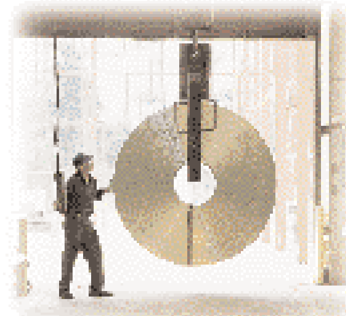

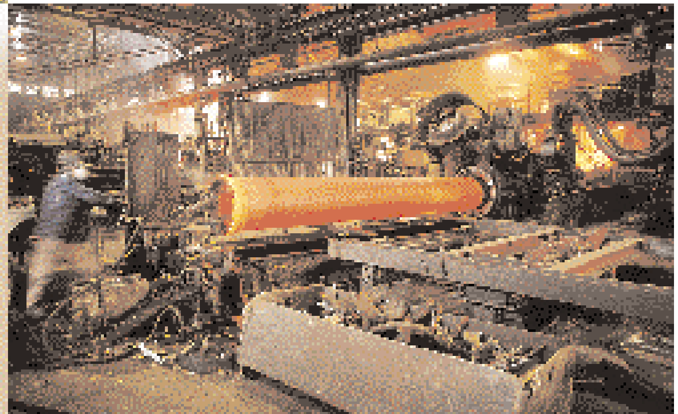

Homebuilding and Related financing

Water and Waste Water Transmission Products

Natural Resources

Industrial and Other Products

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COMPANY PROFILE

Walter Industries, founded in 1946, is a diversified holding company engaged in homebuilding and financing, pipe manufacturing, natural resource development, building materials and industrial manufacturing. We principally serve residential and non-residential construction, water and waste water transmission and industrial markets.

As this report is being published, our common stock is trading on Nasdaq's over-the-counter bulletin board system under the ticker symbol WLTR, pending its formal listing on the Nasdaq National Market.

For reporting purposes, our diverse subsidiaries are organized into four operating groups according to the markets they serve. A detailed description of each business segment, its recent operating performance and outlook for 1996 is provided in the Operations Review section of this report, beginning on page 5. Additional financial detail by group can be found in the Segment Information section of the Notes to Financial Statements, on page 49.

PERCENT OF TOTAL SALES AND REVENUES

	1995	**1994**	**1993**	**1992**	**1991**
Homebuilding and Related Financing	28%	32%	32%	30%	29%
Water and Waste Water Transmission Products	29	27	25	24	24
Natural Resources	23	24	27	31	32
Industrial and Other Products	20	17	16	15	14
Corporate	—	—	—	—	1
	100%	100%	100%	100%	100%

PERCENT OF TOTAL OPERATING INCOME

	1995	1994	1993	1992	1991
Homebuilding and Related Financing (a)	64%	84%	59%	72%	48%
Water and Waste Water Transmission Products	24	21	11	20	16
Natural Resources	17	(1)	34	14	43
Industrial and Other Products	10	12	8	13	8
Corporate	(15)	(16)	(12)	(19)	(15)
	100%	100%	100%	100%	100%

(a) After interest expense

TO OUR SHAREHOLDERS

It is with great pleasure that we introduce you to the new Walter Industries. With this annual report, we record the events of perhaps the most extraordinary year in our 49-year history. More importantly, we acknowledge the commencement of our new fiscal year that began June 1—and with it, the beginning of a new life for our company.

In describing fiscal 1995, it is probably best to begin at the end. Of all the events to occur during the year, none was more noteworthy or gratifying than our emergence from Chapter 11 reorganization on March 17, 1995, accompanied by the complete and final resolution of the complex financial and asbestos-related veil-piercing issues that had forced Walter Industries and its subsidiaries to voluntarily seek court protection more than five years earlier.

We won't burden you or this letter with an attempt to chronicle our Chapter 11 saga. A detailed account of the proceedings is presented in the financial section of this report. Suffice to say, the past year witnessed many extraordinary twists and turns before confirmation of a consensual plan of reorganization could be achieved. In the final analysis, we are glad the reorganization is complete so that we may focus fully on the company's prospects for the future.

OPERATING RESULTS

Despite the significant distractions of the Chapter 11 proceedings, our operations performed reasonably well in 1995. Net sales and revenues reached $1.442 billion, a 9 percent increase from the prior year. Income from operations, net of corporate expense, amounted to $250.2 million compared with $249.7 million in 1994.

As expected, our emergence from Chapter 11 during the fiscal fourth quarter exacted a heavy toll on annual net results. We absorbed $583.8 million of Chapter 11-related expenses, including $141.4 million of additional interest and amortization of debt discount and expense, $390 million in final settlement of asbestos-related veil-piercing claims and

James W. Walter (seated) and G. Robert Durham

related legal fees, and $52.4 million for professional fees, settlement of various disputed claims and other bankruptcy-related costs. As a result, we incurred a net loss of $358.6 million, or $7.10 per share, for the year.

Results from operations reflected the intrinsic balance of the company's diverse businesses. Three of our four operating groups reported higher sales and revenues. Operating income was higher in two groups but below prior year levels in two others. We encourage you to read the Operations Review and Management's Discussion sections of this report for a thorough summary of our results by business segment.

OTHER CORPORATE DEVELOPMENTS

Two significant corporate developments accompanied implementation of the Plan of Reorganization:

- We established a new board of directors consisting of four members of our previous board and five new directors. We are pleased to welcome these accomplished professionals and are confident that their diverse experiences and perspec-

tives will prove invaluable as the company evolves. A full listing of directors, their affiliations and board committee assignments can be found on page 52.

- Upon court confirmation of the Plan of Reorganization on March 2, 1995, shares of new Walter Industries common stock began trading on Nasdaq's over-the-counter bulletin board system on a when-issued basis and subsequently on a regular basis. As this report is being published, we are awaiting SEC approval of Registration Statements filed by the company, at which time we intend to formally list the shares on the Nasdaq National Market under their current trading symbol WLTR.

OUTLOOK

We enter fiscal 1996 with a greater sense of urgency and optimism than at any time in our history. For more than five years, our company and its employees have operated under a cloud of uncertainty that has now been lifted. Our sense of relief is undoubtedly shared by the customers, suppliers and other constituents who stood by us during this difficult period. We are grateful for their ongoing support and loyalty. Our resolve was also strengthened by the knowledge that there would one day be new life for Walter Industries, beyond Chapter 11. To that end, we continued to invest significant capital to build and strengthen our operations so that they would remain competitive and well-positioned for growth. During 1995 alone, we invested more than $91 million in capital projects, bringing the total invested during the last five years to more than $370 million.

