MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

This discussion should be read in conjunction with the consolidated financial statements and notes thereto of Walter Industries, Inc. and subsidiaries, particularly Note 15 of "Notes to Consolidated Financial Statements" which presents sales and revenues and operating income by operating segment.

RESULTS OF OPERATIONS

Years Ended May 31, 1999 and 1998

Net sales and revenues for the year ended May 31, 1999 increased $134.8 million, or 9.1%, over the prior year. The increase was attributable to improved performances from all operating segments, particularly the Energy Services Group reflecting a full year contribution from Applied Industrial Materials Corporation ("AIMCOR") versus eight months last year, slightly offset by the disposition of JW Window Components, Inc. ("JWWC") during fiscal 1999. See Note 2 of "Notes to Consolidated Financial Statements" regarding the acquisition of AIMCOR and disposition of JWWC.

Cost of sales, exclusive of depreciation, of $1,073.2 million was 79.5% of net sales versus $980.6 million and 80.7% in 1998. The percentage improvement principally reflected higher gross profit margins on pipe products, aluminum foil and sheet products, foundry coke and chemicals.

Selling, general and administrative expenses of $168.7 million were 10.4% of net sales and revenues versus $156.4 million and 10.5% last year.

Interest and amortization of debt expense was $185.0 million versus $193.6 million in 1998 as a result of lower interest rates and lower average outstanding debt balances. The average rate of interest in 1999 was 7.6% as compared to 8.0% in 1998. The average prime rate of interest was 8.0% and 8.5% in 1999 and 1998, respectively.

The Company's effective tax rate from continuing operations in 1999 and 1998 differed from the statutory tax rate primarily due to amortization of goodwill (excluding amounts related to the AIMCOR acquisition), which is not deductible for tax purposes. Additionally, in 1999, the Company's effective tax rate differed from the statutory rate as a result of a $9.8 million non-recurring tax benefit recognized on the sale of JWWC. See Note 7 of "Notes to Consolidated Financial Statements" for further discussion of income taxes.

The discontinued operation reflects a loss, net of tax, of $17.9 million in fiscal 1999 compared to after tax income of $29.8 million in fiscal 1998. This loss reflects the costs associated with the shut down of Mine No. 3 of $53 million, partially offset by a $25 million gain resulting from a reduction in other postretirement benefits. See Note 3 of "Notes to Consolidated Financial Statements."

Net income in 1999 was $35.6 million, including an after-tax loss of $17.9 million from the discontinued operations of Jim Walter Resources, Inc. ("JWR") and an after-tax gain of $4.9 million from the sale of JWWC. This compared to net income of $56.2 million in 1998, which included an after-tax gain of $29.8 million from the discontinued operations of JWR and a $2.7 million extraordinary loss from the write-off of unamortized debt expense related to the early repayment of a $550.0 million credit facility in conjunction with the Company's acquisition of AIMCOR (see Note 8 of "Notes to Consolidated Financial Statements"). The Company's diluted earnings per share in 1999 were $.69 compared to $1.03 in 1998. Income from continuing operations in 1999 was $53.5 million ($1.04 per diluted share) compared to $29.1 million ($.53 per diluted share) in 1998 and reflects all of the factors discussed in the following segment analysis.

Segment Analysis

Homebuilding and Financing sales and revenues increased $11.8 million, or 2.6%, over the prior year. The increase reflects a higher average net selling price, from $48,700 in 1998 to $52,000 in 1999, an increase in the number of units sold, from 3,702 units in 1998 to 3,737 units in 1999, and greater time charge income (revenues received from Mid-State's instalment note portfolio), from $242.9 million in 1998 to $246.4 million in 1999. The higher average selling price primarily resulted from price increases instituted to compensate for higher building material and labor costs, coupled with consumer preference for new and more upscale models and amenities being offered by Jim Walter Homes. The order backlog at May 31, 1999 was 2,683 units (all of which are expected to be completed by the end of fiscal 2000) compared to 1,883 units at May 31, 1998. The increase in time charge income resulted from increased payoffs received in advance of maturity and to an increase in the average balance per account in the portfolio, partially offset by a reduction in the total number of accounts. Operating income of $113.5 million (net of interest

expense) was $14.0 million greater than the prior year, reflecting the increases in the average net selling price and number of homes sold, higher time charge income, lower interest expense in 1999 ($98.9 million) compared to the prior year ($116.0 million) and lower goodwill amortization in 1999 ($23.3 million) compared to 1998 ($23.9 million).

Water Transmission Products sales and revenues increased $34.3 million, or 8.1%, over the prior year. The increase was the result of increased shipments of ductile iron pressure pipe, fittings, valves and hydrants and slightly higher average selling prices for ductile iron pressure pipe. Total shipments of 615,800 tons were 7.2% greater than the prior year. The order backlog of ductile iron pressure pipe at May 31, 1999 was 119,900 tons, representing approximately three months shipments, compared with 121,709 tons at May 31, 1998. Operating income of $33.0 million was $16.8 million greater than the prior year period. This performance was the result of improved gross profit margins realized due to lower raw material costs (primarily scrap iron) and improved operating efficiencies combined with the previously mentioned increase in sales and revenues.

Energy Services sales and revenues increased $75.3 million, or 26.3%, over the prior year's eight month contribution (see Note 2 of "Notes to Consolidated Financial Statements"). Operating income of $24.9 million exceeded the prior year by $3.9 million. Sales and earnings in the current year, however, were adversely impacted by a decline in U.S. and European steel production which affected pricing and demand for petroleum coke and specialty metal products, as well as from higher bulk handling costs at the Texas Gulf Coast terminals and services operations principally caused by equipment problems following intense tropical storm activity in that region during the fiscal second quarter.

The Other segment's sales and revenues increased $12.3 million, or 3.8%, over the prior year. This increase was primarily due to improved shipments of aluminum foil and sheet products, foundry coke and chemicals, coupled with improved selling prices for foundry coke and slag fiber, partially offset by lower selling prices for aluminum foil and sheet products. Operating income of $26.2 million was $1.2 million greater than the prior year. The segment's performance reflects the sales increases and higher gross profit margins realized on aluminum foil and sheet products, foundry coke and chemicals, partially offset by the pre-tax loss on the sale of JWWC (see Note 2 of "Notes to Consolidated Financial Statements").

Years Ended May 31, 1998 and 1997

Net sales and revenues for the year ended May 31, 1998 increased $311.9 million over the prior year, a 26.6% increase of which 24.4% was attributable to the acquisition of AIMCOR. The balance of the increase was the result of improved performances from all other operating segments.

Cost of sales, exclusive of depreciation, of $980.6 million was 80.7% of net sales in 1998 versus $725.9 million and 79.1% in 1997. The percentage increase reflected lower gross profit margins realized on pipe products, aluminum products, furnace and foundry coke, slag fiber, chemicals and window components, partially offset by improved margins on home sales.

Selling, general and administrative expenses of $156.4 million were 10.5% of net sales and revenues in 1998 versus $132.4 million and 11.3% in 1997. The dollar increase was primarily attributable to the acquisition of AIMCOR.

Interest and amortization of debt expense was $193.6 million in 1998 versus $179.2 million in 1997, reflecting higher outstanding debt balances, primarily resulting from the AIMCOR acquisition. The average rate of interest in 1998 was 8.0%, compared to 8.1% in 1997. The prime rate of interest was 8.5% in 1998 compared to a range of 8.25% to 8.5% in 1997.

The Company's effective tax rate in 1998 and 1997 differed from the statutory tax rate primarily due to amortization of goodwill (excluding amounts related to the AIMCOR acquisition), which is not deductible for tax purposes. See Note 7 of "Notes to Consolidated Financial Statements" for further discussion of income taxes.

After tax income from the discontinued operation increased from $20.6 million in 1997 to $29.8 million in 1998 reflecting higher coal shipments and methane gas sales volumes combined with increased coal productivity which contributed to lower production costs, partially offset by the reduced coal and methane gas selling prices. Fiscal 1998 results also included a $8.0 million credit from settlement of insurance claims whereas fiscal 1997 results included a $10.0 million settlement of a legal claim related to a theft of coal inventory at the Port of Mobile, Alabama, partially offset by a $6.2 million charge relating to a reduction in Jim Walter Resources' salaried workforce under a voluntary early retirement program.

Net income for the year ended May 31, 1998 was $56.2 million, including after-tax income of $29.8 million from the discontinued operations of JWR and a $2.7 million extraordinary loss from the write-off of unamortized debt expense related to the early repayment of a $550.0 million credit facility in conjunction with the Company's acquisition of

AIMCOR (see Note 8 of "Notes to Consolidated Financial Statements"). The Company's diluted earnings per share were $1.03 compared to $.67 in 1997. Income from continuing operations in 1998 was $29.1 million ($.53 per diluted share) compared to $16.5 million ($.30 per diluted share) and reflects all of the factors discussed in the following segment analysis as well as the income contribution from Energy Services, and lower postretirement benefits and provision for possible losses in 1998.

Segment Analysis

Homebuilding and Financing sales and revenues increased $8.7 million, or 2.0%, over the prior year. The increase reflects greater time charge income, from $231.4 million in 1997 to $242.9 million in 1998 and an increase in the average net selling price, from $47,500 in 1997 to $48,700 in 1998, partially offset by a decrease in the number of units sold, from 3,900 units in 1997 to 3,702 units in 1998. The increase in time charge income was attributable to increased payoffs received in advance of maturity and to an increase in the average balance per account in the portfolio, partially offset by a reduction in the total number of accounts. The higher average selling price was primarily attributable to price increases instituted during the year to compensate for higher building materials and labor costs. The decrease in unit sales resulted from intense competition from local and regional homebuilders as well as labor shortages due to high demand for subcontractors and construction crews. Jim Walter Homes and its affiliated companies had 1,883 units in backlog at May 31, 1998 compared to 1,972 units at May 31, 1997. Operating income of $99.4 million (net of interest expense) was $14.7 million greater than the prior year, reflecting the higher time charge income, the increase in the average net selling price per home sold, an improved homebuilding gross profit margin, lower interest expense in 1998 ($116.0 million) as compared to the prior year ($119.0 million), and lower goodwill amortization in 1998 ($23.9 million) versus 1997 ($25.5 million), partially offset by the decrease in the number of homes sold.

Water Transmission Products sales and revenues increased $6.6 million over the prior year, representing a 1.6% increase. The increase reflected greater shipments of ductile iron pressure pipe, valves and hydrants, partially offset by lower selling prices across most product lines, combined with lower sales volumes of fittings. Total shipments of 574,500 tons were 5.0% higher than the prior year, while average selling prices were 3.2% lower, reflecting intense competitive conditions related to the slow pace of funding for domestic infrastructure repair and replacement projects. The order backlog for ductile iron pressure pipe at May 31, 1998 was 121,709 tons compared with 108,341 tons at May 31, 1997. Operating income of $16.2 million was $.2 million below the prior year. This performance was the result of the lower selling prices and gross profit margins for ductile iron pressure pipe and fittings, partially offset by the previously mentioned increase in sales volumes.

The Other segment's sales and revenues increased $11.4 million, or 3.7%, over the prior year. The increase was principally the result of greater shipments of aluminum foil and sheet products, foundry coke and slag fiber, combined with higher selling prices for aluminum foil and sheet products and furnace and foundry coke. These increases were partially offset by lower shipments of chemicals and window components. Operating income of $25.0 million was $1.3 million below the prior year, reflecting lower gross profit margins realized on aluminum foil and sheet products, furnace and foundry coke, slag fiber, chemicals and window components.

