except per share data) | | | |
| Net sales | \$ 173,512 | 100.0% | \$ 194,851 | 100.0% |
| Cost of goods sold | 122,257 | 70.5 | 130,243 | 66.8 |
| Gross profit | 51,255 | 29.5 | 64,608 | 33.2 |
| Selling, general and administrative expenses: | | | | |
| Operating expenses | 54,105 | 31.2 | 47,050 | 24.2 |
| Repositioning charge | | | 5,397 | 2.8 |
| Operating earnings (loss) | (2,850) | (1.7) | 12,161 | 6.2 |
| Other expense (income): | | | | |
| Interest expense | 3,597 | 2.1 | 4,967 | 2.5 |
| Interest and other income | (245) | (0.1) | (866) | (0.4) |
| Loss on early extinguishment of debt | 1,906 | 1.0 | | |
| Gain on litigation settlement | | | (557) | (0.3) |
| | 5,258 | 3.0 | 3,544 | 1.8 |
| Earnings (loss) before equity in net earnings (loss) of joint venture and income taxes | (8,108) | (4.7) | 8,617 | 4.4 |
| Equity in net earnings (loss) of joint venture | 16,199 | 9.3 | (598) | (0.3) |
| Earnings (loss) before income taxes | 8,091 | 4.6 | 8,019 | 4.1 |
| Income tax expense (benefit) | 3,236 | 1.8 | 2,805 | 1.4 |
| Net earnings (loss) | \$ 4,855 | 2.8% | \$ 5,214 | 2.7% |
| Earnings (loss) per common share: | | | | |
| Earnings (loss) per common share basic | \$ 0.21 | | \$ 0.22 | |
| Earnings (loss) per common share diluted | \$ 0.20 | | \$ 0.22 | |

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

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

| | Nine Months Ended September 30, | | | |
|--|---------------------------------------|--------|--------------------|---------|
| | 2003 | | 2002 | |
| | (In thousands, except per share data) | | | |
| Net sales | \$ 431,598 | 100.0% | \$ 505,948 | 100.0% |
| Cost of goods sold | 302,882 | 70.2 | 346,562 | 68.5 |
| | <u>128,716</u> | 29.8 | <u>159,386</u> | 31.5 |
| Gross profit | | | | |
| Selling, general and administrative expenses: | | | | |
| Operating expenses | 135,320 | 31.4 | 137,545 | 27.2 |
| Repositioning charge | | | 10,643 | 2.1 |
| | <u>(6,604)</u> | (1.6) | <u>11,198</u> | 2.2 |
| Operating earnings (loss) | | | | |
| Other expense (income): | | | | |
| Interest expense | 11,431 | 2.6 | 12,624 | 2.5 |
| Interest and other income | (893) | (0.2) | (1,612) | (0.3) |
| Loss on early extinguishment of debt | 1,906 | 0.4 | | |
| Gain on litigation settlement | | | (557) | (0.1) |
| | <u>12,444</u> | 2.8 | <u>10,455</u> | 2.1 |
| Earnings (loss) before equity in net earnings (loss) of joint ventures, income taxes and cumulative effect of change in accounting principle | (19,048) | (4.4) | 743 | 0.1 |
| Equity in net earnings (loss) of joint ventures | 55,199 | 12.8 | (783) | (0.1) |
| | <u>36,151</u> | 8.4 | <u>(40)</u> | 0.0 |
| Earnings (loss) before income taxes and cumulative effect of change in accounting principle | | | | |
| Income tax expense (benefit) | 14,460 | 3.4 | (16) | 0.0 |
| | <u>21,691</u> | 5.0 | <u>(24)</u> | 0.0 |
| Earnings (loss) before cumulative effect of change in accounting principle | | | | |
| Cumulative effect of change in accounting principle, net of tax benefit of \$0 and \$42,447 in 2003 and 2002 | | | (78,829) | (15.6) |
| | <u>\$ 21,691</u> | 5.0% | <u>\$ (78,853)</u> | (15.6)% |
| Net earnings (loss) | | | | |
| Earnings (loss) per common share basic: | | | | |
| Earnings (loss) before cumulative effect of change in accounting principle | \$ 0.92 | | \$ 0.00 | |
| Cumulative effect of change in accounting principle | | | (3.37) | |
| | <u>\$ 0.92</u> | | <u>\$ (3.37)</u> | |
| Earnings (loss) per common share basic | | | | |
| Earnings (loss) per common share diluted: | | | | |
| Earnings (loss) before cumulative effect of change in accounting principle | \$ 0.87 | | \$ 0.00 | |
| Cumulative effect of change in accounting principle | | | (3.37) | |

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| | | |
|--|----------------|------------------|
| Earnings (loss) per common share - diluted | <u>\$ 0.87</u> | <u>\$ (3.37)</u> |
|--|----------------|------------------|

The accompanying notes are an integral part of these statements.

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

**Nine Months Ended
September 30,**

| | 2003 | 2002 |
|---|-------------|-------------|
| (In thousands) | | |
| Cash flows from operating activities: | | |
| Net earnings (loss) | \$ 21,691 | \$ (78,853) |
| Reconciliation to net cash provided by (used in) operating activities: | | |
| Depreciation of property, plant and equipment | 15,184 | 14,799 |
| Provision for doubtful accounts | 3,276 | 5,719 |
| Amortization of intangible assets | 6,915 | 6,772 |
| Loss on early extinguishment of debt | 1,906 | |
| Gain on litigation settlement | | (557) |
| Cumulative effect of change in accounting principle, net of tax | | 78,829 |
| Deferred income taxes | 15,308 | (7,644) |
| Other non-cash changes in equity items | 10 | 78 |
| Equity in net (earnings) loss of joint venture | (55,199) | 783 |
| Changes in assets and liabilities: | | |
| Accounts and other receivables | 9,379 | 16,776 |
| Inventories | (40,118) | (37,142) |
| Prepaid expenses and other | (2,113) | (5,822) |
| Other assets | 3,064 | (6,320) |
| Accounts payable and accrued expenses | 12,298 | 18,877 |
| Current income taxes | 1,819 | (2,296) |
| Other liabilities | 491 | (464) |
| Net cash provided by (used in) operating activities | (6,089) | 3,535 |
| Cash flows from investing activities: | | |
| Purchase of Weitech, Inc. | | (17,002) |
| Additions to property, plant and equipment | (9,536) | (12,255) |
| Distributions from (investments in) joint ventures net | 51,410 | (667) |
| Receivables from affiliates | 503 | 975 |
| Net cash (used in) provided by investing activities | 42,377 | (28,949) |
| Cash flows from financing activities: | | |
| Net (payments) borrowings under lines of credit | (7,900) | 16,023 |
| Redemption of long-term debt | (31,500) | |
| Exercise of stock options and issuance of common stock under employee stock purchase plan | 1,043 | 1,091 |
| Interest receivable from officer | (30) | (46) |
| Net cash (used in) provided by financing activities | (38,387) | 17,068 |
| Effect of exchange rate changes on cash | 1,390 | 1,959 |
| Decrease in cash and cash equivalents | (709) | (6,387) |
| Cash and cash equivalents at beginning of period | 7,683 | 15,743 |
| Cash and cash equivalents at end of period | \$ 6,974 | \$ 9,356 |

Supplemental Disclosures of Cash Flow Information:

Cash paid during the nine-month period ended September 30:

| | | |
|--------------|-----------|-----------|
| Interest | \$ 14,232 | \$ 15,384 |
| Income taxes | | \$ 9,785 |

Non-cash investing and financing activities:

On May 31, 2002, Applica Consumer Products, Inc., the U.S. operating subsidiary, purchased all of the outstanding shares of Weitech, Inc. in exchange for \$17.0 million in cash and \$3.0 million of notes payable.

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

Table of Contents**Applica Incorporated and Subsidiaries****Notes to Consolidated Financial Statements****1. SUMMARY OF ACCOUNTING POLICIES****Interim Reporting**

The accompanying unaudited consolidated financial statements include the accounts of Applica Incorporated and its subsidiaries (Applica). All significant intercompany transactions and balances have been eliminated. The unaudited consolidated financial statements have been prepared in conformity with Rule 10-01 of Regulation S-X of the Securities and Exchange Commission and therefore do not include information or footnotes necessary for a complete presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. However, all adjustments (consisting of normal recurring accruals), which, in the opinion of management, are necessary for a fair presentation of the financial statements, have been included. Operating results for the period ended September 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003 due to seasonal fluctuations in Applica s business, changes in economic conditions and other factors. For further information, please refer to the Consolidated Financial Statements and Notes thereto contained in Applica s Annual Report on Form 10-K for the year ended December 31, 2002.