We will continue to focus our capital resources on achieving growth in our core businesses. Capital expenditures are budgeted to approach $80 million in 1996, part of a $420 million capital program planned for the next five years. Our basic objective is to enhance the competitive advantages of each of our subsidiary operations. Within the framework of our diverse businesses, competitive advantage takes on many forms: lower manufacturing costs, superior customer relationships, stronger market penetration, proprietary products and technological leadership. Maintaining a competitive advantage will apply not only to decisions concerning our existing businesses, but also decisions to engage in new business opportunities that will enhance our present sphere of operations and heighten our market value.

OUR PEOPLE RESOURCES

In support of our strong operating position, the attention of our employees remains focused on building the company for sustained growth. It follows that a management imperative for our future is to foster a corporate-wide culture that emphasizes integrity, professionalism, flexibility and teamwork. Having just emerged from a period when the need for management stability and continuity was paramount—though our ability to attract qualified executive talent to our ranks was impeded by the uncertainties of the reorganization process—we may now begin an orderly transition of leadership from the hands of the senior executives who led the company to its past achievements and who have remained on board beyond normal retirement to ensure our successful transition out of Chapter 11. An immediate priority, therefore, is to assemble the executive team that will chart the company's future course and ensure that our operations realize their full potential.

In a major step toward this objective, we were pleased to announce in August that Kenneth E. Hyatt had been elected president and chief operating officer of the corporation. Mr. Hyatt, 55, was among the senior executives who guided our predecessor company, Jim Walter Corporation, to record sales and earnings in the mid-1980s. Following the company's leveraged buyout in 1988, he joined the handful of former executives who participated in the separate buyout of the company's then-largest subsidiary, The Celotex Corporation, where he has served as president and chief executive officer for the last several years. Ken was a 22-year veteran of Jim Walter Corporation at the time of his departure, having distinguished himself at The Georgia Marble Company, which he lead to eight consecutive years of

record earnings as its president, and later as a corporate group executive responsible for several subsidiaries that remain integral to our company today. In 1986 he was named executive vice president and chief operating officer of Jim Walter Corporation; as such, he clearly was in line to one day lead the company. We welcome him back and have every confidence in his ability to help reshape and strengthen Walter Industries for a bright future.

In closing, we would like to express our appreciation to the employees, past and present, and all others whose loyalty and perseverance contributed to the successful conclusion of the reorganization. We also welcome you, our new shareholders, to Walter Industries, and assure you that the resources, skills and energies of our company, its board of directors and management are committed to achieving long-term profitability and increasing the value of your investment.

James W. Walter
Chairman

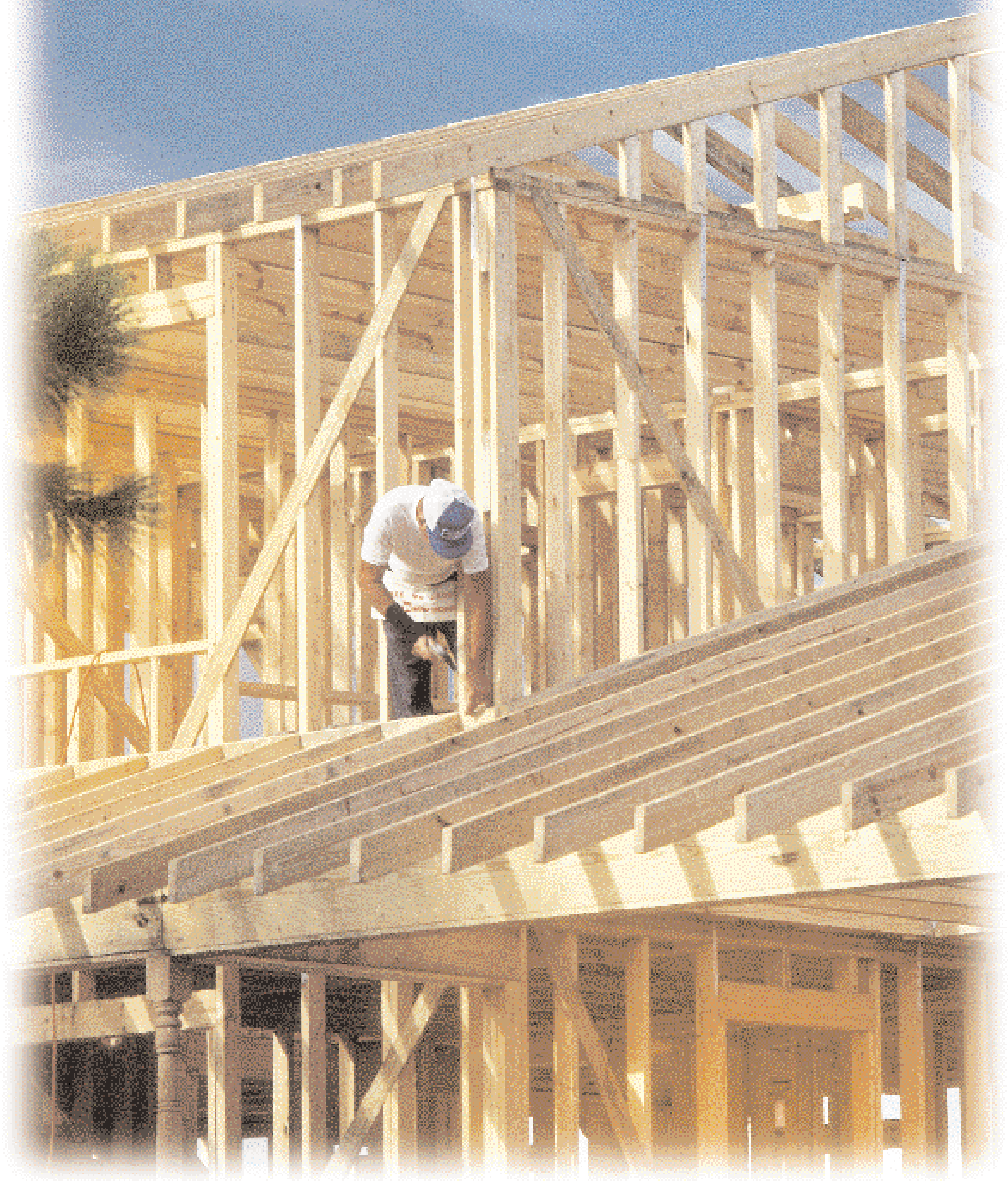
G. Robert Durham

President and Chief Executive Officer

August 15, 1995

As Walter Industries looks toward the future, it is also a time to reflect upon our past ... and the immeasurable contributions of our chairman, James W. Walter, 72, who is retiring in October after nearly 50 years at the helm of the company he founded. He will be succeeded as chairman by G. Robert Durham, who continues as chief executive officer. Mr. Walter will remain on the company's board as chairman emeritus.