FINANCIAL CONDITION

In fiscal 1999, total debt decreased by $168.1 million. In June 1998, agreement was reached with Financial Security Assurance, Inc. to release approximately $121.6 million of funds held by Mid-State Trust II which were subject to retention at July 1, 1998. Such funds were utilized to pay down Trust IV indebtedness.

On December 10, 1998, Mid-State purchased from Trust V instalment notes having a gross value of $858.7 million and an economic balance of $335.3 million. Mid-State subsequently sold these notes to Trust VII, a business trust organized by Mid-State. These sales were in exchange for the net proceeds from the public issuance of $313.5 million of Asset Backed Notes by Trust VII. Net proceeds from the public offering were primarily used to repay related asset-backed borrowings of $284.0 million under the Trust V warehouse facility. See Note 8 of "Notes to Consolidated Financial Statements."

On May 27, 1999, Mid-State renewed its 364 day, $90 million Loan and Security Agreement with Kitty Hawk Funding Corporation. Proceeds from the additional borrowings in 1999 ($9.0 million) were utilized to pay down the Revolving Credit Facility. See Note 8 of "Notes to Consolidated Financial Statements."

Borrowings under the Credit Facilities totaled $552.2 million at May 31, 1999. The Revolving Credit Facility includes a sub-facility for trade and other standby letters of credit in an amount up to $75.0 million at any time outstanding and a sub-facility for swingline advances in an amount not in excess of $25.0 million at any time outstanding. At May 31, 1999, letters of credit in the aggregate face amount of $24.5 million have been issued and swingline

advances were $2.2 million. See Note 8 of "Notes to Consolidated Financial Statements."

The Credit Facilities contain a number of significant covenants including maintaining specified financial ratios and complying with certain financial tests, including a fixed charge coverage ratio and a maximum leverage ratio. The borrowers fixed charge coverage ratio (the ratio of (a) EBITDA minus capital expenditures to (b) the sum of all required principal payments on outstanding indebtedness, interest expense and dividends paid) is required to be at least 1.25 to 1 at the end of each measurement period for the duration of the Credit Facilities. The borrowers are required to maintain a leverage ratio (the ratio of indebtedness to consolidated EBITDA (as defined in the Credit Facilities)) of not more than 3.25 to 1 at the end of each measurement period for the duration of the Credit Facilities. The Company was in compliance with these covenants at May 31, 1999. See Note 8 of "Notes to Consolidated Financial Statements."

The Trust V Variable Funding Loan Agreement's covenants, among other things, restrict the ability of Trust V to dispose of assets, create liens and engage in mergers or consolidations. The Company was in compliance with these covenants at May 31, 1999.

The Loan and Security Agreement contains a number of covenants that, among other things, restrict the ability of Mid-State to dispose of assets, create liens on assets, engage in mergers, incur any unsecured or recourse debt, or make material changes to their credit and collection policy. In addition, Mid-State is required to maintain specified net income and net worth levels. The Company was in compliance with these covenants at May 31, 1999.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents, net of book overdrafts, were approximately $7.2 million at May 31, 1999. Operating cash flows for the year ended May 31, 1999, together with issuance of long-term debt under Trust VII and Trust V Variable Funding Loan Agreement, borrowings under the Credit Facilities, the Loan and Security Agreement and the use of available cash balances, were primarily used for retirement of long-term senior debt, interest payments, capital expenditures and to purchase approximately 3.6 million shares of common stock. In September 1998, the Company's Board of Directors authorized an increase, from two to four million, in the number of shares of the Company's common stock which may be repurchased under its July 1998 stock repurchase program.

Working capital is required to fund adequate levels of inventories and accounts receivable. Commitments for capital expenditures at May 31, 1999 were not significant; however, it is estimated that gross capital expenditures for the Company's continuing operations for the fiscal year ending May 31, 2000 will approximate $75 million.

Because the Company's operating cash flow is significantly influenced by the general economy and, in particular, levels of domestic construction activity, current results should not necessarily be used to predict the Company's liquidity, capital expenditures, investment in instalment notes receivable or results of operations. The Company believes that the Mid-State Trust V Variable Funding Loan Agreement will provide Mid-State with the funds needed to purchase the instalment notes and mortgages generated by Jim Walter Homes and its affiliates. It is anticipated that one or more permanent financings similar to the previous Mid-State asset-backed financings will be required over the next several years to repay borrowings under the Trust V Variable Funding Loan Agreement. The Company believes that, under present operating conditions, sufficient cash flow will be generated to make all required interest and principal payments on its indebtedness, to make all planned capital expenditures and meet substantially all operating needs. It is further expected that amounts under the Revolving Credit Facility will be sufficient to meet peak operating needs of the Company and to repurchase up to an additional 400,000 shares of the Company's common stock, the amount remaining at May 31, 1999 under the current authorization.

MARKET RISK

The Company is exposed to certain market risks inherent in the Company's financial instruments. These instruments arise from transactions entered into in the normal course of business. The Company is subject to interest rate risk on its existing Credit Facilities, Loan and Security Agreement, Trust V Variable Funding Loan, and any future financing requirements.

The Company's primary market risk exposure relates to (i) the interest rate risk on long-term and short-term borrowings, (ii) the impact of interest rate movements on its ability to meet interest rate expense requirements and comply with financial covenants, and (iii) the impact of interest rate movements on the Company's ability to obtain adequate financing to fund future acquisitions. The Company has historically managed interest rate risk through the periodic use of interest rate hedging instruments. There were no such instruments outstanding at May 31, 1999. While the Company can not predict its ability to refinance existing debt or the impact interest rate movements will have on its

existing debt, management continues to evaluate its financial position on an ongoing basis.

The Company is also subject to a limited amount of foreign currency risk, but does not currently engage in any significant foreign currency hedging transactions to manage exposure for transactions denominated in currencies other than the U.S. dollar.

YEAR 2000

Introduction

The Company is currently working to resolve the potential impact of the Year 2000 ("Y2K") on the processing of date-sensitive information by the Company's computerized information systems. The Y2K problem is the result of computer programs being written using two digits (rather than four) to define the applicable year. Any of the Company's programs that have time-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000 which could result in miscalculations or system failures. The problems created by using abbreviated dates appear in hardware (such as microchips), operating systems and other software programs. The Company's Y2K compliance project is intended to determine the readiness of the Company's business for the year 2000 and to address the issues, if any, which were identified. The Company defines Y2K "compliance" to mean that the computer code will process all defined future dates properly and give accurate results.

Description of Areas of Impact and Risk

The Company has identified three areas where the Y2K issue creates risk to the Company: a) internal Information Technology ("IT") systems; b) non-IT systems with embedded chip technology and c) system capabilities of third party businesses with relationships with the Company, including product suppliers, customers, service providers (such as telephone, power, logistics, financial services) and other businesses whose failure to be Y2K compliant could have a material adverse effect on the Company's business, financial condition or results of operations.

Plan to Address Year 2000 Compliance

The Company has established a Corporate Steering Committee (the "Committee") to coordinate solutions to Y2K issues for its information systems, non-IT systems with embedded chips and third party business trading partners. The Committee includes a representative from each subsidiary as well as a member of the Company's Law Department, the Director of Information Technology and the Chief Financial Officer. Each subsidiary also has a steering committee consisting of a representative on the Committee and other members from all functional areas of the respective subsidiary. The Committee has identified systems and applications that require modification and has evaluated alternative solutions. The Committee also developed a Y2K Standard that was issued to all subsidiaries and must be followed for Y2K compliance. Status conferences are held monthly and on-site progress reviews are held quarterly. The Company has two data centers which have installed Y2K-compliant mainframe equipment, operating systems and system software. Separate virtual machines within a computer have been installed for the purpose of testing. During the first calendar quarter of 1999, the Company conducted a detailed review of all Year 2000 remediation activities and associated required documentation to ensure that the process was on schedule.

State of Readiness

IT Systems — The initial inventory and prioritization process for the Company's IT systems was completed in 1998 with the current focus on remediation and testing. Approximately 80% of all identified IT system business components have been tested and are considered compliant as of May 31, 1999. Coding changes for all legacy systems have been completed and the final testing phase is in process. The Y2K test environment is fully functional. Compliance testing will continue through 1999 and will be completed by November 1999. All financial systems have been remediated, tested and were considered fully compliant as of May 31, 1999. Personal computer and other hardware compliant upgrades are 90% complete, with the remainder on order.

Non-IT systems — Non-IT systems consist of any device which is able to store and report date-related information, such as access control systems, elevators, conveyors, and other items containing a microprocessor or internal clock. The plan utilized by the Company for analysis of the IT systems was also used for non-IT systems. All identified non-IT systems have been tested and are considered compliant as of May 31, 1999.

Material Third Parties — The Company has created an inventory of what it believes to be all material third parties with whom the Company has a business relationship. Y2K readiness surveys were sent to these third parties beginning in January 1998. The Company has reviewed the responses to these surveys to determine the Y2K readiness of these third parties. For those material third party suppliers, service providers and customers who fail to respond to the Company's survey, the Company is pursuing alternative means of obtaining Y2K readiness information, such as review of publicly available information published by such third parties. The Company plans to continue to review its third party relationships throughout the Y2K compliance program to ensure all material third party relationships are addressed.

Contingency Planning and Risks
Contingency plan guidelines have been developed by the Committee and provided to each subsidiary. Contingency plans are currently being prepared at all subsidiaries and are scheduled to be completed by October 1999. On-site reviews of written contingency plans were conducted in the second calendar quarter of 1999. While the Company believes that its approach to Y2K readiness is sound, it is possible that some business components may not be identified in the inventory, or that the scanning or testing process may not result in analysis and remediation of all source code. The Company will assume a third party is not Y2K ready if no Y2K verification is obtained and take action, as appropriate. The Company's contingency plan will address alternative providers and processes to deal with business interruptions that may be caused by the internal system or by the failure of third party providers to be Y2K ready to the extent possible. In the unlikely event of a Y2K issue, the Company's contingency plan focus is on employee safety, equipment safety and prompt business resumption.

The failure to correct a material Y2K issue could result in an interruption in, or a failure of, certain normal business activities or operations. Such failure could materially and adversely affect the Company's results of operations, liquidity and financial condition.

Cost of Project
The overall budget for the Company's Y2K compliance effort is approximately $16.5 million. The project is 80% complete with the remaining 20% related to contingency planning, final testing of remediated applications and post-Y2K monitoring. Approximately $14.2 million or 86% of the project budget has been spent as of May 31, 1999.

EURO CONVERSION

On January 1, 1999, eleven of the fifteen member countries of the European Union commenced conversion from their existing sovereign currencies to a new, single currency called the Euro. Fixed conversion rates between the existing currencies, the legacy currencies, and the Euro will be established and the Euro will become the common legal currency of the participating countries by January 1, 2000. The Euro is trading on currency exchanges and is available for non-cash transactions. The participants are issuing sovereign debt exclusively in Euro and are redenominating outstanding sovereign debt. Following this introduction period, the participating members legacy currencies will remain legal tender as denominations of Euro until January 1, 2002. At that time, countries will issue new Euro-denominated bills for use in cash transactions. All legacy currency will be withdrawn prior to July 1, 2002, completing the Euro conversion on this date. As of January 1, 1999, the participating countries no `longer control their own monetary policies by directing independent interest rates for the legacy currencies; instead, the authority to direct monetary policy, including money supply and official interest rates for the Euro, is being exercised by the new European Central Bank.