Reclassifications

Certain prior period amounts have been reclassified for comparability.

Receivables from Affiliates

Receivables from affiliates include the current portion of receivables due from the Chairman of the Board of Applica. These receivables are due upon demand or upon termination of the applicable employment contract and bear interest at prevailing market interest rates. Receivables due from Applica s senior officers are unsecured.

Foreign Currency Reporting Argentina

Effective January 1, 2003, the functional currency of the Argentinean operation was changed from the U.S. dollar to the Argentinean peso. For 2002, the functional currency of our Argentinean operation was the U.S. dollar and, accordingly, Applica recognized a translation loss of approximately \$2.0 million for the nine months ended September 30, 2002. However, the peso stabilized and further translation gains or losses after such date are recognized as part of other accumulated comprehensive earnings, a component of shareholders equity.

Inventories

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

| | September 30, 2003 | December 31, 2002 |
|-----------------|-----------------------|----------------------|
| | (In thousands) | |
| Raw materials | \$ 2,697 | \$ 4,103 |
| Work in process | 5,587 | 1,513 |
| Finished goods | 141,897 | 105,837 |
| | <u>\$ 150,181</u> | <u>\$ 111,453</u> |

Stock Based Compensation

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At September 30, 2003, the Company had four active stock based compensation plans. The Company accounts for stock-based compensation using the intrinsic value method. Accordingly, compensation cost for stock options issued is measured as the excess, if any, of the fair value of the Company's common stock at the date of

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Notes to Consolidated Financial Statements Continued**

grant over the exercise price of the options. The Company's net earnings (loss) and earnings (loss) per share would have been changed to the pro forma amounts indicated below had compensation cost for the stock option plans and non-qualified options issued to employees been determined based on the fair value of the options at the grant dates consistent with the method of SFAS 123.

| | For the three months ended | | For the nine months ended | |
|---------------------------------------|----------------------------|--------------------|---------------------------|--------------------|
| | September 30, 2003 | September 30, 2002 | September 30, 2003 | September 30, 2002 |
| (In thousands, except per share data) | | | | |
| Net earnings (loss): | | | | |
| As reported | \$4,855 | \$ 5,214 | \$21,691 | \$(78,853) |
| Pro forma | \$4,707 | \$ 4,783 | \$21,370 | \$(79,795) |
| Basic earnings (loss) per share: | | | | |
| As reported | \$ 0.21 | \$ 0.22 | \$ 0.92 | \$ (3.37) |
| Pro forma | \$ 0.20 | \$ 0.20 | \$ 0.91 | \$ (3.41) |
| Diluted earnings (loss) per share: | | | | |
| As reported | \$ 0.20 | \$ 0.22 | \$ 0.87 | \$ (3.37) |
| Pro forma | \$ 0.19 | \$ 0.20 | \$ 0.86 | \$ (3.41) |

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

In accordance with the requirements of SFAS 123, the fair value of each option grant was estimated on the date of grant using a binomial option-pricing model with the following weighted-average assumptions used for grants in 2003 and 2002, respectively: no dividend yield; expected volatility ranging from 93.3% to 96.5%; risk-free interest rates of 5.3%; and expected holding periods of four years.

Recent Accounting Pronouncements

In December 2002, the FASB issued Statement No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure* (SFAS No. 148). SFAS No. 148 amends SFAS Statement No. 123, *Accounting for Stock-Based Compensation*, to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. Additionally, SFAS No. 148 requires prominent disclosures about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. SFAS No. 148 also amends APB Opinion No. 28, *Interim Financial Reporting*, to require disclosures about such effects in interim financial information. Applica currently accounts for its stock-based compensation awards to employees and directors under the accounting prescribed by Accounting Principles Board Opinion No. 25 and provides the disclosures required by SFAS No. 123. Applica currently intends to continue to account for its stock-based compensation awards to employees and directors under the accounting prescribed by Accounting Principles Board Opinion No. 25. Applica adopted the additional disclosure provisions of SFAS No. 148 during the first quarter of 2003.

In December 2002, the FASB issued Interpretation 45 (FIN 45), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. For a guarantor subject to FASB Interpretation 45, a guarantor is required to:

measure and recognize the fair value of the guarantee at inception (for many guarantees, fair value will be determined using a present value method); and

provide new disclosures regarding the nature of any guarantees, the maximum potential amount of future guarantee payments, the current carrying amount of the guarantee liability, and the nature of any recourse provisions or assets held as collateral that could be liquidated and allow the guarantor to recover all or a portion of its payments in the event guarantee payments are required.

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**Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements Continued**

The disclosure requirement of this Interpretation is effective for financial statements for fiscal years ending after December 15, 2002 and did not have a material effect on Applica financial statements. The initial recognition and measurement provision are effective prospectively for guarantees issued or modified on or after January 1, 2003, which did not have a material effect on Applica's financial statements.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities (and Interpretation of ARB No. 51) (FIN 46). FIN 46 addresses consolidation by business enterprises of certain variable interest entities, commonly referred to as special purpose entities. The adoption of FIN 46 did not have a material effect on Applica's financial statement presentation or disclosure.

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement No. 133 on Derivative Instruments with Characteristics of both Liabilities and Equity. This statement amends and clarifies accounting for derivatives instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. This statement is effective for contracts entered into or modified after June 30, 2003, except as for provisions that relate to SFAS No. 133 implementation issues that have been effective for fiscal quarters that began prior to June 15, 2003, which should continue to be applied in accordance with their respective dates. The adoption of SFAS No. 149 did not have a material impact on Applica's financial condition, results of operations, and cash flows.

Loss on Early Extinguishments of Debt

In July 2003, Applica redeemed \$30 million of its 10% notes due 2008. The notes were redeemed, using availability under Applica's senior credit facility, at 105% of the principal amount, plus accrued interest up to, but not including, the redemption date. Applica incurred a \$1.5 million loss in connection with the prepayment premiums and an additional loss of \$406,000 related to the write-off of the related unamortized debt issuance cost. The losses are reflected in the Statement of Operations as a component of other income.

2. SHAREHOLDERS EQUITY

Earnings Per Share

Basic shares for the three-month periods ended September 30, 2003 and 2002 were 23,631,586 and 23,465,880, respectively. Basic shares for the nine-month periods ended September 30, 2003 and 2002 were 23,544,311 and 23,397,663. Included in diluted shares for the three-month and nine-month periods ended September 30, 2003 are common stock equivalents relating to options of 320,060 and 1,378,138, respectively. Included in diluted shares for the three-month period ended September 30, 2002 are common stock equivalents relating to options of 532,745. All common stock equivalents have been excluded from the diluted per share calculations in the nine-month period ended September 30, 2002 because their inclusion would have been anti-dilutive. Potential common stock equivalents for the three-month and nine-month periods ended September 30, 2003 were 678,441 and 390,096, with exercise prices ranging from \$7.98 to \$31.69 and \$6.25 to \$31.69, respectively.

3. COMMITMENTS AND CONTINGENCIES

Toaster Recall. In February 2002, Applica Consumer Products, Inc., in cooperation with the Consumer Products Safety Commission, voluntarily recalled approximately 2.1 million Black & Decker® T1200 and T1400 toasters. Applica's Canadian operating subsidiary, Applica Canada Corporation, also recalled approximately 180,000 of these toasters in Canada. Management charged 2001 operations with an estimated accrual of \$13.4 million for these recalls and does not believe the ultimate liability will be greater than the amount accrued.

Six lawsuits have been filed in connection with property damage or bodily injury relating to the recalled toasters (three of which have been settled) and several other claims have been made. We believe that the amount of ultimate liability of these claims, if any, is not likely to have a material effect on our business, financial condition, results of operations or liquidity. However, as the outcome of litigation is difficult to predict, significant changes in the estimated exposures could occur.

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Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements Continued

Tilia Matters. In May 2003, Applica brought suit against Tilia International, Inc. in U.S. district court in Miami, Florida to invalidate certain patents held by Tilia relating to its home vacuum packaging products. Immediately thereafter, Tilia sued Applica in the U.S. district court in California for alleged patent infringement by Applica's Black & Decker branded vacuum packaging machine and accessories. These matters are in their initial stages.