The story of how Jim Walter pioneered the concept of affordable, "on-your-lot" homebuilding and eventually guided the company's growth into a major industrial organization has become a part of American corporate folklore. He is recognized internationally as an industrial leader and over the years has been profiled extensively in our nation's leading business publications. However, few people outside of his fellow employees and close associates can fully appreciate the depth of his contributions, particularly the value of his steadfast presence during the company's five-year long reorganization. For that, and for his nearly half century of leadership, we salute the man whose basic integrity, wisdom and sense of fair play will remain with us always.

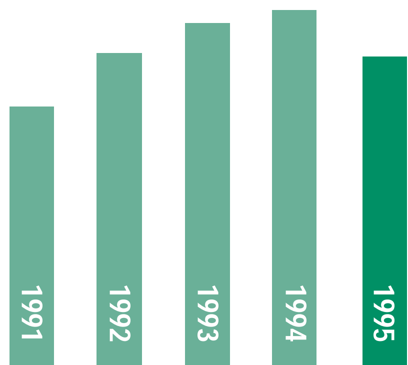


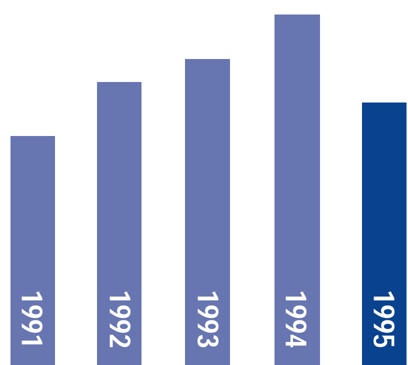
JIM WALTER HOMES
Detached, single-family houses

MID-STATE HOMES
Mortgage servicing for Jim Walter Homes customers

BEST INSURORS
Home and general insurance services

CARDEM
Reinsurance for customer property and credit life insurance





JIM WALTER HOMES

OPERATIONS AND MARKET CHARACTERISTICS

Jim Walter Homes is the company's original business, founded in 1946 when Jim Walter pioneered the concept of affordable, unfinished houses for American families who owned their own property but lacked the financial resources to buy a completed, conventional home.

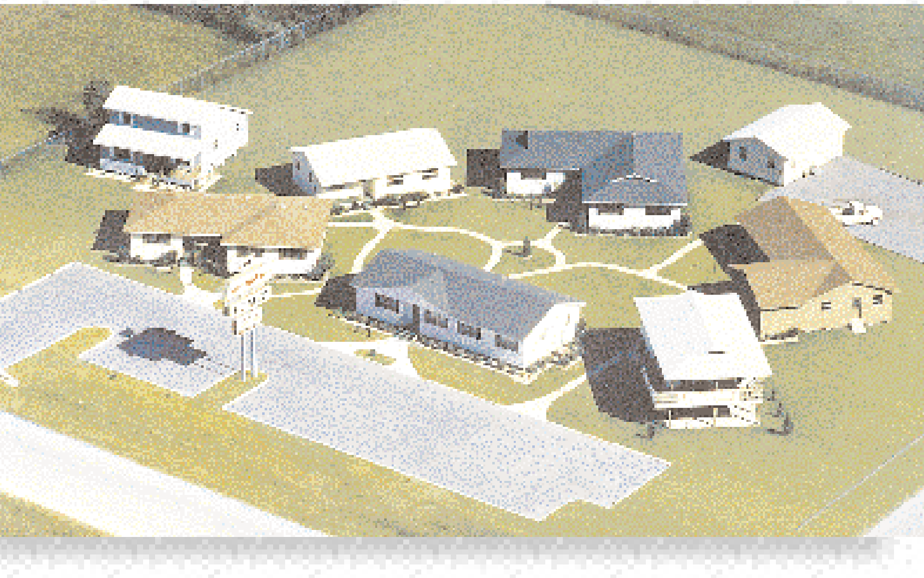
Since its inception, Jim Walter Homes has built more than 300,000 houses and today ranks as America's largest builder of single-family, on-your-lot homes. Its current line features 35 models of homes that are marketed through 105 model display centers serving 23 southern and surrounding states.

By constructing partially finished homes and allowing the buyer the option of finishing all or part of the interior, Jim Walter Homes has successfully pursued its original philosophy throughout its 49-year history: provide attractive, functional single-family housing at an affordable price.

The ability to provide financing terms to buyers has contributed greatly to Jim Walter Homes' success; 96 percent of the homes sold are financed by the company. After the home is released to the customer, Jim Walter Homes sells the notes and mortgages to Mid-State Homes, the group's mortgage servicing arm. At year end, the mortgage portfolio contained instal-

ment note receivables totalling $4.3 billion, representing 80,000 active Jim Walter home-owner accounts.

The company's line of 35 models is divided into three product groups: Affordable, Classic and Regency Series. Contrary to popular perception, Jim Walter homes are not pre-fabricated; all are conventionally built, on site, of wood frame construction. The Affordable line consists of five models with an average sales price of $31,700 and accounted for 30 percent of unit completions in 1995. The Classic line consists of 23 models—several developed in recent years as well as redesigned versions of plans offered for more than 25 years—at an average sales price of $42,200 and accounting for 61 percent of homes sold in 1995. The Regency Series, introduced in 1989, contains seven models of more upscale design, with an average sales price of $55,100; the Regency Series accounted for 9 percent of completed homes.



Jim Walter Homes is not a "speculative" builder; it builds only against firm orders and only on property owned by the customer (if the home is to be financed). This "land equity" substitutes for the cash down payment required by most lenders. Financing is provided at a 10 percent annual rate, with no points or closing costs, at terms up to 30 years.

More than any other major homebuilder today, Jim Walter Homes offers its customers an unparalleled range of options. Perhaps its most notable feature is the "partially finished" design concept that allows customers to purchase a home completed to one of several stages of interior finishing.

"Shell" homes are finished completely on the outside, but with only stud framing inside. Homes sold as "90 percent complete" exclude only inside paint, floor coverings, appliances, and water and sewer hook-ups. The balance of homes are built to various stages of interior finishing selected by the customer. This basic concept makes Jim Walter Homes tremendously appealing to a broad range of buyers with varying financial considerations and "do-it-yourself" skills.

Price is a highly important consideration for Jim Walter Homes' customers. During 1995, the company's average customer assumed a monthly payment of just $458, which represented less than 18 percent of combined monthly family income. This ratio has remained consistently below the average percentage of family income spent for housing nationally and is an important contributor to the stability of the company's multi-billion dollar mortgage portfolio.

Because Jim Walter not only builds homes, but also finances them for up to 30 years, customer satisfaction is essential to the strength of the homebuilding activities—as it has been throughout Jim Walter Homes' nearly 50 years as America's leading supplier of affordable housing. This customer base comprises a segment of the home-buying public that our company distinctly and proudly serves.