The Company has established a plan to address issues raised by the Euro conversion. These issues, which are applicable to the operations of AIMCOR include but are not limited to: the competitive impact created by cross-border price transparency; the need for the Company and its business partners to adapt IT and non-IT systems to accommodate Euro-denominated transactions, and the need to analyze the legal and contractual implications of the Company's contracts. The Company currently anticipates that the required modifications to its systems, equipment and processes will be made on a timely basis and does not expect that the costs of such modifications will have a material effect on the Company's financial position or results of operations. As part of Phase I, the core IT system has been modified for Euro Currency compliance. The Company's European locations are currently processing Euro-compliant transactions. Phase II of the Euro Currency project focuses on the conversion effect to a Euro base currency. Phase II is scheduled to be complete by July 1, 2002. The project budget is approximately $183,000 of which approximately $143,000 has been spent.

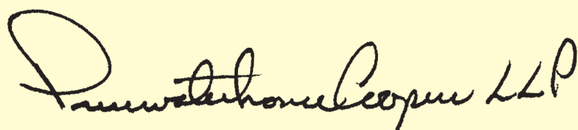
NEW ACCOUNTING PRONOUNCEMENTS

Statement of Financial Accounting Standards No. 137 — "Accounting for Derivative Instruments and Hedging Activities — Deferral of the Effective Date of FAS No. 133" ("FAS 137") was issued in June 1999. This statement was issued to clarify implementation issues and allow a better understanding of the Financial Accounting Standards Board's intent regarding certain fundamental issues that pertain to the application of Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities." FAS 137 becomes effective for all fiscal quarters of fiscal years beginning after June 15, 2000 (fiscal 2001 for the Company). Historically, the Company's only derivative instruments related to interest lock agreements (see Note 8 of "Notes to Consolidated Financial Statements"). Management of the Company believes the statement will not materially affect its performance or reporting.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders
of Walter Industries, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, changes in stockholders' equity and cash flows present fairly, in all material respects, the financial position of Walter Industries, Inc. and its subsidiaries at May 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended May 31, 1999, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.



PricewaterhouseCoopers LLP

Tampa, Florida

July 14, 1999

CONSOLIDATED BALANCE SHEETS

At May 31, (in thousands, except share amounts)	1999	1998
ASSETS		
Cash and cash equivalents	$ 40,783	$ 54,647
Short-term investments, restricted	145,658	244,173
Marketable securities	4,803	39,064
Instalment notes receivable	4,191,138	4,238,745
Less - Allowance for possible losses	(25,813)	(26,221)
Unearned time charges	(2,874,556)	(2,894,459)
Net	1,290,769	1,318,065
Trade receivables	196,734	192,235
Less - Allowance for possible losses	(3,337)	(3,933)
Net	193,397	188,302
Other receivables	14,996	9,445
Inventories		
Finished goods	152,806	158,276
Goods in process	44,178	36,876
Raw materials and supplies	44,612	45,539
Houses held for resale	3,377	3,153
Total inventories	244,973	243,844
Prepaid expenses	9,270	8,117
Property, plant and equipment	398,591	396,340
Investments	6,389	5,053
Deferred income taxes	36,857	59,581
Unamortized debt expense	50,623	31,215
Other long-term assets	40,613	38,419
Goodwill, net	518,575	543,896
Assets held for disposition	365,729	382,509
	$ 3,362,026	$ 3,562,670
LIABILITIES AND STOCKHOLDERS' EQUITY		
Book overdrafts	$ 33,579	$ 24,867
Accounts payable	125,846	145,476
Accrued expenses	135,959	126,022
Income taxes payable	53,032	60,098
Short-term notes payable	2,200	5,800
Long-term senior debt		
Mortgage-backed/asset-backed notes	1,758,151	1,886,167
Other senior debt	553,000	589,450
Accrued interest	25,670	27,147
Accumulated postretirement benefits obligation	270,409	283,708
Other long-term liabilities	61,261	54,848
Stockholders' equity		
Common stock, $.01 par value per share:		
Authorized - 200,000,000 shares		
Issued - 55,304,184 shares and 55,283,686 shares	553	553
Capital in excess of par value	1,169,377	1,169,052
Accumulated deficit	(748,905)	(784,503)
Treasury stock - 4,992,292 shares and 1,398,092 shares, at cost	(72,078)	(21,841)
Cumulative foreign currency translation adjustment	(341)	(52)
Excess of additional pension liability over unrecognized prior years service cost	(5,621)	(4,122)
Net unrealized depreciation in marketable securities	(66)	–
Total stockholders' equity	342,919	359,087
	$ 3,362,026	$ 3,562,670

See accompanying "Notes to Consolidated Financial Statements"

CONSOLIDATED STATEMENTS OF OPERATIONS

For the years ended May 31, (in thousands, except per share amounts)	1999	1998	1997
Sales and revenues:			
Net sales	$1,350,089	$1,215,564	$ 917,445
Time charges	246,440	242,858	231,388
Miscellaneous	21,306	24,629	22,350
	1,617,835	1,483,051	1,171,183
Cost and expenses:			
Cost of sales	1,073,196	980,619	725,898
Depreciation	44,559	40,716	35,410
Selling, general and administrative	168,711	156,441	132,380
Postretirement benefits	7,753	6,645	10,868
Provision for possible losses	1,745	676	3,340
Interest and amortization of debt expense	184,997	193,580	179,180
Amortization of goodwill	43,118	40,352	36,615
Loss on sale of subsidiary	4,907	–	–
	1,528,986	1,419,029	1,123,691
Income from continuing operations before income tax expense	88,849	64,022	47,492
Income tax expense:			
Current	(14,053)	(17)	(3,106)
Deferred	(21,281)	(34,932)	(27,882)
Income from continuing operations	53,515	29,073	16,504
Income (loss) from discontinued operation, net of tax	(17,917)	29,831	20,613
Extraordinary loss on early extinguishment of debt (net of income tax benefit of $1,434)	–	(2,663)	–
Net income	$ 35,598	$ 56,241	$ 37,117
Basic income (loss) per share:			
Income from continuing operations	$ 1.04	$ .54	$ .30
Income (loss) from discontinued operation	(.35)	.55	.38
Extraordinary item	–	(.05)	–
Net income	$ .69	$ 1.04	$ .68
Diluted income (loss) per share:			
Income from continuing operations	$ 1.04	$ .53	$ .30
Income (loss) from discontinued operation	(.35)	.55	.37
Extraordinary item	–	(.05)	–
Net income	$ .69	$ 1.03	$ .67

See accompanying “Notes to Consolidated Financial Statements”

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands)	Total	Comprehensive Income	Accumulated Deficit	Accumulated Other Comprehensive Income	Common Stock	Capital in Excess	Treasury Stock
Balance at May 31, 1996	$ 276,694		$ (877,861)	$ (5,326)	$ 549	$ 1,159,332	$ –
Comprehensive income:							
Net income	37,117	$ 37,117	37,117				
Other comprehensive income, net of tax:							
Excess of additional pension liability	670	670		670			
Comprehensive income		$ 37,787					
Stock issued in lieu of qualified securities	5,375				2	5,373	
Canceled shares	(431)					(431)	
Fractional share payments	(13)					(13)	
Balance at May 31, 1997	319,412		(840,744)	(4,656)	551	1,164,261	–
Comprehensive income							
Net income	56,241	$ 56,241	56,241				
Other comprehensive income, net of tax:							
Foreign currency translation adjustment	(52)	(52)		(52)			
Excess of additional pension liability	534	534		534			
Comprehensive income		$ 56,723					
Stock issued from option exercises	4,793				2	4,791	
Purchases of treasury stock	(21,841)						(21,841)
Balance at May 31, 1998	359,087		(784,503)	(4,174)	553	1,169,052	(21,841)
Comprehensive income							
Net income	35,598	$ 35,598	35,598				
Other comprehensive income, net of tax:							
Net unrealized depreciation in marketable securities	(66)	(66)		(66)			
Foreign currency translation adjustment	(289)	(289)		(289)			
Excess of additional pension liability	(1,499)	(1,499)		(1,499)			
Comprehensive income		$ 33,744					
Stock issued from option exercises	325					325	
Purchases of treasury stock	(50,237)						(50,237)
Balance at May 31, 1999	$ 342,919		$ (748,905)	$ (6,028)	$ 553	$ 1,169,377	$(72,078)

See accompanying "Notes to Consolidated Financial Statements"

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended May 31, (in thousands)	1999	1998	1997
OPERATING ACTIVITIES			
Net income	$ 35,598	$ 56,241	$ 37,117
Charges to income from continuing operations not affecting cash:			
Depreciation	44,559	40,716	35,410
Provision for deferred income taxes	21,281	34,932	27,882
Accumulated postretirement benefits obligation	(13,299)	14,749	21,132
Provision for other long-term liabilities	4,489	694	1,336
Amortization of goodwill	43,118	40,352	36,615
Amortization of debt expense	6,785	6,624	6,914
Loss on sale of subsidiary	4,907	–	–
Extraordinary loss on early extinguishment of debt (net of income tax benefit)	–	2,663	–
	147,438	196,971	166,406
Decrease (increase) in assets, net of effects from acquisitions and dispositions:			
Short-term investments, restricted	98,515	(51,554)	23,116
Marketable securities	34,195	2,158	(20,939)
Instalment notes receivable, net (a)	27,296	15,869	(3,781)
Trade and other receivables, net	(9,334)	(12,025)	1,056
Inventories	(7,037)	968	5,507
Prepaid expenses	(1,139)	(322)	399
Deferred income taxes	–	–	21,411
Assets of discontinued operation	16,780	(10,608)	(11,932)
Increase (decrease) in liabilities, net of effects from acquisitions and dispositions:			
Book overdrafts	8,712	(656)	(2,671)
Accounts payable	(22,372)	14,057	14,850
Accrued expenses	6,407	(21,412)	11,937
Income taxes payable	(7,825)	1,258	2,646
Accrued interest	(1,477)	3,927	(5,599)
Cash flows from operating activities	290,159	138,631	202,406
INVESTING ACTIVITIES			
Additions to property, plant and equipment, net of retirements and effects from acquisitions and dispositions	(52,016)	(65,060)	(43,069)
Decrease (increase) in investments and other assets, net of effects from acquisitions and dispositions	(3,472)	2,169	1,360
Acquisitions, net of cash acquired	(18,953)	(386,319)	–
Proceeds from sale of subsidiary	14,878	–	–
Cash flows used in investing activities	(59,563)	(449,210)	(41,709)
FINANCING ACTIVITIES			
Issuance of short-term notes payable and long-term senior debt	658,859	1,550,500	159,000
Retirement of long-term senior debt	(826,925)	(1,185,198)	(304,721)
Additions to unamortized debt expense	(26,193)	(19,143)	(159)
Purchases of treasury stock	(50,237)	(21,841)	–
Exercise of employee stock options	325	4,793	–
Disposition of liabilities subject to Chapter 11 proceedings	–	–	3,427
Fractional share payments	–	–	(13)
Cash flows from (used in) financing activities	(244,171)	329,111	(142,466)
EFFECT OF EXCHANGE RATE ON CASH	(289)	389	–
Net increase (decrease) in cash and cash equivalents	(13,864)	18,921	18,231
Cash and cash equivalents at beginning of year	54,647	35,726	17,495
Cash and cash equivalents at end of year	$ 40,783	$ 54,647	$ 35,726

(a) Consists of sales and resales, net of repossessions and provision for possible losses, of $170,503 and $171,081 and $173,418 and cash collections on account and payouts in advance of maturity of $197,799, $186,950 and $169,637 for the years ended May 31, 1999, 1998 and 1997, respectively.