In July 2003, Tilia filed a complaint against Applica and other parties with the International Trade Commission (ITC) in Washington D.C. Tilia alleged infringement of its patent related to vacuum packaging machines and is seeking a temporary exclusion order that would prevent Applica from selling its vacuum sealer product in the U.S. A hearing was held before an Administrative Law Judge (ALJ) in September 2003. The ALJ is expected to rule on the request for the exclusion order in December 2003. After such ruling, the ITC is required to affirm, reverse or modify the ruling of the ALJ, which action is scheduled to be taken in January 2004. A full hearing before the ALJ on issues related to Tilia's complaint is scheduled for May 2004, with an initial determination by the ALJ expected in June 2004.

In late September 2003, Applica also brought a nullity action in Germany seeking to invalidate the German counterpart of the Tilia vacuum sealer machine patent. This matter is in its initial stages.

We believe that the amount of ultimate liability of these matters, if any, is not likely to have a material effect on our business, financial condition, results of operations or liquidity. However, as the outcome of litigation is difficult to predict, significant changes in the estimated exposures could occur.

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

4. REPOSITIONING AND OTHER CHARGES

For the nine months ended September 30, 2003, the activity in the accrued repositioning and other charges was as follows:

| Activity | Amount Accrued at 12/31/2002 | Amount Paid | Amount Accrued at 9/30/2003 |
|-----------------------------------|------------------------------------|-------------------|-----------------------------------|
| | | (In thousands) | |
| Recall | \$ 4,763 | \$ 505 | \$4,258 |
| Back-office consolidation | 5,956 | 3,850 | 2,106 |
| Shareholder litigation settlement | 450 | 450 | |
| | <u>\$ 11,169</u> | <u>\$ 4,805</u> | <u>\$ 6,364</u> |

For the nine months ended September 30, 2002, the activity in the accrued repositioning and other charges was as follows:

| Activity | Amount Accrued at 12/31/2001 | Amount Paid | Amount Accrued at 9/30/2002 |
|-----------------------------------|------------------------------------|----------------|-----------------------------------|
| | | (In thousands) | |
| Recall | \$ 13,418 | \$ 8,479 | \$4,939 |
| Back-office consolidation | 5,179 | 1,353 | 3,826 |
| Shareholder litigation settlement | 1,000 | 550 | 450 |

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| | | |
|-------------------|-------------------|-------------------|
| <u> </u> | <u> </u> | <u> </u> |
| \$19,597 | \$10,382 | \$9,215 |
| <u> </u> | <u> </u> | <u> </u> |

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

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Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements Continued

5. INVESTMENT IN JOINT VENTURE

In the fourth quarter of 2002, Anasazi Partners, L.P., a partnership owned 50% by Applica, engaged an investment banker to pursue exit strategies for Anasazi's equity investment in ZonePerfect Nutrition Company. In July 2003, ZonePerfect was sold for approximately \$160.0 million in cash, \$20.0 million of which is being held in escrow. Ten million of the sale price is dependent upon the future negotiation of a contractual matter and no portion thereof has been reflected in the net income of Anasazi. The net earnings from the joint venture were \$16.2 million for the third quarter of 2003, as compared to a loss of \$598,000 in the third quarter of 2002. For the nine months ended September 30, 2003, the net earnings from the joint venture was \$55.2 million, as compared to a loss of \$783,000 in the same period of 2002.

In August 2003, Applica received a cash distribution from Anasazi of \$51.4 million resulting from the sale of ZonePerfect, which reduced Applica's investment in Anasazi. The funds held in escrow are to be released to the sellers, including Anasazi, at 18 and 24 months from date of closing, subject to any adjustments to the escrowed funds for representations and warranties, and the future contractual matter to be negotiated.

Anasazi's investments include certain privately traded securities whose values have been estimated by the general partner in the absence of readily ascertainable market values. Fair value of these securities may differ significantly from the values that would have been used had a ready market for the securities existed. Any change from the estimated values could have a significant impact on the Company's operations. In July 2003, the general partner of Anasazi Partners L.P. began the process of liquidating the remaining partnership investments and dissolving the partnership.

6. GOODWILL AND INTANGIBLE ASSETS

Applica applied the provisions of SFAS 142 beginning on January 1, 2002 and performed a transitional fair valued based impairment test. Based on the initial impairment test, Applica recognized a non-cash adjustment of \$121.3 million (\$78.8 million, net of tax) in the first quarter of 2002 to reduce the carrying value of goodwill to its implied fair value, which was estimated using a combination of market-multiples, comparable transactions and discounted cash flow methodologies. Under SFAS 142, the impairment adjustment was reflected as a cumulative effect of change in accounting principle in the first quarter of 2002.

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

| | Average Life (Years) | September 30, 2003 | | December 31, 2002 | |
|----------------|----------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| | | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| (In thousands) | | | | | |
| Licenses | 6.5 | \$49,200 | \$(38,399) | \$49,200 | \$(32,786) |
| Contract-Based | 3.3 | 5,988 | (2,261) | 5,968 | (1,522) |
| | | <u>\$55,188</u> | <u>\$(40,660)</u> | <u>\$55,168</u> | <u>\$(34,308)</u> |

Amortization expense for intangible assets during the three months ended September 30, 2003 was \$2.3 million and during the first nine months of 2003 was \$6.4 million.

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Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements Continued

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

| | (In thousands) |
|------|----------------|
| 2003 | \$ 8,581 |
| 2004 | \$ 8,751 |
| 2005 | \$ 1,449 |
| 2006 | \$ 1,113 |
| 2007 | \$ 469 |
| 2008 | \$ 161 |

7. CONDENSED CONSOLIDATING FINANCIAL INFORMATION

Applica Incorporated's domestic subsidiaries are guarantors of its 10% Senior Subordinated Notes due 2008. The following condensed consolidating financial information presents the results of operations, financial position and cash flows of Applica Incorporated (on a stand alone basis), the guarantor subsidiaries (on a combined basis), the non-guarantor subsidiaries (on a combined basis) and the eliminations necessary to arrive at the consolidated results of Applica. The results of operations and cash flows presented below assume that the guarantor subsidiaries were in place for all periods presented. Applica Incorporated and the subsidiary guarantors have accounted for investments in their respective subsidiaries on an unconsolidated basis using the equity method of accounting. The subsidiary guarantors are wholly-owned subsidiaries of Applica and have fully and unconditionally guaranteed the notes on a joint and several basis. The notes contain certain covenants that, among other things, restrict the ability of the subsidiary guarantors to make distributions to Applica Incorporated.

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Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements Continued

Nine months Ended September 30, 2003

| | Parent | Guarantors | Non-Guarantors | Eliminations | Consolidated |
|--|------------|-------------|----------------|--------------|--------------|
| (In thousands) | | | | | |
| Statement of Operations: | | | | | |
| Net sales | \$ | \$ 341,137 | \$ 287,474 | \$ (197,013) | \$ 431,598 |
| Cost of goods sold | | 237,295 | 262,600 | (197,013) | 302,882 |
| Gross profit | | 103,842 | 24,874 | | 128,716 |
| Operating (income) expenses | 6 | 115,396 | 19,918 | | 135,320 |
| Operating earnings (loss) | (6) | (11,554) | 4,956 | | (6,604) |
| Other income expense, net | (69) | 13,268 | (2,661) | | 10,538 |
| Loss on early extinguishment of debt | | 1,906 | | | 1,906 |
| Earnings (loss) before equity in net earnings (loss) of joint venture and subsidiaries, and income taxes | 63 | (26,728) | 7,617 | | (19,048) |
| Equity in net earnings (loss) of joint venture | 55,199 | | | | 55,199 |
| Equity in net earnings (loss) of subsidiaries | (11,491) | | | 11,491 | |
| Income tax expense (benefit) | 22,080 | (3,666) | (3,954) | | 14,460 |
| Net earnings (loss) | \$ 21,691 | \$ (23,062) | \$ 11,571 | \$ 11,491 | \$ 21,691 |
| Balance Sheet: | | | | | |
| Cash and cash equivalents | \$ | \$ 2,861 | \$ 4,113 | \$ | \$ 6,974 |
| Accounts and other receivables, net | | 101,036 | 32,876 | | 133,912 |
| Receivables from affiliates | (374,165) | 37,540 | 81,828 | 256,384 | 1,587 |
| Inventories | | 106,088 | 44,093 | | 150,181 |
| Future income tax benefits | | 14,906 | (252) | | 14,654 |
| Other current assets | | 4,532 | 13,382 | | 17,914 |
| Total current assets | (374,165) | 266,963 | 176,040 | 256,384 | 325,222 |
| Investment in joint venture | 5,038 | | | | 5,038 |
| Investment in subsidiaries | 689,853 | 113,503 | 70,430 | (873,786) | |
| Property, plant and equipment, net | | 16,166 | 55,149 | | 71,315 |
| Long-term future income tax benefits | | 37,850 | 5,220 | | 43,070 |
| Other assets | 2,054 | 109,465 | 13,919 | (44,108) | 81,330 |
| Total assets | \$ 322,780 | \$ 543,947 | \$ 320,758 | \$ (661,510) | \$ 525,975 |
| Accounts payable and accrued expenses | \$ | \$ 46,411 | \$ 72,019 | \$ | \$ 118,430 |
| Current maturities of long-term debt | 151 | | | | 151 |
| Deferred rent | | 319 | | | 319 |
| Current taxes payable | | 539 | 4,074 | | 4,613 |
| Total current liabilities | 151 | 47,269 | 76,093 | | 123,513 |
| Long-term debt | 155,931 | 37,914 | 13,142 | (51,056) | 155,931 |
| Future income tax liabilities | | (780) | 780 | | |
| Other long-term liabilities | 1,643 | 434 | | | 2,077 |