RECENT PERFORMANCE

Homebuilding and the related mortgage financing activities remained a cornerstone of Walter Industries' financial performance during 1995. The Homebuilding and Related Financing Group's earnings of $76.5 million (after interest expense) represented 64 percent of total Walter Industries' operating income.

Because of the company's unique financing programs, sales of Jim Walter-built homes historically run counter to traditional cycles of the homebuilding industry—that is, sales tend to rise sharply during periods of high interest rates and limited availability of mortgage funds. Conversely, sales decline when interest rates abate and mortgage funds are readily available, conditions that heighten competition from small, local builders.

Unit completions totaled 4,126 units in 1995 compared to 4,331 units in 1994. Of the current year's units, 25 percent were shell homes, 9 percent were completed to various partially finished stages, and 66 percent were 90 percent complete.

The group's performance for both years was affected by the exceptionally low mortgage rates nationally. Prior year income was favorably enhanced by an abnormally high number of mortgage payoffs in advance of maturities as conventional interest rates reached low levels not seen since the late 1960s, and homeowners rushed to refinance their higher rate mortgages. This artificial rise in mortgage financing income due to prepayments subsided in fiscal 1995 and resumed a more normal trend that, while negatively impacting year-to-year comparisons, restores the earnings consistency that has been the mortgage portfolio's hallmark strength, particularly during the inevitable down cycles in home sales.

OUTLOOK

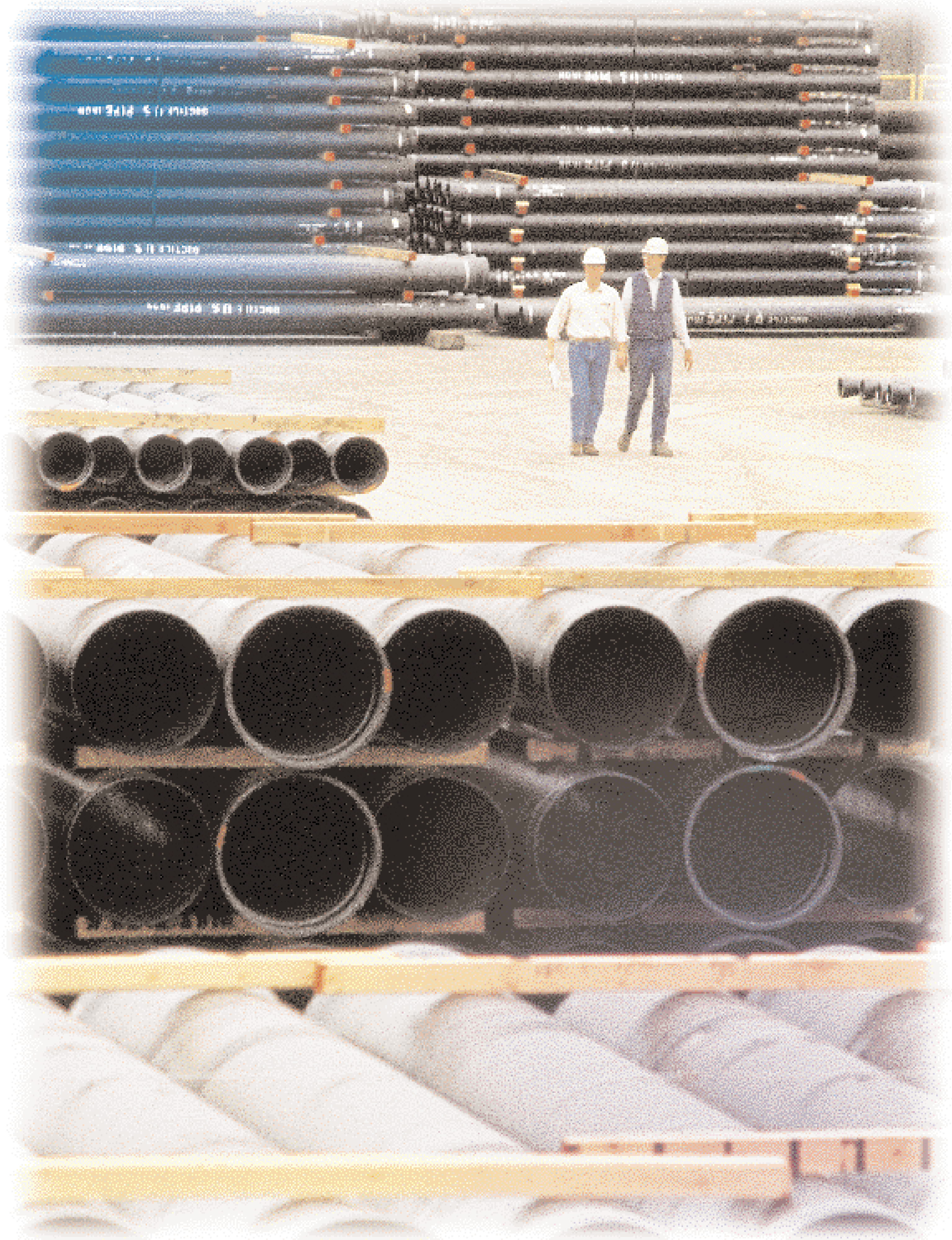
Within Jim Walter Homes' "countercyclical" periods—and as an ongoing strategy—a necessary objective is to develop new and innovative ways to maintain or increase demand for the company's homes.

Because there is no builder of comparable size and market scope as that enjoyed by Jim Walter Homes, competition comes primarily from manufactured housing and small, local homebuilders who are capitalizing on prevailing moderate interest rates and the availability of mortgage funds from conventional lending institutions. Lacking a rise in interest rates that will increase the competitiveness of Jim Walter Homes' financing terms, unit completions are projected to increase only modestly in fiscal 1996.

In response to its current countercycle, Jim Walter Homes will be instituting discounts throughout the year in the form of promotions on selected models, enhanced option packages and material upgrades. Unit gains can also be derived from expansion of the company's geographic operations. To that end, within the past three years the company has opened new model centers in Columbus, Ohio; Bentonville, Arkansas; New Iberia, Louisiana; Lynchburg, Virginia; Louisville, Kentucky; and Lafayette, Louisiana. In addition, the company has purchased land in Cincinnati, Ohio and Indianapolis, Indiana for further expansion during the second and third quarters of fiscal 1996 and is considering other sites in Ohio, Pennsylvania, West Virginia, West Texas and Kansas as an extension of its current market area.

CARDEM AND BEST INSURORS

Cardem is a Bermuda-based reinsurance company established in 1984 to capture a portion of fire and extended coverage policies that are sold to Jim Walter Homes' customers through Best Insurors, a wholly owned insurance agency. Both operations are relatively modest contributors to group revenues and income.