SUPPLEMENTAL DISCLOSURES			
Interest paid	$ 181,073	$ 183,866	$ 179,749
Income taxes paid	10,211	7,331	5,598
Income tax refunds	–	–	21,411

See accompanying "Notes to Consolidated Financial Statements"

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: Recent History and Summary of Significant Accounting Policies

Walter Industries, Inc. (the "Company") was organized in 1987 for the purpose of acquiring Jim Walter Corporation ("Original Jim Walter"). The Company's financial statements reflect the allocation of the purchase price of Original Jim Walter based upon the fair value of the assets acquired and the liabilities assumed. On December 27, 1989, the Company and most of its subsidiaries each filed a voluntary petition for reorganization under Chapter 11 of Title 11 of the United States Code in the United States Bankruptcy Court for the Middle District of Florida, Tampa Division (the "Bankruptcy Court"). The Company emerged from bankruptcy on March 17, 1995 (the "Effective Date") pursuant to the Amended Joint Plan of Reorganization Dated as of December 9, 1994, as modified on March 1, 1995 (as so modified the "Consensual Plan"). Despite the confirmation and effectiveness of the Consensual Plan, the Bankruptcy Court continues to have jurisdiction over, among other things, the resolution of disputed prepetition claims against the Company and other matters that may arise in connection with or related to the Consensual Plan.

Principles of Consolidation

The Company is a diversified holding company with three reportable segments: Homebuilding and Financing, Water Transmission Products and Energy Services. Through these operating segments and other operations, the Company offers a diversified line of products and services primarily including home construction and financing, ductile iron pressure pipe, alloys, metals, petroleum coke distribution and refinery outsourcing services, aluminum foil and sheet products, furnace and foundry coke, chemicals and slag fiber. The Company's coal mining and methane gas subsidiary, Jim Walter Resources, Inc. ("JWR"), has been classified as a discontinued operation (see Note 3 for further discussion). The consolidated financial statements include the accounts of the Company and all of its subsidiaries. Preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Actual results could differ from those estimates. All significant intercompany balances have been eliminated. In addition, certain reclassifications of prior year amounts have been made in the accompanying consolidated financial statements in order to conform with the fiscal 1999 presentation. Current and prior year financial statements have been revised to reflect the reclassification of JWR financial information.

Foreign Currency Translation

Assets and liabilities of foreign subsidiaries included in Energy Services are translated at current exchange rates, while revenues and expenses are translated at average rates prevailing during the year. Translation adjustments are reported as a component of stockholders' equity. Gains and losses on foreign currency transactions are included in selling, general and administrative expenses.

Concentrations of Credit Risk

Financial instruments, which potentially subject the Company to significant concentrations of credit risk, consist principally of cash and cash equivalents, marketable securities, instalment notes receivable and trade receivables.

The Company maintains cash and cash equivalents and marketable securities in high quality securities with various financial institutions. Concentrations of credit risk with respect to instalment notes receivable and trade receivables are limited due to the large number of customers and their dispersion across many geographic areas. However, of the gross amount of instalment notes receivable at May 31, 1999, 22%, 13%, 10% and 10% (20%, 12%, 10% and 10% in 1998) are secured by homes located in the states of Texas, Mississippi, Florida and Alabama respectively. The Company believes the potential for incurring material losses related to these credit risks is remote.

Revenue Recognition

Revenue is recognized when products are shipped or services are provided to customers for all segments except Homebuilding and Financing. Revenue from the sale of a home is included in income upon completion of construction and legal transfer to the customer. Time charges are included in equal parts in each monthly payment and taken into income as collected. This method of time charge income recognition approximates the effective interest method since a much larger provision for losses would be required if time charge income were accelerated.

Cash and Cash Equivalents and Marketable Securities

Cash and cash equivalents include short-term deposits and highly liquid investments which have original maturities of three months or less and are stated at cost which approximates market. The Company's cash management system provides for the reimbursement of all major bank disbursement accounts on a daily basis. Checks issued

but not yet presented to the banks for payment are classified as book overdrafts.

Investments with original maturities greater than three months are classified as marketable securities. In accordance with Statement of Financial Accounting Standards No. 115 - "Accounting for Certain Investments in Debt and Equity Securities," the Company's marketable securities are classified as available for sale and are carried at estimated fair values which approximate cost at May 31, 1998. The unrealized depreciation is reflected in stockholders' equity, net of tax, at May 31, 1999.

Inventories
Inventories are valued at the lower of cost or market using either the first-in, first-out ("FIFO") or average cost method of accounting.

Goodwill
Goodwill acquired in connection with the acquisition of Original Jim Walter is being amortized over periods ranging up to 20 years. Goodwill acquired in connection with the acquisition of Applied Industrial Materials Corporation ("AIMCOR") is being amortized over 35 years. Goodwill acquired in connection with all other acquisitions is being amortized over 15 years. The Company evaluates, on a regular basis, whether events or circumstances have occurred that indicate the carrying amount of goodwill may warrant revision or may not be recoverable. The Company measures impairment of goodwill and other long-term assets based upon estimated future undiscounted cash flows from operations of the related business unit. At May 31, 1999 and 1998, the accumulated amortization of goodwill was approximately $570.0 million and $524.6 million, respectively. At May 31, 1999, the net unamortized balance of goodwill and other long-term assets were not considered to be impaired.

Depreciation
The Company provides depreciation for financial reporting purposes principally on the straight-line method over the useful lives of the assets. Assets (primarily mine development costs) extending for the full life of a coal mine are depreciated on the unit of production basis. For federal income tax purposes, accelerated methods are used for substantially all eligible properties. The depreciable property categories and the principal rates for depreciation used are as follows:

Land improvements	3 - 30 years
Buildings	5 - 50 years
Leasehold improvements	Over term of lease
Mine development costs	Over life of mine
Machinery and equipment	3 - 20 years

Depletion of minerals is provided based on estimated recoverable quantities.

Capitalized Interest
The Company has capitalized interest on qualifying properties in accordance with Statement of Financial Accounting Standards No. 34 - "Capitalization of Interest Cost." Interest capitalized for the years ended May 31, 1999, 1998 and 1997 was immaterial.

Operating Leases
Rent expense was $19.9 million, $13.7 million and $12.0 million for the years ended May 31, 1999, 1998 and 1997, respectively. Future minimum payments under noncancelable operating leases at May 31, 1999 are: 2000, $18.4 million; 2001, $14.3 million; 2002, $12.1 million; 2003, $6.6 million; and 2004, $2.9 million.

Environmental Expenditures
The Company capitalizes environmental expenditures that increase the life or efficiency of property or that reduce or prevent environmental contamination. The Company accrues for environmental expenses resulting from existing conditions that relate to past operations when the costs are probable and reasonably estimable.

Taxes
The Company complies with Statement of Financial Accounting Standards No. 109 - "Accounting for Income Taxes" ("FAS 109"). FAS 109 is an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. FAS 109 generally considers all expected future events other than changes in tax law or rates.

Earnings Per Share

Basic earnings per share is calculated by dividing the income available to common stockholders by the weighted average number of common shares outstanding for the period, without consideration of common stock equivalents. Diluted earnings per share includes the number of shares issuable on the exercise of dilutive employee stock options less the number of shares of common stock that could have been purchased with the proceeds from the exercise of such options.

Comprehensive Income

Effective for the fiscal year ended May 31, 1999, the Company adopted FAS No. 130, "Reporting Comprehensive Income" ("FAS 130"). FAS 130 establishes standards for reporting and display of comprehensive income and its components in the Company's consolidated financial statements. Comprehensive income is defined as the change in equity (net assets) of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. The Company's balance of other comprehensive income is comprised exclusively of unrealized depreciation in marketable securities, changes in cumulative foreign currency translation adjustment and excess of additional pension liability. The deferred income taxes related to the cumulative foreign currency translation adjustment for the years ended May 31, 1999, 1998 and 1997 was not significant.

NOTE 2: Acquisitions and Divestiture

Effective September 23, 1998, Jim Walter Homes, Inc., the Company's homebuilding subsidiary, acquired Texas-based homebuilder Dream Homes, Inc. On February 26, 1999, Jim Walter Homes, Inc. acquired Crestline Homes, Inc., a modular homebuilder, located in Laurinburg, North Carolina. These acquisitions did not materially affect the operating results of the Company.

On October 1, 1998, the Company sold the assets of the window balance operations of JW Window Components, Inc. ("JWWC"). On November 23, 1998, the Company sold the outstanding capital stock of JWWC, which comprised the roll form and screen products operations. These transactions completed the Company's divestiture of JWWC. The Company recorded a pre-tax loss of $4.9 million and a tax benefit of $9.8 million on the sale of JWWC. This divestiture did not materially affect the operating results of the Company.

On October 15, 1997, the Company completed the acquisition of AIMCOR, which, through its Carbon Group, is a leading international provider of products and outsourcing services to the petroleum, steel, foundry and aluminum industries. Through its Metals Group, AIMCOR is also a leading supplier of ferrosilicon in the southeastern United States. The purchase price was approximately $400.0 million, including direct acquisition costs of $4.8 million, and is subject to certain indemnity obligations of the parties as required by the Stock Purchase Agreement. The acquisition was accounted for using the purchase method of accounting and had an effective date of September 30, 1997.

The following unaudited results of operations reflect the effect on the Company's operations as if the acquisition of AIMCOR had occurred as of June 1, 1997 (in thousands, except per share amounts).

	Year ended May 31, 1998
Net sales and revenues	$ 1,640,562
Income from continuing operations	34,059
Net income	61,227
Basic income per share	1.14
Diluted income per share	1.13

The unaudited pro forma information is presented for informational purposes only and is not necessarily indicative of the operating results that would have occurred had the acquisition been consummated as of June 1, 1997, nor are they necessarily indicative of future operating results.

NOTE 3: Discontinued Operation

In February 1999 (the "measurement date"), a decision was made to dispose of JWR, the Company's coal mining and methane gas subsidiary. The Company expects to complete the disposition within calendar 1999. As a result, the operations of JWR have been classified as a discontinued operation in the consolidated financial statements.

JWR comprised substantially all of the Company's previously reported Natural Resources operating segment. In February 1999, a decision was also made to shut down Blue Creek Mine No. 3 ("Mine No. 3"). The estimated costs to shut down the mine approximated $53 million. In addition, the Company realized a $25 million pre-tax gain from a reduction in JWR's postretirement benefit obligation (see Note 9). Both of the above items were recorded in the fiscal 1999 third quarter, net of taxes, within the results of discontinued operation prior to the measurement date.