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| | | | | | |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|
| Total liabilities | 157,725 | 84,837 | 90,015 | (51,056) | 281,521 |
| Shareholders' equity | 165,055 | 459,110 | 230,743 | (610,454) | 244,454 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total liabilities and shareholders' equity | \$ 322,780 | \$ 543,947 | \$ 320,758 | \$(661,510) | \$ 525,975 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

Cash Flow Information:

| | | | | | |
|---|----------|-------------|-----------|-----------|------------|
| Net cash provided by (used in) operating activities | \$ 5,567 | \$(106,259) | \$ 59,078 | \$ 35,525 | \$ (6,089) |
| Net cash provided by (used in) investing activities | 56,696 | 58,687 | (51,872) | (21,134) | 42,377 |
| Net cash provided by (used in) financing activities | (63,653) | 46,824 | (7,167) | (14,391) | (38,387) |
| Effect of exchange rate changes on cash | 1,390 | | | | 1,390 |
| Cash at beginning | | 3,609 | 4,074 | | 7,683 |
| Cash at end | | 2,861 | 4,113 | | 6,974 |

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Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements **Continued**

Nine months Ended September 30, 2002

| | Parent | Guarantors | Non-Guarantors | Eliminations | Consolidated |
|---|-------------|-------------|----------------|--------------|--------------|
| (In thousands) | | | | | |
| Statement of Operations: | | | | | |
| Net sales | \$ | \$ 381,022 | \$ 380,898 | \$ (255,972) | \$ 505,948 |
| Cost of goods sold | | 257,146 | 345,388 | (255,972) | 346,562 |
| | | _____ | _____ | _____ | _____ |
| Gross profit | | 123,876 | 35,510 | | 159,386 |
| Operating (income) expenses | (766) | 111,412 | 26,899 | | 137,545 |
| Repositioning charge | | 10,643 | | | 10,643 |
| | | _____ | _____ | _____ | _____ |
| Operating earnings (loss) | 766 | 1,821 | 8,611 | | 11,198 |
| Other (income) expense, net | 4 | 767 | 10,241 | | 11,012 |
| Gain on litigation settlement | | (1,070) | 513 | | (557) |
| | | _____ | _____ | _____ | _____ |
| Earnings (loss) before equity in net earnings (loss) of joint venture and subsidiaries, and income taxes and cumulative effect of change in accounting principle | 762 | 2,124 | (2,143) | | 743 |
| Equity in net earnings (loss) of joint venture | (783) | | | | (783) |
| Equity in net earnings (loss) of subsidiaries | (87,470) | | | 87,470 | |
| Income tax expense (benefit) | (8,638) | | 8,622 | | (16) |
| | | _____ | _____ | _____ | _____ |
| Earnings (loss) before cumulative effect of change in accounting principle | (78,853) | 2,124 | (10,765) | 87,470 | (24) |
| Cumulative effect of change in accounting principle | | (78,829) | | | (78,829) |
| | | _____ | _____ | _____ | _____ |
| Net earnings (loss) | \$ (78,853) | \$ (76,705) | \$ (10,765) | \$ 87,470 | \$ (78,853) |
| | | _____ | _____ | _____ | _____ |
| Balance Sheet: | | | | | |
| Cash and cash equivalents | \$ | \$ 463 | \$ 8,893 | \$ | \$ 9,356 |
| Accounts and other receivables, net | | 111,830 | 49,110 | | 160,940 |
| Receivables from affiliates | (303,543) | (17,127) | 53,749 | 269,523 | 2,602 |
| Inventories | | 99,106 | 43,276 | | 142,382 |
| Future income tax benefits | | 32,036 | | | 32,036 |
| Other current assets | | 5,480 | 17,099 | | 22,579 |
| | | _____ | _____ | _____ | _____ |
| Total current assets | (303,543) | 231,788 | 172,127 | 269,523 | 369,895 |
| Investments in joint venture | 1,296 | | | | 1,296 |
| Investment in subsidiaries | 643,502 | 113,552 | 70,476 | (827,530) | |
| Property, plant and equipment, net | | 17,410 | 62,663 | | 80,073 |
| Long-term future income tax benefits | 8,644 | 40,463 | 652 | | 49,759 |
| Other assets | 2,446 | 122,773 | 29,291 | (63,461) | 91,049 |
| | | _____ | _____ | _____ | _____ |
| Total assets | \$ 352,345 | \$ 525,986 | \$ 335,209 | \$ (621,468) | \$ 592,072 |
| | | _____ | _____ | _____ | _____ |
| Accounts payable and accrued expenses | 4 | 48,237 | 81,562 | | 129,803 |
| Current maturities of long-term debt | | 141 | | | 141 |
| Deferred rent | | 408 | | | 408 |

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| | | | | | |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|
| Current taxes payable | | (176) | 3,962 | 1,106 | 4,892 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total current liabilities | 4 | 48,610 | 85,524 | 1,106 | 135,244 |
| Long-term debt | 235,805 | 31,357 | 23,966 | (49,520) | 241,608 |
| Future income tax liabilities | | 22,432 | 2,804 | (25,236) | |
| Other long-term liabilities | | 3,000 | | | 3,000 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total liabilities | 235,809 | 105,399 | 112,294 | (73,650) | 379,852 |
| Shareholders' equity | 116,536 | 420,587 | 222,915 | (547,818) | 212,220 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total liabilities and shareholders' equity | \$ 352,345 | \$ 525,986 | \$ 335,209 | \$ (621,468) | \$ 592,072 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

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Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements Continued

Cash Flow Information:

| | | | | | |
|---|------------|-------------|-----------|-----------|----------|
| Net cash provided by (used in) operating activities | \$ (4,942) | \$ (41,910) | \$ 30,182 | \$ 20,205 | \$ 3,535 |
| Net cash provided by (used in) investing activities | 48,140 | 66,683 | (32,837) | (110,935) | (28,949) |
| Net cash provided by (used in) financing activities | (45,157) | (25,066) | (3,439) | 90,730 | 17,068 |
| Effect of exchange rate changes on cash | 1,959 | | | | 1,959 |
| Cash at beginning | | 756 | 14,987 | | 15,743 |
| Cash at end | | 463 | 8,893 | | 9,356 |

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**Applica Incorporated and Subsidiaries
Notes to Consolidated Financial Statements Continued**

8. SUBSEQUENT EVENT

On October 3, 2003, Applica redeemed an additional \$25 million of its 10% Senior Subordinated Notes due 2008. The notes were redeemed, using availability under Applica's senior credit facility, at 105% of the principal amount, plus accrued interest up to, but not including, the redemption date. The cost of the redemption of the notes includes approximately \$1.3 million in prepayment premiums and approximately \$338,000 related to the write-off of deferred financing costs, which will be recorded in the fourth quarter of 2003.

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

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

The following discussion and analysis and the related financial data present a review of the consolidated operating results and financial condition of Applica for the three-month and nine-month periods ended September 30, 2003 and 2002. This discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto contained in Applica's Annual Report on Form 10-K for the year ended December 31, 2002.

General

Applica Incorporated is a Florida corporation that was incorporated in 1963. Applica is a manufacturer, marketer and distributor of a broad range of branded and private-label small electric consumer goods. In 1998, we acquired the Black & Decker Household Products Group and became a leading supplier of brand name small household appliances in North and Latin America. We also manufacture and distribute professional personal care products, home environment products, pet care products, including the LitterMaid® self-cleaning cat litter box, and pest control products. We manufacture and market products under licensed brand names, such as Black & Decker®, our own brand names, such as Windmere® and Applica®, and other private-label brand names. Our customers include mass merchandisers, specialty retailers and appliance distributors primarily in North America, Latin America and the Caribbean.