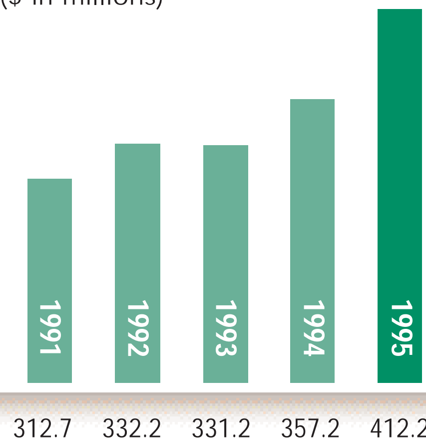


U.S. PIPE

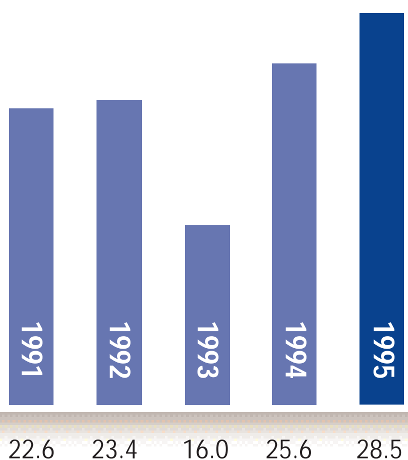
PRESSURE PIPE DIVISION
Ductile iron pressure pipe;
valves, hydrants and fittings

CASTINGS DIVISION
Gray and ductile iron castings

SALES AND REVENUES
($ in millions)



OPERATING INCOME ($ in millions)



PRESSURE PIPE DIVISION

OPERATIONS AND MARKET CHARACTERISTICS

Water and Waste Water Transmission Products is comprised of the two divisions of United States Pipe and Foundry Company: Pressure Pipe and Castings. The manufacture and distribution of ductile iron pressure pipe is the dominant contributor to the group's performance.

U.S. Pipe is widely recognized as a leading U.S. manufacturer of ductile iron pressure pipe. Its reputation has been built on the strength of important product innovations, modern manufacturing operations, aggressive sales and marketing programs, and superior customer service. It holds one of the largest U.S. market positions and is the industry's lowest cost producer as a result of significant, ongoing cost improvement expenditures and the development of new and improved proprietary manufacturing processes. Its well-known slogan, "New Ideas are Flowing at U.S. Pipe," symbolizes a long-standing reputation as the innovator in a typically non-glamorous and mature industry.

In the area of production innovation, U.S. Pipe has earned the respect and loyalty of its customers and

peers by recognizing industry needs and finding solutions. U.S. Pipe introduced the deLavaud method of centrifugal casting to pipe production in the United States; today, it is the standard method employed throughout the world. U.S. Pipe's bottle-tight TYTON JOINT® is unsurpassed as a joint sealer in pressure applications and collector pipes in gravity sewer systems. The company pioneered the use of loose polyethylene sleeving for cost-effective corrosion protection on ductile iron pipelines, and its TR-FLEX® restrained joint system is recognized as the premier method of joint restraint, an integral component of pipeline construction.

In many ways, "new ideas" have made U.S. Pipe the industry leader for nearly a century. No other company offers a better and broader line of pipe systems and restrained joint pipe and fittings adaptable to nearly all field conditions.

U.S. Pipe's broad geographical presence also provides a major competitive advantage. The company owns five manufacturing facilities located through-

out the United States. Ductile iron pipe is manufactured at four facilities—Bessemer, Alabama (which produces 14" to 64" pipe); Birmingham, Alabama (4" to 12"); Burlington, New Jersey (6" to 24") and Union City, California (6" to 24")—and a facility in Chattanooga, Tennessee, which produces complementary fittings, valves and hydrants. These manufacturing operations are supported by a nationwide network of 34 strategically based sales offices. U.S. Pipe's products are sold primarily to contractors, water works supply houses, municipalities and private utilities.

RECENT PERFORMANCE

Sales of the Pressure Pipe Division in 1995 increased 15 percent over the prior year, resulting in a 10 percent improvement in operating income. Profitability was constrained by the cost of ferrous scrap metal, the principal raw material and cost component of pipe manufacturing, which escalated to peak levels in fiscal 1995 before declining moderately by year end. Annualized scrap costs were 7 percent higher than in fiscal 1994 and, more significantly, 35 percent higher than in 1993. They are projected to remain at their year-end levels throughout fiscal 1996.

Shipments from U.S. Pipe's four pipe plants reached 548,000 tons in fiscal 1995, a 14 percent increase over the prior year. All domestic market regions experienced improved tonnage shipments. In addition, 4 percent of shipments (or 22,000 tons) was directed to projects in export markets where U.S. Pipe is gradually strengthening its position against foreign competitors. The improved performance in the United States reflected the general improvement in the economy, resulting from lower interest rates, increases in single-family construction, and greater public works spending.

OUTLOOK

U.S. Pipe entered fiscal 1996 with a backlog of more than 121,000 tons, a 9 percent increase over the prior year. Given its excellent backlog, coupled with its low cost structure, strategic manufacturing position and strong base of sales and customer support,

U.S. Pipe is well-positioned to capitalize on anticipated demand from its two principal markets, new residential construction and public works projects, including the long-overdue rehabilitation or replacement of municipal water and waste water pipelines.

New construction is the major contributor to U.S. Pipe's demand and, given prevailing favorable interest rates, construction activity is expected to remain healthy in fiscal 1996. In addition, the replacement market, including rehabilitation or replacement of municipal water and waste water transmission lines, continues to provide significant demand. Many cities throughout the United States are being required to address long-planned programs to upgrade aging or inadequate water and waste water systems. Although it is difficult to measure the size of this market precisely, it is estimated that as much as 30 percent of the water and waste water products shipped by U.S. Pipe result from such infrastructure improvement projects. This market offers continuing opportunities for domestic pipe sales, as well as increased sales of valve, hydrant and fitting products.

U.S. Pipe's strategy for growth is not to capture the entire market, but to grow at a rate consistent with its ability to service its customers while improving profitability. It has concentrated on improving penetration into markets served by producers of substitute pipe materials such as PVC, concrete and steel pipe, capitalizing on ductile iron's superior strength and durability versus other products. In part, demand for ductile iron pressure pipe as the product of choice for large-scale water and waste water transmission projects reflects an understanding by the market that the cost of pipe is secondary to the enormous cost of installation or repair.