The following is a summary of the operating results of JWR (in thousands):

		Prior to Measurement Date		
	Three months ended	Nine months ended	Years ended	
	May 31, 1999	Feb. 28, 1999	May 31, 1998	May 31, 1997
Sales and revenues	$ 59,252	$ 237,056	$ 354,149	$ 335,878
Costs and expenses	58,775	274,763	320,465	313,272
Income (loss) before tax	477	(37,707)	33,684	22,606
Income tax benefit (expense)	1,308	18,005	(3,853)	(1,993)
Income (loss) from discontinued operation	$ 1,785	$ (19,702)	$ 29,831	$ 20,613

The assets of JWR have been segregated on the balance sheet from their historical classification to separately identify them as assets held for disposition. Such amounts are summarized as follows (in thousands):

At May 31,	1999	1998
Cash and cash equivalents	$ 58	$ 62
Short-term investments, restricted	3,491	3,290
Trade and other receivables, net	28,476	26,944
Inventories	61,434	55,210
Prepaid expenses	10,056	4,039
Property, plant and equipment, net	235,655	276,008
Deferred income taxes	33,093	24,828
Investments and other long-term assets	(6,534)	(7,872)
Total Assets Held for Disposition	$ 365,729	$ 382,509

The liabilities of JWR, aggregating approximately $247.6 million at May 31, 1999, have not been classified separately pending determination of the form and structure of disposition. Management does not presently anticipate a loss on the ultimate disposition.

NOTE 4: Restricted Short-Term Investments

Restricted short-term investments at May 31, 1999 and 1998 include (i) temporary investment of reserve funds and collections on instalment notes receivable owned by Mid-State Trusts II, III, IV, V, VI and VII (the "Trusts") ($115.9 million and $125.3 million, respectively) which are available only to pay expenses of the Trusts and principal and interest on indebtedness of the Trusts, (ii) certain funds held by Trust II that are in excess of the amount required to be paid for expenses, principal and interest on the Trust II Mortgage-Backed Notes, but which are subject to retention ($17.1 million and $106.9 million, respectively) and (iii) miscellaneous other segregated accounts restricted to specific uses ($12.7 million and $12.0 million, respectively). In June 1998, an agreement was reached with Financial Security Assurance Inc. to release approximately $121.6 million of funds held by Trust II which were subject to retention at July 1, 1998. Such funds were utilized to pay down Trust IV indebtedness.

NOTE 5: Instalment Notes Receivable

Instalment notes receivable arise from sales of detached, single-family homes to customers. These receivables require periodic payments, primarily over periods of 12 to 30 years, and are secured by first mortgages or similar security instruments. The credit terms offered by Jim Walter Homes, Inc. ("Jim Walter Homes") and its affiliates are usually for 100% of the purchase price of the home. The buyer's ownership of the land and improvements necessary to complete the home constitute a significant equity investment to which the Company has access should the buyer default on payment of the instalment note obligation. Instalment notes receivable currently carry either an 8.5% or 10% annual percentage rate, without points or closing costs. The aggregate amount of instalment notes

receivable having at least one payment 90 or more days delinquent was 3.29% and 3.06% of total instalment notes receivable at May 31, 1999 and 1998, respectively. The allowance for possible losses as a percentage of net instalment notes receivable was approximately 2.0% in both years which reflects management's assessment of the amount necessary to provide against future loss in the portfolio.

Mid-State Homes, Inc. ("Mid-State") purchases instalment notes from Jim Walter Homes and its affiliates on homes constructed and sold by Jim Walter Homes and its affiliates and services such instalment notes. Mid-State Trust II ("Trust II"), Mid-State Trust III ("Trust III"), Mid-State Trust IV ("Trust IV"), Mid-State Trust VI ("Trust VI") and Mid-State Trust VII ("Trust VII") are business trusts organized by Mid-State, which owns all of the beneficial interest in Trust III, Trust IV, Trust VI, and Trust VII. Trust IV owns all of the beneficial interest in Trust II. The Trusts were organized for the purpose of purchasing instalment notes receivable from Mid-State with the net proceeds from the issuance of mortgage-backed or asset-backed notes. The assets of Trust II, Trust III, Trust IV, Trust VI and Trust VII, including the instalment notes receivable, are not available to satisfy claims of general creditors of the Company and its subsidiaries. The liabilities of Trusts II, III, IV, VI, and VII for their publicly issued debt are to be satisfied solely from the proceeds of the underlying instalment notes and are non-recourse to the Company and its subsidiaries. Mid-State Trust V ("Trust V"), a business trust in which Mid-State holds all the beneficial interest, was organized as a warehouse facility to hold instalment notes receivable as collateral for borrowings to provide temporary financing to Mid-State for its current purchases of instalment notes and mortgages from Jim Walter Homes and its affiliates.

The gross amount of instalment notes receivable and the economic balance by trust are as follows (in thousands):

	1999		1998	
At May 31,	**Gross Balance**	**Economic Balance**	**Gross Balance**	**Economic Balance**
Trust II	$ 617,265	$ 398,932	$ 784,641	$ 502,034
Trust III	257,751	145,573	310,526	171,071
Trust IV	1,219,063	561,602	1,416,842	635,678
Trust V	332,938	126,188	673,043	261,986
Trust VI	925,677	379,118	1,050,695	419,430
Trust VII	817,339	323,210	–	–
Unpledged	21,105	8,113	2,998	1,329
Total	$ 4,191,138	$ 1,942,736	$ 4,238,745	$ 1,991,528

The economic balance of an account is the present value of the future scheduled monthly payments due on the account. Such present value is calculated by discounting the remaining future scheduled monthly payments on an account using the effective financing rate. The effective financing rate is determined by calculating the discount rate which, when applied in a present value calculation, results in the present value of all originally scheduled monthly payments on such account being equal to the original amount financed. In effect, the economic balance of an account is the amount of principal that can be amortized by the instalment payments due over the remaining term of the account at the effective financing rate.

At May 31, 1999, instalment payments estimated to be receivable within each of the next five fiscal years and thereafter are as follows (in thousands):

2000	$ 267,928
2001	262,448
2002	256,949
2003	249,205
2004	240,030
Thereafter	2,914,578
	$ 4,191,138

NOTE 6: Property, Plant and Equipment

Property, plant and equipment are summarized as follows (in thousands):

At May 31,	1999	1998
Land and minerals	$ 77,928	$ 77,551
Land improvements	20,403	20,113
Buildings and leasehold improvements	130,217	124,556
Machinery and equipment	503,773	471,109
Construction in progress	19,808	29,576
Gross	752,129	722,905
Less: Accumulated depreciation	(353,538)	(326,565)
Net	$ 398,591	$ 396,340

NOTE 7: Income Taxes

Income tax expense (benefit) from continuing operations consist of the following components (in thousands):

	1999		1998		1997	
For the years ended May 31,	Current	Deferred	Current	Deferred	Current	Deferred
Federal	$ 11,310	$ 21,290	$ (3,545)	$ 34,883	$ 1,064	$ 28,250
State and local	1,637	(9)	1,639	49	2,042	(368)
Foreign	1,106	–	1,923	–	–	–
Total	$ 14,053	$ 21,281	$ 17	$ 34,932	$ 3,106	$ 27,882

The income tax expense (benefit) from continuing operations at the Company's effective tax rate differed from the statutory rate as follows:

For the years ended May 31,	1999	1998	1997
Statutory tax rate	35.0 %	35.0 %	35.0 %
Effect of:			
State and local income tax	1.2	1.7	2.3
Amortization of goodwill	13.4	19.3	27.0
Foreign sales corporation benefit	(.2)	(.5)	–
Capital loss on sale of subsidiary	(9.1)	–	–
Other, net	(.5)	(.9)	.9
Effective tax rate from continuing operations	39.8 %	54.6 %	65.2 %

The discontinued operation is reported net of tax expense (benefit) of $(19,313), $3,853 and $1,993 for 1999, 1998 and 1997, respectively. The effective tax rate for the discontinued operation differs from the statutory rate primarily as a result of utilizing percentage depletion for income tax purposes. In fiscal 1998, the income tax benefit related to the extraordinary item approximated the statutory rate and is deferred federal income tax.

Deferred tax liabilities (assets) are comprised of the following (in thousands):

At May 31,	1999	1998
Bad debts	$ (10,832)	$ (10,712)
Instalment sales method for instalment notes receivable in prior years	15,774	21,268
Depreciation and amortization	37,739	30,569
Difference in basis of assets under purchase accounting	14,922	17,253
Net operating loss/capital loss/credit carryforwards	(26,661)	(51,214)
Accrued expenses	(22,495)	(22,978)
Postretirement benefits other than pensions	(49,155)	(47,294)
Pensions	3,851	3,527
Total deferred tax (asset)	$ (36,857)	$ (59,581)

The Revenue Act of 1987 eliminated the instalment sales method of tax reporting for instalment sales after December 31, 1987.

The change in the deferred tax accounts during fiscal 1999 includes a purchase accounting adjustment of $1.6 million for the AIMCOR acquisition. Deferred tax assets of $33,093 and $24,828 at May 31, 1999 and 1998, respectively, are included in assets held for disposition (see Note 3). The Company believes that it is more likely than not that the total deferred tax asset will be realized through taxable earnings or alternative tax strategies; therefore, a valuation allowance is not warranted.

The Company's net operating loss carryforward at May 31, 1999 approximates $30.9 million, which will expire in fiscal 2010. The Company's minimum tax credit carryforward at May 31, 1999 approximates $13.2 million. The Company's foreign tax credit carryforward at May 31, 1999 approximates $.4 million which will expire in fiscal 2003. The Company's capital loss carryforward at May 31, 1999 approximates $6.3 million which will expire in fiscal 2004. Under the Internal Revenue Code, if certain substantial changes in the Company's ownership occur, there are annual limitations on the amount of loss and credit carryforwards.

A substantial controversy exists with regard to federal income taxes allegedly owed by the Company. Proofs of claim have been filed by the Internal Revenue Service ("IRS") for taxes, interest and penalties in the total amounts of $347.3 million with respect to fiscal years ended August 31, 1980 and August 31, 1983 through May 31, 1994. The claims for fiscal years ended May 31, 1993 and May 31, 1994 do not reflect tentative net operating carryback allowances in the amount of $21.4 million. These proofs of claim represent total adjustments to taxable income of approximately $507.2 million for all tax periods at issue. The Company has filed objections to the proofs of claim, and the various issues are being litigated in the Bankruptcy Court. By joint stipulation between the IRS and the Company, confirmed by Order of the Bankruptcy Court dated January 3, 1997, the IRS conceded an issue involving an adjustment to taxable income of approximately $51.0 million for hedging losses incurred during fiscal year 1988. Also by joint stipulation, confirmed by Order of the Bankruptcy Court dated March 10, 1998, the IRS has conceded an issue involving adjustments to taxable income of approximately $127.0 million for amortization deductions related to certain debt issuance costs for tax years 1988 through 1991. The Company believes that the balance of such proofs of claim are substantially without merit and intends to defend vigorously such claims, but there can be no assurance as to the ultimate outcome. The Company's U. S. federal income tax returns for the fiscal years ended May 31, 1995 and 1996 are currently being audited by the IRS.