We operate manufacturing facilities in China and Mexico. Applica's manufacturing operations are conducted by two wholly owned subsidiaries: Applica Durable Manufacturing Limited in China and Applica Manufacturing, S. de R.L. de C.V. in Mexico. The distribution, sales, and marketing operations are primarily handled through our U.S. operating subsidiary, Applica Consumer Products, Inc. Applica also has separate entities providing distribution, sales and marketing operations in Canada, Puerto Rico, Mexico, Chile, Argentina, Venezuela and Colombia.

In the fourth quarter of 2000, Applica entered into a joint product development relationship with The Procter & Gamble Company to develop, manufacture, market and distribute new products. We have entered into agreements related to two products and are in the process of reviewing other opportunities for joint product development with Procter & Gamble in household appliance categories. This relationship has initially been targeted to the Black & Decker® brand, but may be expanded to new brands and wider categories. We anticipate that the first new product developed will be launched in February 2004 direct-to-consumer, with a national launch in the second quarter of 2004. The second product is also scheduled to be launched in the second quarter of 2004.

In June 1996, Applica made a \$1.3 million investment representing a 50% interest in Anasazi Partners L.P. In the fourth quarter of 2002, Anasazi engaged an investment banker to pursue exit strategies for its equity investment in ZonePerfect Nutrition Company. In July 2003, the ZonePerfect Nutrition Company was sold for approximately \$160.0 million in cash, \$20.0 million of which is being held in escrow. In August 2003, Applica received a cash distribution from Anasazi of \$51.4 million related to the sale, which reduced Applica's investment in Anasazi. In July 2003, the general partner of Anasazi Partners L.P. began the process of liquidating the remaining partnership investments and dissolving the partnership.

In September 2003, a bipartisan group of U.S. senators introduced legislation that would impose a 27.5% duty on all imports from China until China stopped fixing the value of its currency, the yuan, to the dollar. The legislation maintains that the yuan is artificially pegged below its market value and therefore acts as a virtual trade barrier. Since 1994, China has pegged the yuan at an exchange rate of 8.28 to the dollar. U.S. groups have argued that the peg makes China's exports to the U.S. cheaper, and U.S. exports to China more expensive, thus greatly contributing to China's trade surplus with the U.S. A House version of the bill was recently introduced. Action has not been completed on either bills. We do not believe the legislations will be adopted in its current form. However, because a substantial number of our products are imported from China, the adoption of such legislation in its current or a similar form would have a material adverse effect on our business.

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Forward Looking Statement Disclosure

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

You should carefully consider the following risk factors, together with the other information contained in our annual report on Form 10-K for the year ended December 31, 2002, in evaluating us and our business before making an investment decision regarding our securities:

If We Are Unable To Renew The Black & Decker® Trademark License Agreement, Our Business Could Be Adversely Affected.

Our Business Could Be Adversely Affected By Changes In Trade Relations With China.

We Depend On Purchases By Several Large Customers And Any Significant Decline In These Purchases Or Pressure From These Customers To Reduce Prices Could Have A Negative Effect On Our Business.

The Bankruptcy Or Financial Difficulty Of Any Major Customer Or Fluctuations In The Financial Condition Of The Retail Industry Could Adversely Affect Our Business.

Our Business Is Very Sensitive To The Strength Of The U.S. Retail Market And Weakness In This Market Could Adversely Affect Our Business.

Uncertainties Regarding The Impact Of Terrorist Activities and The Current War On Terrorism Could Have A Material Adverse Effect On Our Business.

Our Business Can Be Adversely Affected By Fluctuations In Cost And Availability Of Raw Materials (Particularly The Cost Of Plastic Resins) And Components.

Our Business Involves The Potential For Product Recalls And Product Liability Claims Against Us.

Our Business Could Be Adversely Affected By Currency Fluctuations In Our International Operations.

The Imposition Of Increased Duty Rates By The U.S. Government On Products Made In China Would Have A Negative Effect On Our Business.

We Operate A Significant Portion Of Our Business Outside Of The United States Which Subjects Us To Additional Risks.

Our Business Could Be Adversely Affected By Retailer Inventory Management Or The Failure of Our Logistical Systems.

Our Future Success Requires Us To Develop New And Innovative Products On A Consistent Basis In Order To Increase Revenues And We May Not Be Able To Do So.

We Rely Heavily On Our Manufacturing Facilities To Manufacture And Assemble Our Products. An Extended Interruption In The Operation Of Any Facility Could Have An Adverse Impact On Our Operating Results.

We Are Subject To Several Production-Related Risks Which Could Jeopardize Our Ability To Realize Anticipated Sales And Profits.

The Infringement Or Loss Of Our Proprietary Rights Could Have An Adverse Effect On Our Business.

Our Operating Results Can Be Affected By Seasonality.

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We Compete With Other Large Companies That Produce Similar Products.

Our Debt Agreements Contain Covenants That Restrict Our Ability To Take Certain Actions.

Our Business Can Be Adversely Affected By Newly Acquired Businesses Or Product Lines.

Government Regulations Could Adversely Impact Our Operations.

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

Outlook

The following discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Such forward-looking statements are subject to the risks, uncertainties and assumptions discussed above. If any such events or circumstances actually occur, our business, financial condition or results of operations could be materially adversely affected. The risks listed above are not the only risks that we face. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations.

Management anticipates that sales for the year ended December 31, 2003 will be between \$630 million and \$640 million. Earnings per share is expected to be approximately \$0.60 for the 2003 year.

Looking forward, our management is currently focused on creating a more variable and lower cost operating model. As part of that focus, we have taken or intend to take the following actions:

We reduced the workforce at our Miami Lakes location at the end of September, while shifting certain product development processes from the United States to our China locations.

We intend to downsize our Mexico manufacturing operations in the fourth quarter of 2003 and move production of certain items to China. We expect to have approximately \$5.0 million in severance costs related to the reduction of employees in Mexico.

We are reducing fixed costs and capacity in our Chinese factories and focusing on products with proprietary technologies. We are planning to outsource the more commodity-type products to strategic sourcing partners within China. In doing this, we expect to reduce the labor force in our Durable facilities and close two locations in the fourth quarter of 2003, which will result in additional retrenchment costs of approximately \$7.0 million.

The total head count reduction is expected to be approximately 25% worldwide. Management expects these actions to result in an annual savings of approximately \$25 million to \$30 million beginning in January 2004 based on expected sales volumes. We are also opening a Shanghai office to enhance our engineering, design and procurement capabilities in an emerging area of China as related to our industry. Finally, we have signed a letter of intent to sell the executive office facility located in Miami Lakes, Florida. We intend to move to a smaller, less expensive building in the same geographical area in the third quarter of 2004.

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Results of Operations

Three Months Ended September 30, 2003 Compared To Three Months Ended September 30, 2002

Net Sales. Sales for Applica decreased by \$21.4 million to \$173.5 million, a decrease of 11.0% over the third quarter of 2002. The decrease was largely the result of planned lower contract manufacturing sales and softer U.S. sales in certain distribution channels. For the quarter:

contract manufacturing decreased by \$15.5 million,

sales of pest products decreased \$5.6 million,

sales of Windmere and other branded products decreased by \$0.9 million, and

sales of Littermaid products decreased by \$0.9 million.

These decreases were partially offset by increases in sales of Black & Decker branded products of \$1.5 million. Management expects that reduced contract manufacturing orders will continue to negatively affect sales in the fourth quarter of 2003.

Gross Profit. Applica's gross profit margin decreased to 29.5% in the third quarter of 2003 as compared to 33.2% for the same period in 2002. The gross profit margin decrease is primarily attributed to a poor product mix and unabsorbed overhead related to lower production levels. The lower production levels resulted from lower sales and increased third party sourcing of products. Management anticipates that Applica will continue to lower production at our factories (with a corresponding plan to reduce overhead expenses) and increase third party sourcing of products. Management anticipates that gross margins for the fourth quarter will be negatively affected by the retrenchment of our Mexican and Chinese facilities, as discussed in Outlook above, a poor product mix and continued lower production at our manufacturing operations.

Selling, General and Administrative Expenses.