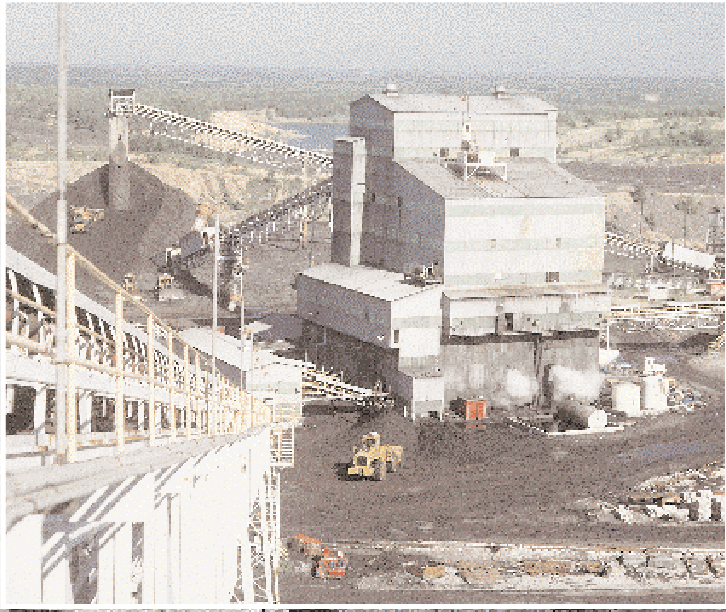
Many municipalities remain skeptical as to the durability of PVC pipe, particularly in larger diameters. Concrete is more rigid than ductile iron and has caused several well-publicized failures. Thin-wall welded steel is more susceptible to failure as a result of deflection caused by inadequate design or improper installation. When preparing to tear up a city street, experienced municipalities know to specify ductile iron pressure pipe engineered with the proven ability to withstand the test of time and the elements.

Marketing efforts will continue to focus on developing direct relationships with contractors and engineers who recognize that long-term performance is more important than the initial costs of materials for a project. In waste water, the use of specialty coatings and linings is increasing ductile iron's share of the pipe market.

General worldwide economic recovery should lead to further sales opportunities internationally as more and more foreign governments push to build modern infrastructures.

CASTINGS DIVISION

The Castings Division produces a wide variety of gray and ductile iron castings for a diversified customer base. In fiscal 1995, approximately 37 percent of the division's sales were to the Pressure Pipe Division, with the balance sold to various capital goods industries. Manufacturing operations are conducted at a single plant in Anniston, Alabama.



JIM WALTER RESOURCES

MINING DIVISION

Metallurgical and steam coal

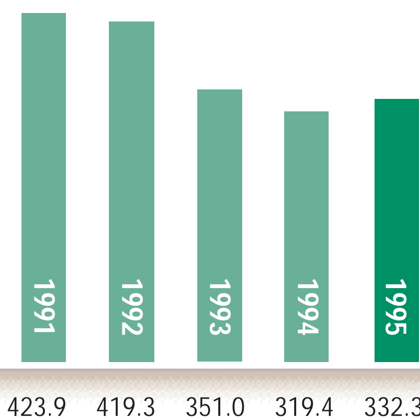
DE-GAS DIVISION

Methane gas production

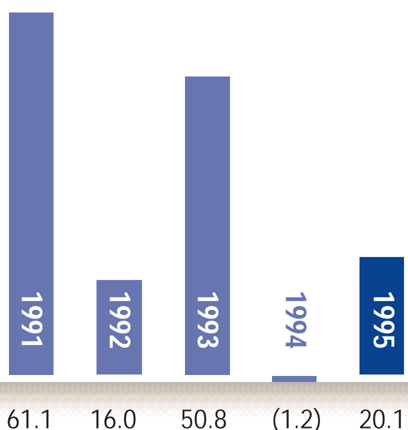
UNITED LAND

Coal, timber, oil and gas royalties; land sales

SALES AND REVENUES
($ in millions)



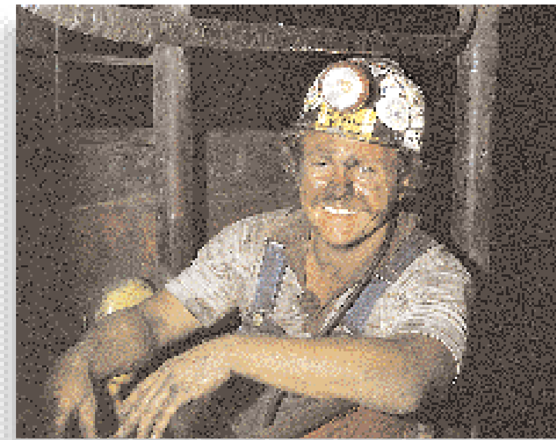
OPERATING INCOME ($ in millions)



MINING DIVISION

OPERATIONS AND MARKET CHARACTERISTICS

Jim Walter Resources (JWR) is the southernmost Appalachian coal producer. The company was formed in 1976 from the former Coke, Iron and Chemicals Division of U.S. Pipe. Its businesses consist of mining high quality coal from Alabama's Blue Creek seam and related methane gas operations. Since its inception, JWR has grown from a small, captive producer of less than one million tons of coal per year, produced solely for use in the company's coke ovens, into one of the 25 largest coal producers in the United States, with current rated annual capacity of approximately 9.5 million tons.



JWR's four deep-shaft underground mines all employ advanced longwall mining technology for primary production, complemented by the more standard continuous mining method, which uses room and pillar systems, for development of underground access and panel entry areas. In contrast to coal strip mining or typical underground mines located 200 to 500 feet below the surface, JWR's mines are 1,500 to 2,200 feet underground, making them among the deepest coal mines in North America.

Blue Creek coal is synonymous with quality to markets worldwide. Its general characteristics—very low sulfur, strong coking properties, high heat value (BTU) per ton—make it ideally suited to the requirements of steel makers as a coking coal and to utilities as a steam coal, since a large portion of the reserves meets environmental compliance specifications. These qualities enable JWR to successfully market steam coal domestically and metallurgical coal to the

worldwide export market. Moreover, JWR's total recoverable coal reserves are currently estimated at 224 million tons, thus assuring a long-term source of supply to all customers.

From its base in north-central Alabama, JWR also has access to a full range of transportation alternatives—rail, barge and truck. Its ability to switch from one mode of coal transport to another provides competitive advantages for obtaining favorable volume-sensitive transportation contracts with carriers. In addition, JWR's proximity to the seaport at Mobile, Alabama on the Gulf of Mexico provides year-round favorable weather advantages for overseas customers relative to other East Coast coal producers.

This combination of superior quality, abundant availability and transportation convenience has made JWR's Blue Creek coal particularly marketable. JWR has long-term contracts to sell approximately 50 percent of its annual output and relies on long-term relationships with its annual contract customers for its remaining coal sales.

RECENT PERFORMANCE

Results of Jim Walter Resources, although significantly below historical peak earnings, improved sharply in the second half of fiscal 1995 following extensive development work and restoration of full production at one of the company's mines following its 1994 shutdown because of a fire. The division produced 7.6 million tons of coal in 1995 versus 6.5 million tons in 1994, although output in both years reflected curtailed production levels stemming from the fire and adverse geological conditions.