NOTE 8: Debt

Long-term debt, in accordance with its contractual terms, consisted of the following at each year end (in thousands):

At May 31,	1999	1998
Senior debt:		
Walter Industries, Inc.		
Revolving Credit Facility	$ 125,000	$ 135,000
Term Loan	425,000	450,000
Other	3,000	4,450
	553,000	589,450
Mid-State Trusts		
Loan & Security Agreement	89,300	80,300
Trust II Mortgage-Backed Notes	258,400	323,000
Trust III Asset Backed Notes	48,576	85,145
Trust IV Asset Backed Notes	590,783	774,024
Trust V Variable Funding Loan	105,000	218,000
Trust VI Asset Backed Notes	359,342	405,698
Trust VII Asset Backed Notes	306,750	–
	1,758,151	1,886,167
Total	$ 2,311,151	$ 2,475,617

In conjunction with the closing of the AIMCOR acquisition on October 15, 1997, the Company completed an $800.0 million financing with Bank of America (as successor to NationsBank, National Association) and other lenders. The financing consisted of a $350.0 million revolving credit facility ("Revolving Credit Facility") and a $450.0 million six-year term loan (the "Term Loan"), (collectively, the "Credit Facilities"). Proceeds from the

financing were used to (a) finance the acquisition of AIMCOR, (b) pay transaction costs, (c) provide ongoing working capital, and (d) repay outstanding indebtedness under a $550.0 million credit facility. The Company recorded an extraordinary loss of $4.1 million ($2.7 million net of income tax benefit) during fiscal 1998 consisting of a write-off of unamortized debt expense related to the early repayment of the $550.0 million credit facility.

The Credit Facilities are secured by guarantees and pledges of the capital stock of all domestic subsidiaries of the Company other than Mid-State Holdings Corporation and its sole subsidiary Mid-State. Net cash proceeds from (a) asset sales where the aggregate consideration received (on a cumulative basis from October 15, 1997) exceeds $20.0 million and the cumulative amount of such proceeds from such sales since the most recent preceding prepayment equals or exceeds $5.0 million, (b) each Permitted Receivables Securitization (as defined in the Credit Facilities) or (c) the issuance of Consolidated Indebtedness (as defined in the Credit Facilities) permitted thereunder must be applied to permanently reduce the Credit Facilities. There have been no such reductions to date. Interest, at the option of the Company, is at (i) the greater of (a) the prime rate, or (b) the federal funds effective rate plus .50% or (ii) a LIBOR rate plus an Applicable Margin (as defined in the Credit Facilities) of .50% to 1.25% (based upon a leverage ratio pricing grid). At May 31, 1999, the weighted average interest rate was 6.02%.

The Revolving Credit Facility includes a sub-facility for trade and other standby letters of credit in an amount up to $75.0 million at any time outstanding and a sub-facility for swingline advances in an amount not in excess of $25.0 million at any time outstanding. A commitment fee ranging from .175% to .30% per annum (based upon a leverage ratio pricing grid) is payable on the daily average unutilized commitment. The fee for outstanding letters of credit is priced at the Applicable Margin less .125%. At May 31, 1999, letters of credit in the aggregate face amount of $24.5 million have been issued and swingline advances outstanding were $2.2 million. The Revolving Credit Facility is due October 15, 2003.

Scheduled principal payments on the Term Loan in each of the five years from May 31, 1999 are $50 million, $75 million, $75 million, $100 million, and $125 million, respectively.

On May 27, 1999, Mid-State renewed its 364-day, $90.0 million Loan and Security Agreement with Kitty Hawk Funding Corporation, an affiliate of Bank of America (as successor to NationsBank), as lender and as agent and bank investor. Advances under the Loan and Security Agreement are secured by Mid-State's beneficial interest in Trust III and evidenced by a variable funding note. The proceeds from the borrowings outstanding at May 31, 1999 and 1998 were used to pay down the Revolving Credit Facility. Future proceeds will be used for general corporate purposes. The facility currently matures on May 25, 2000, but provides for extensions of the maturity through May 31, 2002. Accordingly, the $89.3 million of borrowings outstanding at May 31, 1999 have been classified as long-term debt. Principal payments are required on any day in which the outstanding principal amount of all advances under the Loan and Security Agreement exceed the borrowing base. Additionally, commencing on May 31, 2001, Mid-State is required to prepay $1.5 million on May 31, August 31, November 30, and February 28. The outstanding principal of all advances must be paid when the facility is terminated. Interest must be paid on the last day of each tranche period at either the commercial paper rate, the prime rate or the LIBOR rate plus .47% as determined by Mid-State and approved by the lender. The advances under the Loan and Security Agreement are to be satisfied solely from the assets of Mid-State and are non-recourse to the Company and any of its other subsidiaries.

The Trust II Mortgage-Backed Notes were issued in five classes in varying principal amounts. Four of the classes have been fully repaid. The remaining class, A4 ("Class A4 Notes"), bears interest at the rate of 9.625%. Interest on the notes is payable quarterly on January 1, April 1, July 1 and October 1 (each a "Payment Date"). On each Payment Date, regular scheduled principal payments will be made on the Class A4 Notes until maturity on April 1, 2003. Class A4 Notes are subject to special principal payments and may be subject to optional redemption under specified circumstances. The scheduled principal amount of notes maturing in each of the four years from May 31, 1999 is $64.6 million.

The Trust III Asset Backed Notes bear interest at 7.625%, constitute a single class and have a final maturity date of April 1, 2022. Payments are made quarterly on January 1, April 1, July 1 and October 1 based on collections on the underlying collateral less amounts paid for interest on the notes and Trust III expenses.

The Trust IV Asset Backed Notes bear interest at 8.33%, constitute a single class and have a final maturity of April 1, 2030. Payments are made quarterly on January 1, April 1, July 1 and October 1 based on collections on the underlying collateral and distributions from Trust II, less amounts paid for interest on the notes and Trust IV expenses.

On March 3, 1995, Trust V entered into the three-year $500.0 million Variable Funding Loan Agreement with Enterprise Funding Corporation, an affiliate of Bank of America (as successor to NationsBank), as lender and as Administrative Agent. The agreement was amended to reduce the facility to $400.0 million effective July 31, 1997. This facility is an evergreen facility renewable on an annual basis. Periodic paydowns occur from the proceeds of permanent financings. Accordingly, the $105.0 million of borrowings outstanding at May 31, 1999 have been classified as long-term debt. The facility currently matures on September 29, 1999. Interest is based on the cost of A-1 and P-1 rated commercial paper which was 4.9% at May 31, 1999 plus .35%. The facility fee on the maximum net investment is .15%.

The Trust VI Asset Backed Notes were issued in four classes, bear interest rates ranging from 7.34% to 7.79% and have a final maturity on July 1, 2035. Payments are made quarterly on January 1, April 1, July 1, and October 1 based on collections on the underlying collateral, less amounts paid for interest on the notes and Trust VI expenses.

On December 10, 1998, Mid-State Homes purchased from Trust V instalment notes having a gross value of $858.7 million and an economic balance of $335.3 million. Mid-State subsequently sold these notes to Trust VII, a business trust organized by Mid-State. These sales were in exchange for the net proceeds from the public issuance of $313.5 million of Asset Backed Notes by Trust VII ("Trust VII Asset Backed Notes"). The notes were issued in a single class and bear interest at 6.34% payable quarterly beginning March 15, 1999. The notes have a final maturity of December 1, 2036. Payments are made quarterly on December 15, March 15, June 15, and September 15 based on collections on the underlying collateral, less amounts paid for interest on the notes and Trust VII expenses. The $313.5 million in proceeds were primarily used to repay related asset-backed borrowings of $284.0 million under the Trust V warehouse facility. Lehman Brothers, Inc., an affiliate of Lehman Brothers Holdings, Inc., which owned 2.8 million shares of the Company's common stock at May 31, 1999, served as an underwriter in connection with the public issuance of the Trust VII Asset Backed Notes and received underwriting commissions and fees of $.8 million.

The Company periodically uses interest rate lock agreements as hedge instruments to manage interest rate risks. The Company has two types of interest rate risks: (i) current risk on interest rates related to debt which has floating rates and (ii) risk of interest rate fluctuations from indebtedness secured by fixed-rate instalment notes receivable generated by its homebuilding business. During fiscal 1998, the Company entered into forward-interest rate lock agreements in order to fix the interest rate on a portion of asset-backed long-term debt which was anticipated to be issued in the second quarter of fiscal 1999. The lock agreements had a total notional amount of $250.0 million and had a weighted-average interest rate of 5.57%. Approximately $100.0 million notional amount of interest rate lock agreements were held by Lehman Brothers, Inc. These agreements were terminated on October 9, 1998. The losses incurred ($24.0 million) have been deferred and are being amortized to interest expense over the life of the Trust VII Asset Backed Notes. Additionally, the interest rate lock agreements in effect during fiscal 1997 were terminated on June 11, 1997. The losses incurred ($8.6 million) have been deferred and are being amortized to interest expense over the life of the Trust VI Asset Backed Notes. There were no interest rate lock agreements at May 31, 1999.

The Credit Facilities contain a number of significant covenants that, among other things, restrict the ability of the Company and its subsidiaries to dispose of assets, incur additional indebtedness, pay dividends, create liens on assets, enter into capital leases, make investments or acquisitions, engage in mergers or consolidations, or engage in certain transactions with subsidiaries and affiliates and otherwise restrict corporate activities (including change of control and asset sale transactions). In addition, under the Credit Facilities, the Company is required to maintain specified financial ratios and comply with certain financial tests, including a fixed charge coverage ratio and a maximum leverage ratio. The Company was in compliance with these covenants at May 31, 1999.

The Trust V Variable Funding Loan Agreement's covenants, among other things, restrict the ability of Trust V to dispose of assets, create liens and engage in mergers or consolidations. The Company was in compliance with these covenants at May 31, 1999.

The Loan and Security Agreement contains a number of covenants that, among other things, restrict the ability of Mid-State to dispose of assets, create liens on assets, engage in mergers, incur any unsecured or recourse debt, or make material changes to their credit and collection policies. In addition, Mid-State is required to maintain specified net income and net worth levels. The Company was in compliance with these covenants at May 31, 1999.

NOTE 9: Pension and Other Employee Benefits

The Company has various pension and profit sharing plans covering substantially all employees. In addition to its own pension plans, the Company contributes to certain multi-employer plans. Combined total pension expense for the years ended May 31, 1999, 1998 and 1997, was $3.3 million, $7.5 million and $7.6 million, respectively. The funding of retirement and employee benefit plans is in accordance with the requirements of the plans and, where applicable, in sufficient amounts to satisfy the "Minimum Funding Standards" of the Employee Retirement Income Security Act of 1974 ("ERISA"). The plans provide benefits based on years of service and compensation or at stated amounts for each year of service.

The Company also provides certain postretirement benefits other than pensions, primarily health care, to eligible retirees. The Company's postretirement benefit plans are not funded. As discussed in Note 3, the Company realized a $25.0 million pre-tax curtailment gain from a reduction in JWR's postretirement benefit obligation resulting from a recent actuarial analysis of medical claims experience and a reduction in the workforce, partially offset by the decision to shut down Mine No. 3.