Operating Expenses. Operating expenses for Applica increased \$7.1 million for the third quarter of 2003 to \$54.1 million as compared to the third quarter of 2002. Such expenses increased as a percentage of sales to 31.2% from 24.2% in the 2002 period. In the third quarter of 2003:

payroll and severance-related expenses increased by \$2.4 million,

legal expenses increased by \$2.3 million,

consulting expenses related to the information technology improvements increased by \$2.1 million,

freight and distribution expenses increased by \$1.6 million,

royalty expenses related to the Black & Decker license increased by \$1.5 million,

other expenses increased by \$1.0 million, and

foreign exchange expenses increased by \$500,000.

These increases were partially offset by a decrease in bad debt expenses of \$3.2 million and a decrease in expenses of \$1.1 million as the result of the 2002 consolidation of certain facilities in North and Latin America. Management expects increased royalties and legal expenses to continue in the fourth quarter of 2003.

Repositioning and Other Charges. In the third quarter of 2002, Applica incurred expenses of \$5.4 million relating to its decision to consolidate its Shelton, Connecticut office with the headquarters located in Miami Lakes, Florida, as well as certain back-office and supply chain functions in Canada and Latin America. The consolidation was completed in the third quarter of 2002.

Interest Expense. Interest expense decreased by \$1.4 million to \$3.6 million for the three months ended September 30, 2003, compared to \$5.0 million in the 2002 period, primarily as the result of lower debt levels and lower average interest rates resulting from the redemption of a portion of the 10% notes. As a result of the redemption of the notes, management anticipates that interest expense will decrease in the fourth quarter of 2003 and throughout 2004.

Loss On Early Extinguishment of Debt. On July 31, 2003, Applica redeemed \$30 million of its \$130 million 10% Senior Subordinated Notes due 2008. The notes were redeemed, using availability under Applica's

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senior credit facility, at 105% of the principal amount, plus accrued interest up to, but not including, the redemption date. The cost of the redemption of the notes includes \$1.5 million in prepayment premiums and approximately \$0.4 million related to the write-off of deferred financing costs. On October 3, 2003, Applica redeemed an additional \$25 million of the notes. The notes were redeemed, using a portion of the cash distribution received from Anasazi Partners L.P., at 105% of the principal amount, plus accrued interest up to, but not including, the redemption date. The cost of the redemption of the notes includes \$1.3 million in prepayment premiums and approximately \$0.3 million related to the write-off of deferred financing costs, which will be recorded in the fourth quarter of 2003. Applica may redeem up to an additional \$15 million of the notes in the fourth quarter of 2003.

Equity in Net Earnings (Loss) of Joint Venture. In June 1996, Applica made a \$1.3 million investment representing a 50% interest in Anasazi Partners L.P. In the fourth quarter of 2002, Anasazi engaged an investment banker to pursue exit strategies for Anasazi's equity investment in ZonePerfect Nutrition Company. In July 2003, ZonePerfect was sold for approximately \$160.0 million in cash, \$20.0 million of which is being held in escrow. Ten million of the sale price is dependent upon the future negotiation of a contractual matter and no portion thereof has been reflected in the net income of Anasazi. The net earnings from the joint venture were \$16.2 million for the third quarter of 2003, as compared to a loss of \$598,000 in the third quarter of 2002. The additional gain was related to the sale of ZonePerfect and resulted from the settlement of certain outstanding issues with the general partner of Anasazi in the third quarter of 2003.

In August 2003, Applica received a cash distribution from Anasazi of \$51.4 million resulting from the sale of ZonePerfect, which reduced Applica's investment in Anasazi. The funds held in escrow are to be released to the sellers, including Anasazi, at 18 and 24 months from date of closing, subject to any adjustments to the escrowed funds for representations and warranties, and the future contractual matter to be negotiated.

Anasazi's investments include certain privately traded securities whose values have been estimated by the general partner in the absence of readily ascertainable market values. Fair value of these securities may differ significantly from the values that would have been used had a ready market for the securities existed. Any change from the estimated values could have a significant impact on the Company's operations. In July 2003, the general partner of Anasazi Partners L.P. began the process of liquidating the remaining partnership investments and dissolving the partnership.

Taxes. Applica's tax expense is based on an estimated annual aggregation of the taxes on earnings of each of its foreign and domestic operations. In the third quarter of 2003, Applica used an effective rate of 40%, as compared to 35% for the third quarter of 2002. The change in the tax rate from 2002 reflects additional permanent differences. Applica expects its future effective tax rate to approximate 40%.

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

Earnings Per Share. Basic shares for the three-month periods ended September 30, 2003 and 2002 were 23,631,586 and 23,465,880, respectively. Included in diluted shares for the three-month periods ended September 30, 2003 and 2002 are common stock equivalents relating to options of 320,060 and 532,745.

Nine Months Ended September 30, 2003 Compared To Nine Months Ended September 30, 2002

Net Sales. Sales for Applica decreased by \$74.3 million to \$431.6 million, a decrease of 14.7% over the first nine months of 2002. The decrease was largely the result of lower sales to key retailers and planned lower contract manufacturing sales. For the first nine months of 2003:

contract manufacturing decreased by \$34.1 million,

sales of Black & Decker branded products decreased by \$23.0 million worldwide,

sales of Windmere and other branded products decreased by \$16.6 million, and

sales of Littermaid products decreased by \$3.6 million.

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These decreases were partially offset by increases in sales of pest control products of \$3.0 million. Management expects that reduced contract manufacturing orders will continue to negatively affect sales for the year ended December 31, 2003.

Gross Profit. Applica's gross profit margin decreased to 29.8% in the nine-month period ended September 30, 2003 as compared to 31.5% for the same period in 2002. The gross profit margin decrease is primarily attributed to a poor product mix and unabsorbed overhead at our factories related to lower production levels. Management anticipates that gross margins for the fourth quarter will be negatively affected by the retrenchment of our Mexican and Chinese facilities, as discussed in *Outlook* above, a poor product mix and continued lower production at our manufacturing operations.

Selling, General and Administrative Expenses.

Operating Expenses. Operating expenses for Applica decreased \$2.2 million for the first nine months of 2003 to \$135.3 million as compared to the same period in 2002. Such expenses increased as a percentage of sales to 31.4% from 27.2% in the 2002 period primarily as the result of lower sales volume. In the first nine months of 2003:

Applica experienced a decrease in expenses of \$3.2 million as the result of the 2002 consolidation of certain facilities in North and Latin America, advertising and promotion expenses decreased by \$2.5 million, and bad debt expenses decreased \$2.4 million.

Additionally, foreign exchange losses were \$500,000 in the first nine months of 2003, but totaled \$1.9 million for the same period of 2002. These decreases were partially offset by:

increases of \$2.7 million in consulting expenses related to the information technology improvements, Management expects increased royalties and legal expenses to continue in the fourth quarter of 2003.

Repositioning and Other Charges. In the first nine months of 2002, Applica incurred expenses of \$10.6 million relating to its decision to consolidate its Shelton, Connecticut office with the headquarters located in Miami Lakes, Florida, as well as certain back-office and supply chain functions in Canada and Latin America. Such consolidation was completed in the third quarter of 2002.

Interest Expense. Interest expense decreased by \$1.2 million to \$11.4 million for the nine months ended September 30, 2003, as compared to \$12.6 million for the first nine months of 2002. In the first nine months of 2003, lower debt levels and lower average interest rates (resulting from the redemption of a portion of the 10% notes) were partially offset by reduced income from interest rate management contracts.

Loss On Early Extinguishment of Debt. On July 31, 2003, Applica redeemed \$30 million of its \$130 million 10% Senior Subordinated Notes due 2008. The notes were redeemed, using availability under Applica's senior credit facility, at 105% of the principal amount, plus accrued interest up to, but not including, the redemption date. The cost of the redemption of the notes includes \$1.5 million in prepayment premiums and approximately \$0.4 million related to the write-off of deferred financing costs. On October 3, 2003, Applica redeemed an additional \$25 million of the notes. The notes were redeemed, using a portion of the cash distribution received from Anasazi Partners L.P., at 105% of the principal amount, plus accrued interest up to, but not including, the redemption date. The cost of the redemption of the notes includes \$1.3 million in prepayment premiums and approximately \$0.3 million related to the write-off of deferred financing costs. Applica may redeem up to an additional \$15 million of the notes in the fourth quarter of 2003.

Equity in Net Earnings (Loss) of Joint Venture. The equity in net earnings (loss) of joint venture increased from a \$783,000 loss in the first nine months of 2002 to a gain of \$55.2 million in the first nine months of

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2003. The equity in net earnings resulted primarily from a gain in the fair value of an investment in ZonePerfect Nutrition Company held by such joint venture. The gain was precipitated by the sale of the investment.