In addition, the company's average selling price per ton declined $2.79 compared to the prior year, to $41.34 from $44.13, as prices worldwide reached the bottom of a nearly four-year downcycle. Terms of a new long-term contract with Alabama Power Company, JWR's largest source of demand, were renegotiated at a lower price structure but with a 33 percent increase in annual tonnage to be shipped.

OUTLOOK

The metallurgical export market firmed up considerably beginning in April 1995, as price increases in coal markets worldwide were negotiated for shipments in fiscal 1996. These and other favorable events, coupled with the resumption of JWR's production to acceptable levels, provide a solid base for dramatically improved results in the coming year.

In May 1994, JWR and its long-standing customer, Alabama Power Company, signed a new long-term contract calling for delivery of four million tons of coal per year through August 31, 1999, extendible by JWR for an additional five years until 2004. The new contract has a fixed price subject to escalation based on the Consumer Price Index and adjustments for government impositions and quality. JWR continues to negotiate one-year, market-based contracts to sell approximately one million tons of coal to six Japanese steel mills previously served under long-term agreements initiated in the mid-1970s. In addition, approximately 300,000 tons not previously shipped under the expired Japanese contracts will be shipped during 1996 at the long-term contract price, which is higher than current market prices. JWR also has a long-term contract with Carcoke, S.A., in Belgium for 880,000 tons annually with a customer option for an additional 220,000 tons annually. JWR expects to export the balance of its tonnage to other steel companies throughout the world, typically on one-year contracts at market prices. Some of these additional customers are located in Argentina, Brazil, Mexico, France, Germany, Turkey and the United Kingdom. Approximately 150,000 tons are sold annually to Sloss Industries, another subsidiary of Walter Industries, for production of furnace and foundry coke.

In summary, Jim Walter Resources entered 1996 with all of its mines scheduled for maximum production. Infrastructure, investment and longwall equipment upgrades completed in 1995 provide the basis for a return to highly favorable results in the coming year.

DE-GAS DIVISION

OPERATIONS AND MARKET CHARACTERISTICS

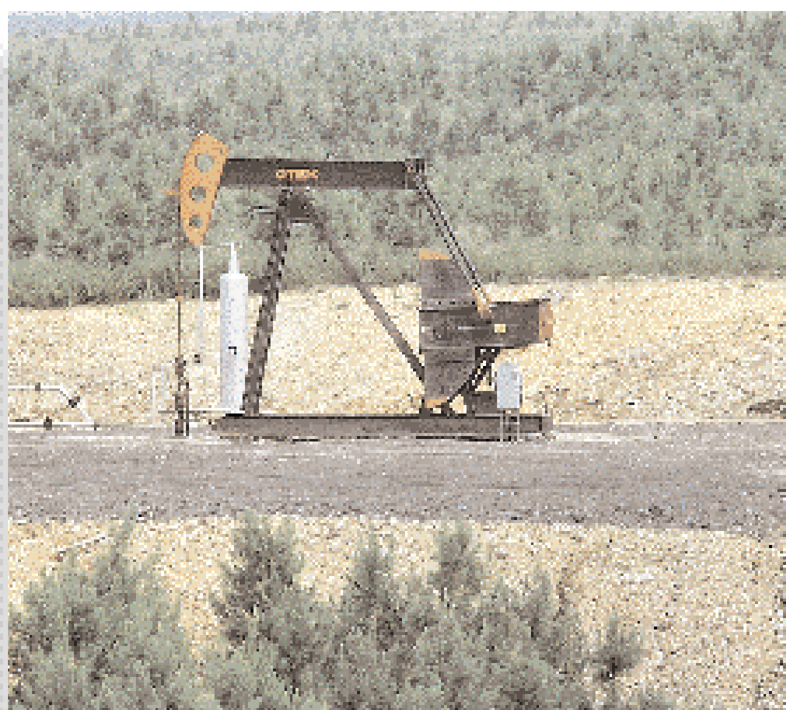
The growth and success of Jim Walter Resources' coal mining operations have continued to fuel the De-Gas Division, a highly profitable joint venture formed in 1981 to recover and market methane gas principally from the Blue Creek coal seam on lands owned or leased by the company.

The original motivation for the joint venture was to increase mine safety by reducing, in advance of mining, the level of methane concentrations in and around the mining operations and to augment productivity by decreasing the amount of gas to be ventilated from the mines. Today, it represents one of the most extensive and comprehensive commercial programs for coal seam degasification in the United States.

Production is obtained from three types of wells: "gob" wells, which are drilled just above the coal seams and begin producing gas from the gob, or loose strata, created after a longwall mining unit passes under the well bore; vertical vent/horizontal wells, a vertical vent hole from the surface to the underground area, connecting a series of horizontally driven bores into a coal seam; and standard conventional wells drilled directly into the coal seam.

RECENT PERFORMANCE

As of fiscal 1995 year-end, 268 wells were producing approximately 33 million cubic feet of gas per day, from which the De-Gas Division is credited with 50 percent of total revenues under the joint venture agreement. The gas is transported through the joint venture's 12-mile pipeline to the project's exclusive customer, Southern Natural Gas Company, a subsidiary of Sonat, Inc. The price paid for the delivered gas is based upon the maximum of two published spot market prices with a floor of approximately two dollars per million cubic feet. In addition, the De-Gas Division receives a guaranteed, monthly reservation fee.