	Pension Benefits		Other Benefits	
(in thousands)	1999	1998	1999	1998
Change in benefit obligation:				
Benefit obligation at beginning of year	$ 285,973	$ 256,040	$ 262,242	$ 225,413
Service cost	7,072	6,290	7,629	8,128
Interest cost	19,372	18,651	16,714	16,005
Amendments	2,375	362	(1,984)	–
Actuarial loss	1,271	18,822	19,476	19,585
Acquisitions	–	2,270	–	–
Benefits paid	(16,961)	(16,462)	(9,130)	(6,889)
Other	600	–	(42,048)	–
Benefit obligation at end of year	$ 299,702	$ 285,973	$ 252,899	$ 262,242
Change in plan assets:				
Fair value of plan assets at beginning of year	$ 283,396	$ 247,067	$ –	$ –
Actual return on plan assets	12,418	45,246	–	–
Employer contribution	3,560	5,328	–	–
Acquisitions	–	2,217	–	–
Benefits paid	(16,961)	(16,462)	–	–
Fair value of plan assets at end of year	$ 282,413	$ 283,396	$ –	$ –
Funded status	$(17,289)	$(2,577)	$(252,899)	$(262,242)
Unrecognized net actuarial gain (loss)	19,591	6,351	(13,480)	(19,199)
Unrecognized prior service cost	6,122	4,318	(4,030)	(2,267)
Unamortized transition amount	(3,498)	(4,062)	–	–
Contribution after measurement date	718	1,057	–	–
Prepaid (accrued) benefit cost	$ 5,644	$ 5,087	$(270,409)	$(283,708)
Amounts recognized in the balance sheet:				
Prepaid benefit cost	$ 5,529	$ 5,648	$ –	$ –
Accrued benefit cost	(11,967)	(10,554)	(270,409)	(283,708)
Intangible asset	6,461	5,871	–	–
Accumulated other comprehensive income	5,621	4,122	–	–
Net amount recognized	$ 5,644	$ 5,087	$(270,409)	$(283,708)

Certain pension plans have benefit obligations in excess of fair value of plan assets. At May 31, 1999 and 1998, these plans had total obligations of $54.3 and $53.0 million, respectively, and had total assets of $41.3 and $41.4 million, respectively.

	Pension Benefits		Other Benefits	
	1999	1998	1999	1998
Weighted average assumptions				
Discount rate	7.00%	7.00%	7.00%	7.00%
Expected return on plan assets	9.00%	9.00%	–	–
Rate of compensation increase	4.50%	4.50%	–	–

For measurement purposes, an 8.50% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2000. The rate was assumed to decrease gradually to 5.25% for 2006 and remain at that level thereafter.

	Pension Benefits		Other Benefits	
(in thousands)	1999	1998	1999	1998
Components of net periodic benefit cost				
Service cost	$ 7,572	$ 6,860	$ 7,629	$ 8,128
Interest cost	19,372	18,651	16,714	16,005
Expected return on plan assets	(24,912)	(21,870)	–	–
Amortization of prior service cost	572	538	(215)	(222)
Recognized net actuarial loss	(540)	(520)	(1,855)	(2,203)
Net periodic benefit cost	$ 2,064	$ 3,659	$ 22,273	$ 21,708

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

(in thousands)	1-Percentage-Point Increase	1-Percentage-Point Decrease
Effect on total of service and interest cost components	$ 4,032	$ (5,127)
Effect on postretirement benefit obligation	$ 42,825	$ (34,302)

The Company and certain of its subsidiaries maintain profit sharing plans. The total cost of these plans for the years ended May 31, 1999, 1998 and 1997 was $3.6 million, $3.5 million and $3.4 million, respectively.

Under the labor contract with the United Mine Workers of America, JWR makes payments into multi-employer pension plan trusts established for union employees. Under ERISA, as amended by the Multiemployer Pension Plan Amendments Act of 1980, an employer is liable for a proportionate part of the plans' unfunded vested benefits liabilities. The Company estimates that its allocated portion of the unfunded vested benefits liabilities of these plans amounted to approximately $46.0 million and $42.5 million at May 31, 1999 and 1998, respectively. However, although the net liability can be estimated, its components, the relative position of each employer with respect to the actuarial present value of accumulated benefits and net assets available for benefits, are not available to the Company.

In February 1997, a reduction in the salaried workforce at JWR was completed under a voluntary early retirement program. The total cost of this program was $6.2 million.

NOTE 10: Stockholders' Equity

The Company is authorized to issue 200,000,000 shares of common stock, $.01 par value. As of May 31, 1999 and 1998, 50,311,892 and 53,885,594 shares of common stock were outstanding, respectively. In September 1998, the Company's Board of Directors authorized an increase, from two to four million, in the number of shares of the Company's common stock which may be purchased under the share repurchase program authorized in July 1998. Information relating to the Company's share repurchases is set forth on the following table (in thousands):

For the years ended May 31,	1999	1998
Shares	3,594	1,398
Amount	$ 50,237	$ 21,841

As of May 31, 1999, 4,992,292 shares of common stock are held as treasury stock. On September 13, 1995, pursuant to the Consensual Plan, 3,880,140 shares of common stock were issued to an escrow account. To the extent that certain federal income tax matters of the Company are resolved satisfactorily, up to a maximum 3,880,140 of the escrowed shares will be distributed to former stockholders of the Company as of the Effective Date. To the extent such matters are not resolved satisfactorily, the escrowed shares will be returned to the Company and canceled.

Pursuant to the Consensual Plan, a total of 54,868,766 shares of common stock were to be issued to creditors and former stockholders of the Company. The plan of reorganization originally proposed by certain creditors and committees (the "Creditors Plan") provided that subordinated bondholders could elect to receive "Qualified Securities" (cash and/or new senior notes) in lieu of common stock of the Company. The Consensual Plan confirmed by the Bankruptcy Court (which technically constituted a modification of the Creditors Plan) kept in place the bondholders election. Certain subordinated bondholders, however, were unable to provide documentation evidencing their right to receive Qualified Securities within the two-year time frame required by the Consensual Plan. As a result, approximately 212,000 additional shares of common stock were issued in lieu of Qualified Securities in fiscal 1997. In addition, certain former stockholders did not tender their shares, which resulted in approximately 17,000 shares not being issued.

NOTE 11: Earnings Per Share

A reconciliation of the basic and diluted per earnings share computations for each of the three years in the period ended May 31, 1999 are as follows (in thousands, except per share data):

	1999		1998		1997	
For the years ended May 31,	Basic	Diluted	Basic	Diluted	Basic	Diluted
Income from continuing operations	$ 53,515	$ 53,515	$ 29,073	$ 29,073	$ 16,504	$ 16,504
Income (loss) from discontinued operation	(17,917)	(17,917)	29,831	29,831	20,613	20,613
Extraordinary item	–	–	(2,663)	(2,663)	–	–
Net income	$ 35,598	$ 35,598	$ 56,241	$ 56,241	$ 37,117	$ 37,117
Shares of common stock outstanding:						
Average number of common shares(a)	51,628	51,628	53,846	53,846	54,922	54,922
Effect of diluted securities:						
Stock options (b)	–	117	–	537	–	142
	51,628	51,745	53,846	54,383	54,922	55,064
Per share:						
Income from continuing operations	$ 1.04	$ 1.04	$ .54	$ .53	$ .30	$ .30
Income (loss) from discontinued operation	(.35)	(.35)	.55	.55	.38	.37
Extraordinary item	–	–	(.05)	(.05)	–	–
Net income	$ .69	$ .69	$ 1.04	$ 1.03	$ .68	$ .67

(a) Fiscal 1999, 1998 and 1997 shares include 3,880,140 additional shares issued to an escrow account on September 13, 1995 pursuant to the Consensual Plan, but do not include shares held in treasury.

(b) Represents the number of shares of common stock issuable on the exercise of dilutive employee stock options less the number of shares of common stock which could have been purchased with the proceeds from the exercise of such options. These purchases were assumed to have been made at the higher of either the market price of the common stock at the end of the period or the average market price for the period.

NOTE 12: Stock Options

Under the Walter Industries, Inc. Long-Term Incentive Stock Plan approved by stockholders in October 1995 and amended in September 1997 and April 1999, an aggregate of 6,000,000 shares (3,000,000, respectively, at May 31, 1998 and 1997) of the Company's common stock have been reserved for the grant and issuance of incentive and non-qualified stock options, stock appreciation rights ("SARs") and stock awards. The maximum number of such shares with respect to which stock options or SARs may be granted to any employee during while the Plan is in effect is 1,000,000 shares, and the aggregate number of such shares that may be used in settlement of stock awards is 3,000,000 shares. An option becomes exercisable at such times and in such instalments as set by the Compensation Committee of the Board (generally, vesting occurs over three years in equal annual increments), but no option will be exercisable after the tenth anniversary of the date on which it is granted. The option price per share may not be less than the fair market value of a share on the date the option is granted.

Information on stock options is summarized as follows:

May 31,	1999		1998		1997	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	3,298,329	$ 14.551	2,669,999	$ 13.301	1,487,000	$ 14.120
Granted	727,500	15.195	906,000	17.955	1,219,000	12.313
Exercised	(20,498)	12.902	(233,341)	13.686	–	–
Canceled	(127,333)	16.198	(44,329)	13.353	(36,001)	13.571
Outstanding at end of year	3,877,998	14.626	3,298,329	14.551	2,669,999	13.301
Exercisable at end of year	2,076,174	13.693	1,143,036	13.570	487,333	14.118

	Options Outstanding		Options Exercisable	
Range of Exercise Prices	Number Outstanding at May 31, 1999	Weighted Average Remaining Contractual Life (years)	Number Exercisable at May 31, 1999	Weighted Average Exercise Price
$ 10.547 - 12.656	1,138,697	7.2	711,693	$ 12.313
12.657 - 14.766	1,245,801	6.1	1,245,801	14.117
14.767 - 16.875	591,000	9.4	10,000	14.875
16.876 - 18.984	855,500	8.6	93,012	17.252
18.985 - 21.094	47,000	8.8	15,668	20.815
	3,877,998	7.5	2,076,174	

The Company applies APB Opinion No. 25 and related interpretations for accounting for stock options. Accordingly, no compensation costs at the grant dates are recorded. Had compensation cost for the Company's option plans been determined based on the fair value at the grant dates as prescribed by Statement of Financial Accounting Standards No. 123 "Accounting for Stock Based Compensation" ("FAS 123"), the Company's net income and net income per share on a pro forma basis would have been (in thousands, except per share data):

	1999	1998	1997
Pro forma net income	$ 32,070	$ 53,836	$ 35,314
Pro forma basic income per share	$ .62	$ 1.00	$ .64
Pro forma diluted income per share	$ .62	$ .99	$ .64

The preceding pro forma results were calculated with the use of the Black Scholes option-pricing model. The following assumptions were used for the year ended May 31, 1999: (1) risk-free interest rate of 5.75%; (2) dividend yield of 0.0%; (3) expected life of 5.0 years; and (4) volatility of 34.66%. The following assumptions were used for the year ended May 31, 1998: (1) risk-free interest rate of 6.07%; (2) dividend yield of 0.0%; (3) expected life of 5.0 years; and (4) volatility of 31.10%.The following assumptions were used for the year ended May 31, 1997: (1) risk-free interest rate of 7.36%; (2) dividend yield of 0.0%; (3) expected life of 5.0 years; and (4) volatility of 29.30%.