The remaining investments of Anasazi Partners include certain privately traded securities whose values have been estimated by the general partner in the absence of readily ascertainable market values. Fair value of these securities may differ significantly from the values that would have been used had a ready market for the securities existed. In July 2003, the general partner of Anasazi Partners L.P. began the process of liquidating the remaining partnership investments and dissolving the partnership.

Taxes. Applica's tax expense is based on an estimated annual aggregation of the taxes on earnings of each of its foreign and domestic operations. In the first nine months of 2003 and 2002, Applica used an effective rate of 40%.

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

Cumulative Effect of Change in Accounting Principle. In June 2001, the Financial Accounting Standards Board approved the issuance of SFAS 142, *Goodwill and Other Intangible Assets*, which established new accounting and reporting requirements for goodwill and other intangible assets. The new standard required that all intangible assets acquired that are obtained through contractual or legal right, or are capable of being separately sold, transferred, licensed, rented or exchanged must be recognized as an asset apart from goodwill. Goodwill and intangibles with indefinite lives are no longer amortized, but are subject to an annual assessment for impairment by applying a fair value based test.

Applica applied the provisions of SFAS 142 beginning in January 2002 and performed a transitional fair valued based impairment test. Based on its initial impairment tests, Applica recognized an adjustment of \$121.3 million (\$78.8 million, or \$3.37 per share, net of tax) in the first nine months of 2002 to reduce the carrying value of goodwill to its implied fair value. Under SFAS 142, the impairment adjustment was reflected as a cumulative effect of change in accounting principle in the first half of 2002.

Earnings Per Share. Basic shares for the nine-month periods ended September 30, 2003 and 2002 were 23,544,311 and 23,397,663, respectively. Included in diluted shares for the nine-month period ended September 30, 2003 are common stock equivalents relating to options of 1,378,138. All common stock equivalents have been excluded from the diluted per share calculations in the nine-month period ended September 30, 2002 because their inclusion would have been anti-dilutive.

Liquidity and Capital Resources

At September 30, 2003, Applica's working capital was \$201.7 million, as compared to \$234.7 million at September 30, 2002. Applica's current ratio was 2.6 to 1 at September 30, 2003 and 2.7 to 1 at September 30, 2002. Applica's quick ratio was 1.2 to 1 at September 30, 2003 and 1.5 to 1 at September 30, 2002.

The net cash used in operating activities totaled \$6.1 million for the nine months ended September 30, 2003 as compared to \$3.5 million provided by operating activities in the same period in 2002, resulting in a period-to-period use of cash of \$9.6 million. This use of cash was primarily driven by the operating loss, partially offset by the continued improvement in accounts receivable, accounts payable and other accruals.

Cash provided by investing activities totaled approximately \$42.4 million for the period, as compared to \$28.9 million used in investing activities in the same period in 2002, and reflected the receipt of a cash distribution of \$51.4 million from Anasazi Partners, L.P. In addition, the 2003 and 2002 periods reflect the purchase of equipment at Applica's manufacturing facilities and tooling for new products. In addition, the 2002 period reflects the acquisition of Weitech, Inc. for \$17.0 million in cash.

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Cash used in financing activities totaled approximately \$38.4 million in 2003, as compared to \$17.1 million provided by financing activities in the same period in 2002, reflecting the \$31.5 million note redemption payment and the continued reduction of net borrowings.

For the nine months ended September 30, 2003 and 2002, the effect of exchange rate changes on cash were \$1.4 million and \$2.0 million.

Applica's primary sources of liquidity are its cash flow from operations and borrowings under its credit facility. As of October 28, 2003, Applica was borrowing approximately \$68.1 million under its senior secured revolving credit facility and had approximately \$92.9 million available for future cash borrowings. Advances under the facility are primarily based upon percentages of eligible accounts receivable and inventories. The credit facility includes a \$10.0 million sublimit for the issuance of letters of credit, with approximately \$2.5 million outstanding under the limit as of October 28, 2003. All amounts outstanding under the credit facility are payable on December 28, 2005.

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

LIBOR (adjusted for any reserves), plus a specified margin which is determined by Applica's leverage ratio and is currently set at 2.00% (3.12% at October 28, 2003); or

the Base Rate (which is Bank of America's prime rate), plus a specified margin, which is determined based upon Applica's leverage ratio and is currently set at 0.00% (4.00% at October 28, 2003).

Swing loans up to \$15.0 million bear interest at the Base Rate plus a specified margin, which is determined based on Applica's leverage ratio and is currently set at 0.00% (4.00% at October 28, 2003).

Management expects its borrowing margins to increase in the first quarter of 2004 as the result of an increase in the leverage ratio related to additional borrowings under the credit facility to repurchase the 10% notes.

In July 1998, Applica issued \$130.0 million in Senior Subordinated Notes. The notes bear interest at a rate of 10%, payable semiannually, and mature on July 31, 2008. The notes are general unsecured obligations of Applica Incorporated and rank subordinate in right of payment to all senior debt of Applica and rank pari passu in right of payment to all future subordinated indebtedness of Applica. The notes may be redeemed at the option of Applica, in whole or in part, on or after July 31, 2003 at various redemption prices. On July 31, 2003, Applica redeemed \$30 million of the notes and, on October 3, 2003, Applica redeemed an additional \$25 million of the notes. The notes were redeemed at 105% of the principal amount, plus accrued interest up to, but not including, the redemption date.

On September 28, 2002, Applica entered into credit approved receivables purchasing agreements with CIT Group/Commercial Services, Inc. (CIT). The agreements allow Applica to transfer to CIT, without recourse, approved receivables of specified customers under certain circumstances, including the bankruptcy of covered customers. Applica remains the servicer of the approved receivables and pays fees based upon a percentage of the gross face amount of each approved receivable. These arrangements are strictly for the purpose of insuring selected receivables. On January 17, 2003, the agreement covering receivables from a significant customer was converted into a full notification agreement under which CIT has agreed to purchase all approved receivables of such customer.

In April 2002, Applica Consumer Products, Inc. entered into a five-year \$6.0 million mortgage loan on Applica's executive offices located in Miami Lakes, Florida. The loan bears interest at an annual rate of 7.25%, with monthly principal and interest payments based on a 20-year amortization. A final balloon payment is due at the end of the term. The loan is secured by a mortgage on the property and the building located thereon. The Company has entered into a letter of intent to sell its executive offices and move to a smaller, less expensive building in the same geographical area in the third quarter of 2004.

Certain of Applica's foreign subsidiaries have approximately \$18.4 million in trade finance lines of credit, payable on demand, which are secured by the subsidiaries' tangible and intangible property, and in some cases, a guarantee by the parent company, Applica Incorporated. As of September 30, 2003, there were no amounts outstanding under the working capital lines and \$800,000 outstanding under the letter of credit lines. As of October 28, 2003, there was approximately \$10.9 million outstanding under the working capital lines and \$4.2 million under the letter of credit lines.

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Applica's aggregate capital expenditures for the nine months ended September 30, 2003 were \$9.5 million, as compared to \$12.3 million for same nine month period in 2002. Applica anticipates that the total capital expenditures for 2003 will be approximately \$19.0 million, which includes new information technology infrastructure, tooling for new products and the cost of equipment at our manufacturing facilities. Applica plans to fund such capital expenditures from cash flow from operations and, if necessary, borrowings under its credit facility.

At September 30, 2003, debt as a percent of total capitalization was 39.0%, as compared to 53.6% at September 30, 2002.

Applica's ability to make scheduled payments of principal of, or to pay the interest on, or to refinance, its indebtedness, or to fund planned capital expenditures, product research and development expenses and marketing expenses will depend on its future performance, which, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory, and international and United States domestic political factors and other factors that are beyond its control. Based upon the current level of operations and anticipated cost savings and revenue growth, we believe that cash flow from operations and available cash, together with available borrowings under our credit facility and other facilities, will be adequate to meet our future liquidity needs for at least the next several years. There can be no assurance that Applica's business will generate sufficient cash flow from operations, that anticipated revenue growth and operating improvements will be realized or that future borrowings will be available under the credit facility in an amount sufficient to enable Applica to service its indebtedness, including the outstanding 10% notes, or to fund its other liquidity needs. In addition, there can be no assurance that Applica will be able to effect any needed refinancing on commercially reasonable terms or at all.

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

Use of Estimates and Critical Accounting Policies

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

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

Collectibility of Accounts Receivable. Applica's allowance for doubtful accounts is based on management's estimates of the creditworthiness of its customers, current economic conditions and historical information, and, in the opinion of management, is believed to be an amount sufficient to respond to normal business conditions. Management sets specific allowances for customers in bankruptcy and other allowances for the remaining customers based upon historical collection experience. Should business conditions deteriorate or any major customer default on its obligations to Applica, this allowance may need to be significantly increased, which would have a negative impact upon Applica's operations.

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

Income Taxes. Significant management judgment is required in developing Applica's provision for income taxes, including the determination of foreign tax liabilities, deferred tax assets and liabilities and any valuation allowances that might be required against the deferred tax assets. At September 30, 2003, Applica had deferred tax assets in excess of deferred tax liabilities of \$67.9 million. Applica determined that it was more likely than not that \$57.7 million of such assets will be realized, resulting in a valuation allowance of \$10.2 million as of September 30, 2003. Applica evaluates quarterly its ability to realize its deferred tax assets and adjusts the amount of its valuation allowance, if necessary. Applica operates within multiple taxing jurisdictions and is subject to audit in those jurisdictions. Because of the complex issues involved, any claims can require an extended period to resolve. In management's opinion, adequate provisions for income taxes have been made.

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Goodwill. On an annual basis, management assesses the composition of Applica's assets and liabilities, as well as the events that have occurred and the circumstances that have changed since the most recent fair value determination. If events occur or circumstances change that would more likely than not reduce the fair value of goodwill below its carrying amount, goodwill will be tested for impairment. Applica will recognize an impairment loss if the carrying value of the asset exceeds the fair value determination. During the first quarter of 2002, Applica recorded a write-down of its goodwill of \$121.3 million (\$78.8 million, net of tax).

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

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

Product Recall Liability. Applica is subject to potential product recalls. We estimate the amount of ultimate liability based on discussions with the Consumer Product Safety Commission and historical claims experience. For example, in February 2002, we voluntarily recalled our Black & Decker® branded T1200 and T1400 toasters. We charged the 2001 operations with an estimated accrual of \$13.4 million for this recall. Applica has charged \$9.2 million against this accrual through September 30, 2003. While we believe that the accrual is adequate, there can be no assurance that significant future adjustments will not be required.

Other Estimates. Applica makes a number of other estimates in the ordinary course of business relating to sales returns and allowances, warranty accruals, and accruals for promotional incentives. Historically, past changes to these estimates have not had a material impact on our financial condition. However, circumstances could change which may alter future expectations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk**Interest Rate Risk Management**

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

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

Outstanding as of September 30, 2003 were interest rate management contracts on approximately \$80 million notional principal amount with a fair value of \$500,000. The market value represents the amount Applica would receive upon exiting the contracts at September 30, 2003 and was determined based on quotes obtained from Applica's financial institutions. The market value related to interest rate risk management contracts is included as other long-term liabilities as of September 30, 2003. Applica does not intend to exit these contracts at this time.

Significant interest rate risk management instruments held by Applica as of September 30, 2003 included pay-fixed and pay-floating swaps. The pay-fixed swaps effectively convert floating rate obligations to fixed-rate instruments. The pay-floating swap effectively converts medium term fixed-rate obligations to LIBOR-rate indexed variable-rate instruments. All swaps have maturity dates that mirror the maturity date of the underlying hedged transaction. For the period ending September 30, 2003, Applica did not discontinue any hedges due to the probability that the original underlying forecasted transaction would not occur.

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The impact of interest rate risk management activities on income during the quarter and nine months ended September 30, 2003 was not material.

Foreign Exchange Risk Management

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

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

Outstanding as of September 30, 2003 were \$22.8 million notional of contracts to purchase and/or sell foreign currency forward with a negative fair market value of approximately \$600,000. The market value represents the amount Applica would pay upon exiting the contracts at September 30, 2003 and was determined based on quotes obtained from Applica's financial institutions. This amount is included in prepaid expenses and other assets as of September 30, 2003. Applica does not intend to exit these contracts at this time.

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

Additional Information

For additional information, see Item 7A. Quantitative and Qualitative Disclosures About Market Risk in Applica's Annual Report on Form 10-K for the year ended December 31, 2002.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures. Applica's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this quarterly report, and they have concluded that these controls and procedures were effective.

Notwithstanding the foregoing, there can be no assurance that Applica's disclosure controls and procedures will detect or uncover all failures of persons within the Company and its consolidated subsidiaries to disclose material information otherwise required to be set forth in Applica's periodic reports.

Changes in Internal Controls. There have been no significant changes in the Company's internal control over financial reporting or in other factors that occurred during the period covered by this quarterly report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Applica's senior management, in conjunction with its Board of Directors, continuously reviews overall company policies and improves documentation of important financial reporting and internal control matters. Accordingly, certain changes to Applica's internal controls were made during the third quarter of 2003, none of which were significant. Applica is committed to continuously improving the state of its internal controls, corporate governance and financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Toaster Recall. In February 2002, Applica Consumer Products, Inc., in cooperation with the Consumer Products Safety Commission, voluntarily recalled approximately 2.1 million Black & Decker® T1200 and T1400 toasters. Applica's Canadian operating subsidiary, Applica Canada Corporation, also recalled approximately 180,000 of these toasters in Canada. Management charged 2001 operations with an estimated accrual of \$13.4 million for these recalls and does not believe the ultimate liability will be greater than the amount accrued.

Six lawsuits have been filed in connection with property damage or bodily injury relating to the recalled toasters (three of which have been settled) and several other claims have been made. We believe that the amount of ultimate liability of these claims, if any, is not likely to have a material effect on our business, financial condition, results of operations or liquidity. However, as the outcome of litigation is difficult to predict, significant changes in the estimated exposures could occur.

Tilia Matters. In May 2003, Applica brought suit against Tilia International, Inc. in U.S. district court in Miami, Florida to invalidate certain patents held by Tilia relating to its home vacuum packaging products. Immediately thereafter, Tilia sued Applica in the U.S. district court in California for alleged patent infringement by Applica's Black & Decker branded vacuum packaging machine and accessories. These matters are in their initial stages.

In July 2003, Tilia filed a complaint against Applica and other parties with the International Trade Commission (ITC) in Washington D.C. Tilia alleged infringement of its patent related to vacuum packaging machines and is seeking a temporary exclusion order that would prevent Applica from selling its vacuum sealer product in the U.S. A hearing was held before an Administrative Law Judge (ALJ) in September 2003. The ALJ is expected to rule on the request for the exclusion order in December 2003. After such ruling, the ITC is required to affirm, reverse or modify the ruling of the ALJ, which action is scheduled to be taken in January 2004. A full hearing before the ALJ on issues related to Tilia's complaint is scheduled for May 2004, with an initial determination by the ALJ expected in June 2004.

In late September 2003, Applica also brought a nullity action in Germany seeking to invalidate the German counterpart of the Tilia vacuum sealer machine patent. This matter is in its initial stages.

We believe that the amount of ultimate liability of these matters, if any, is not likely to have a material effect on our business, financial condition, results of operations or liquidity. However, as the outcome of litigation is difficult to predict, significant changes in the estimated exposures could occur.

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

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

(a) Exhibits:

- | | |
|------|--|
| 10.1 | Amendment to Employment Agreement dated October 1, 2003 between Applica and Harry D. Schulman. |
| 10.2 | Third Amendment to Credit Agreement by and among Applica Incorporated, each of its subsidiaries party thereto, each of the lenders party thereto and Bank of America, N.A., as agent for the lenders, dated July 18, 2003. |
| 31.1 | Certification of Principal Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a) |
| 31.2 | Certification of Principal Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a) |

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- 32.1 Certification of Principal Executive Officer Pursuant to 18 U.S.C. 1350
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. 1350

(b) Reports on Form 8-K:

Form 8-K dated September 16, 2003 reporting under Item 5. Other Events and Required FD Disclosure that Applica issued a press release updating management's sales guidance for the third quarter of 2003 and announcing that it had received a cash distribution of \$51.4 million related to the sale by its joint venture company, Anasazi Partners, of its equity interest in the ZonePerfect Nutrition Company. The applicable press release was attached.

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SIGNATURES

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

APPLICA INCORPORATED
(Registrant)

October 30, 2003

By: /s/ Harry D. Schulman

Harry D. Schulman
President, Chief Executive Officer and Secretary

October 30, 2003

By: /s/ Terry L. Polistina

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