The Walter Industries, Inc. Employee Stock Purchase Plan was adopted in January 1996 and amended in April 1999. All full-time employees of the Company who have attained the age of majority in the state in which they reside are eligible to participate. The Company contributes a sum equal to 15% of each participant's actual payroll deduction as authorized, and remits such funds to a designated brokerage firm which purchases in the open market, as agent for the Company, as many shares of common stock as such funds will permit for the accounts of the participants. The amount of stock purchased depends upon the market prices of the common stock at the time the purchases are made. The total number of shares that may be purchased under the plan is 1,000,000 (1,000,000 at May 31, 1998). Total shares purchased under the plan in 1999, 1998 and 1997 were approximately 225,000, 155,000 and 200,000, respectively, and the Company's contribution was approximately $.4 million in all years.

NOTE 13: Litigation

Income Tax Litigation

A substantial controversy exists with regard to federal income taxes allegedly owed by the Company. (see "Note 7" for a more complete explanation).

Miscellaneous Litigation

The Company and its subsidiaries are parties to a number of other lawsuits arising in the ordinary course of their businesses. The Company provides for costs relating to these matters when a loss is probable and the amount is reasonably estimable. The effect of the outcome of these matters on the Company's future results of operations cannot be predicted with certainty because any such effect depends on future results of operations and the amount and timing of the resolution of such matters. While the results of litigation cannot be predicted with certainty, the Company believes that the final outcome of such other litigation will not have a materially adverse effect on the Company's consolidated financial condition.

NOTE 14: Fair Value of Financial Instruments

Statement of Financial Accounting Standards No. 107 - "Disclosures about Fair Value of Financial Instruments" ("FAS 107") requires disclosure of estimated fair values for all financial instruments for which it is practicable to estimate fair value. Considerable judgment is necessary in developing estimates of fair value and a variety of valuation techniques are permitted under FAS 107. The derived fair value estimates resulting from the judgments and valuation techniques applied cannot be substantiated by comparison to independent materials or to disclosures by other companies with similar financial instruments. Management believes that the disclosures required by FAS 107 have limited relevance to the Company and its operations.

The following methods and assumptions were used to estimate fair value disclosures:

Cash and cash equivalents, restricted short-term investments, marketable securities, trade receivables, other receivables, accounts payable and short-term notes payable - The carrying amounts reported in the balance sheet approximate fair value.

Instalment notes receivable - The estimated fair value of instalment notes receivable at May 31, 1999 and 1998 was in the range of $2,000.0 million to $2,100.0 million and $2,100.0 million to $2,200.0 million, respectively. The estimated fair value is based upon valuations prepared by an investment banking firm as of May 31, 1999 and 1998. The value of mortgage-backed instruments such as instalment notes receivable are very sensitive to changes in interest rates.

Debt - The estimated fair value of long-term senior debt at May 31, 1999 and 1998 was approximated $2,228.0 million and $2,560.0 million, respectively, based on current yields for comparable debt issues or prices for actual transactions.

Interest rate lock agreements - The estimated fair value of the interest rate lock agreements at May 31, 1998 would have resulted in a loss of $.9 million. The fair value was based on quotes from brokers which represented the amounts that the Company would pay if the agreements were terminated at May 31, 1998. There were no interest rate lock agreements at May 31, 1999.

NOTE 15: Segment Information

In June 1997, FAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," was issued effective for fiscal years ending after December 15, 1998. The Company has adopted this statement for the year ended May 31, 1999.

The Company's reportable segments are strategic business units that offer different products and services and have separate management teams. The business units have been aggregated into three reportable segments since the long-term financial performance of each of these reportable segments is affected by similar economic conditions. The three reportable segments are: Homebuilding and Financing, Water Transmission Products and Energy Services. The Company markets and supervises the construction of detached, single-family residential homes, primarily in the Southern United States, and provides mortgage financing on such homes through the Homebuilding and Financing segment. Ductile iron pressure pipe, fittings, valves and hydrants are manufactured and marketed through the Water Transmission Products segment. The Energy Services segment manufactures, markets and distributes petroleum coke and a variety of ferroalloys as well as offering value-added services (such as inventory management, warehousing, shipping and removal of product from refineries) to its vendors and customers.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on operating earnings of the respective business units.

Summarized financial information concerning the Company's reportable segments is shown in the following tables. The Other category consisting of the remaining operating businesses of the Company includes specialty aluminum foil and sheet products, furnace and foundry coke, slag fiber, specialty chemicals, resin-coated sand, patterns and tooling, and land management businesses. The Company's coal mining and methane gas subsidiary, JWR, has been classified as a discontinued operation (see Note 3).

For the years ended May 31,	1999	1998	1997
(in thousands)			
Sales and revenues:			
Homebuilding and Financing	$ 461,315	$ 449,471	$ 440,749
Water Transmission Products	460,738	426,389	419,813
Energy Services	361,250	285,950	–
Other	332,664	320,409	308,984
Corporate	1,868	832	1,637
Consolidated sales and revenues (a)(b)	$ 1,617,835	$ 1,483,051	$ 1,171,183
Operating income (c)(d):			
Homebuilding and Financing (e)	$ 113,451	$ 99,421	$ 84,721
Water Transmission Products	33,039	16,192	16,342
Energy Services	24,891	20,947	–
Other	26,197	25,006	26,311
	197,578	161,566	127,374
Less-corporate interest and other expenses (e)	(108,729)	(97,544)	(79,882)
Income from continuing operations before income tax expense	88,849	64,022	47,492
Income tax expense	(35,334)	(34,949)	(30,988)
Income from continuing operations	$ 53,515	$ 29,073	$ 16,504
Depreciation:			
Homebuilding and Financing	$ 3,950	$ 3,840	$ 3,311
Water Transmission Products	17,335	16,880	17,010
Energy Services	6,268	3,701	–
Other	15,642	14,738	13,398
Corporate	1,364	1,557	1,691
Total	$ 44,559	$ 40,716	$ 35,410

For the years ended May 31,	1999	1998	1997
(in thousands)			
Gross capital expenditures:			
Homebuilding and Financing	$ 6,150	$ 4,908	$ 5,617
Water Transmission Products	23,598	20,492	14,479
Energy Services	6,582	14,169	–
Other	17,445	26,206	26,003
Corporate	2,379	1,120	692
Total	$ 56,154	$ 66,895	$ 46,791
Identifiable assets:			
Homebuilding and Financing	$ 1,730,922	$ 1,833,967	$ 1,796,949
Water Transmission Products	449,972	439,514	452,963
Energy Services	494,014	503,508	–
Other	246,061	250,037	229,431
Corporate	75,328	153,135	176,358
Total	$ 2,996,297	$ 3,180,161	$ 2,655,701

(a) Inter-segment sales (made primarily at prevailing market prices) are deducted from sales of the selling segment and are insignificant in amount with the exception of the sales of Other to Water Transmission Products of $15.7 million, $16.2 million and $14.7 million in 1999, 1998, and 1997, respectively.

(b) Export sales were $143.7 million, $110.5 million, and $23.3 million in 1999, 1998, and 1997, respectively. Export sales to any single geographic area do not exceed 10% of consolidated sales and revenues.

(c) Operating income amounts are after deducting amortization of goodwill. A breakdown by segment of goodwill amortization is as follows (in thousands):

For the years ended May 31,	1999	1998	1997
Homebuilding and Financing	$ 23,288	$ 23,942	$ 25,548
Water Transmission Products	9,858	9,859	9,856
Energy Services	8,756	5,336	–
Other	1,057	1,058	1,056
Corporate	159	157	155
	$ 43,118	$ 40,352	$ 36,615

(d) Operating income amounts include postretirement benefits. A breakdown by segment is as follows (in thousands):

For the years ended May 31,	1999	1998	1997
Homebuilding and Financing	$ 1,707	$ 1,271	$ 1,888
Water Transmission Products	2,510	2,046	3,857
Energy Services	–	–	–
Other	3,219	3,086	4,550
Corporate	317	242	573
	$ 7,753	$ 6,645	$ 10,868

(e) Interest expense incurred by the Homebuilding and Financing segment and Corporate are as follows (in thousands):

For the years ended May 31,	1999	1998	1997
Homebuilding and Financing:			
Gross interest	$ 144,177	$ 154,644	$ 152,094
Less: Intercompany interest income	(45,321)	(38,647)	(33,135)
Net interest	98,856	115,997	118,959
Corporate:			
Senior debt interest	40,820	38,936	27,086
Intercompany interest	45,321	38,647	33,135
	$ 184,997	$ 193,580	$ 179,180

General corporate expense, senior debt interest expense and intercompany interest expense are attributable to all segments, but cannot be reasonably allocated to specific segments.

REPORT OF MANAGEMENT

To the Stockholders of Walter Industries, Inc.

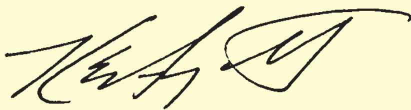
The management of Walter Industries, Inc. is responsible for the preparation, integrity and objectivity of the consolidated financial statements. The statements have been prepared in conformity with generally accepted accounting principles and, therefore, reflect estimates, where appropriate, based upon judgments of management. Financial information contained elsewhere in this annual report is consistent with that in the consolidated financial statements.

Walter Industries, Inc. and its subsidiaries maintain accounting systems and related internal controls that we believe are sufficient to provide reasonable assurance that financial records are reliable for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance is based on the recognition that the cost of a system of internal control should not exceed benefits expected to be derived from the system. The system is augmented by written policies and guidelines, a strong program of internal audit, and the careful selection and training of qualified personnel.

PricewaterhouseCoopers LLP, independent certified public accountants, are engaged to examine the consolidated financial statements. Their examination is conducted in accordance with generally accepted auditing standards and provides an objective, independent review of management's reporting of operating results and financial position. Their examination includes a review of internal controls and tests of transactions to establish a basis for reliance thereon in determining the nature, extent and timing of audit tests applied in the examination of the consolidated financial statements.

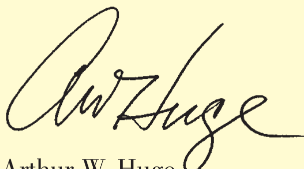
The Board of Directors, through the Audit Committee of the Board, is responsible for recommending to stockholders the independent certified public accountants to be engaged, and for ensuring that management fulfills its responsibilities in the preparation of the consolidated financial statements. The Audit Committee, composed solely of outside directors, meets periodically (separately and jointly) with the independent certified public accountants, representatives of management, and the internal auditors to ensure that each is properly discharging its financial control and reporting responsibilities. The independent certified public accountants and internal auditors each have direct access to the Audit Committee, without management representatives present, to discuss the scope and results of their audit work, the adequacy of internal accounting controls, and the quality of financial reporting.

The management of your Company recognizes its responsibility to conduct the business of Walter Industries, Inc. in accordance with high ethical standards. This responsibility is reflected in key policy statements that, among other things, address potentially conflicting outside business interests of Company employees, proper conduct of domestic and international business activities and compliance with federal and local laws. Ongoing communications and review programs are designed to help ensure compliance with these policies.

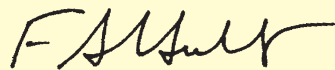


Kenneth E. Hyatt
Chairman, President and
Chief Executive Officer

Richard E. Almy
Executive Vice President and
Chief Operating Officer



Arthur W. Huge
Executive Vice President and
Chief Financial Officer



Frank A. Hult
Vice President, Controller and
Chief Accounting Officer