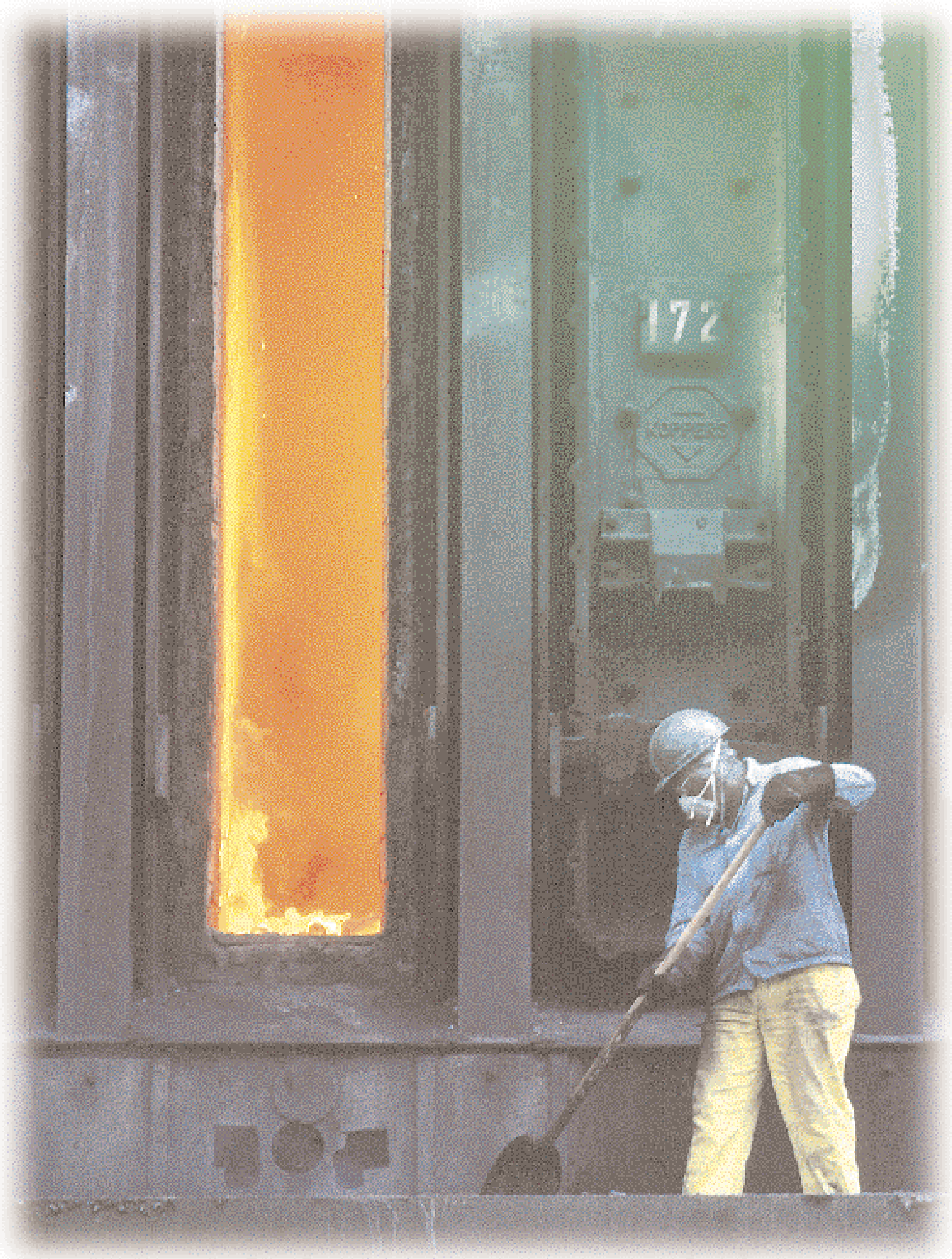


OUTLOOK

An expansion program is now under way to drill an additional 109 conventional wells over a two-year period, further enhancing the division's long-term prospects for increased profitability.

UNITED LAND

United Land Corporation owns and manages approximately 56,000 acres of land, 125,000 acres of mineral rights and 1,800 acres of surface rights, primarily in Alabama. Revenues and income are derived principally from coal royalties generated in connection with strip mining operations conducted by outside surface mining operators, and to a lesser extent from timber royalties, rental income from property leased for commercial use, and gains from land sales.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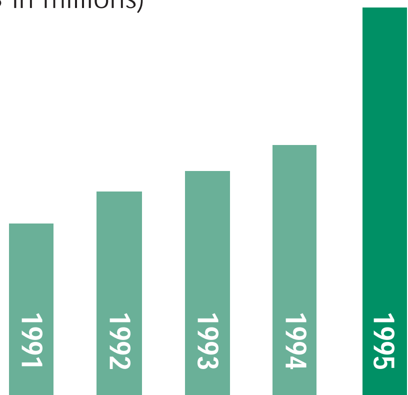
JW ALUMINUM
Aluminum foil and sheet

SLOSS INDUSTRIES
Furnace coke, foundry coke, slag wool, specialty chemicals

SOUTHERN PRECISION
Foundry machine patterns, molds, resin-coated casting sand, numerically controlled machining

JW WINDOW COMPONENTS
Screens and components, window spacers, weatherstripping, sash balances

VESTAL
Building products, fireplaces and accessories, castings for municipal and original equipment manufacturers



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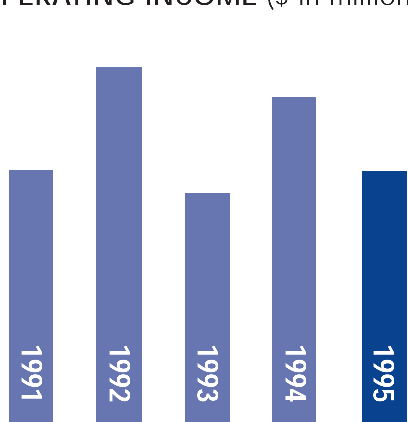

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JW ALUMINUM

OPERATIONS AND MARKET CHARACTERISTICS

Founded in 1979, JW Aluminum (JWA) is a world-wide supplier of aluminum foil and sheet to more than 100 customers. It is a leading producer of fin stock used in heat exchange equipment, including industrial coils in commercial and residential air conditioning applications. Aluminum foil is sold to other household institutional and industrial markets for a wide variety of applications. Cablewrap in foil

gauges is produced for use in the manufacture of communications cable. Other foil products are used in a variety of converter applications, such as in lithoplate for newspaper printing and as a facer on foam insulation board. The company's aluminum sheet products are used primarily for general building applications, such as siding, gutters, downspouts, residential siding, awnings and window components. Foil products are higher value-added and in 1995 accounted for approximately 68 percent of unit sales volume, with sheet products contributing 32 percent.

RECENT PERFORMANCE

Operating from a single manufacturing facility in Mt. Holly, South Carolina, near Charleston, JW

Aluminum sold approximately 121 million pounds of aluminum foil and sheet products in fiscal 1995. In April, the company completed an expansion project that has increased its annual rated capacity to 125 million pounds. JWA has benefitted from increases in demand and market price in fiscal 1995. Total shipments increased 20 percent over the prior year. Operating income increased 61 percent on 54 percent higher revenues.

OUTLOOK

JW Aluminum continues to focus on directing its product mix away from sheet for commodity building products, which are price-sensitive and low value-added, toward higher value-added products, such as coated fin stock, cablewrap and lithoplate, where competing effectively relies on product quality and service, not just price. For example, JW Aluminum has become one of the world's premier suppliers of coated fin stock to air conditioner manufacturers. Coated fin in foil gauges is displacing bare fin stock in corrosive or high humidity environments. Increased emphasis on specific product areas should further improve the company's product mix and margins in 1996. Growth will in part be attained by further seeking out niche opportunities, particularly in higher margin foil products. These efforts will be enhanced significantly as a result of a new continuous caster installed as part of the expansion completed during 1995. This new capacity will enable JWA to capitalize on opportunities to internally produce more sophisticated niche products, as well as provide significant margin enhancements.

SLOSS INDUSTRIES

OPERATIONS AND MARKET CHARACTERISTICS

Sloss Industries consists of three major product groups: coke, specialty chemicals and slag wool. Coke produced by the company falls into two categories: blast furnace coke for use by steel producers (approximately 30 percent of annual revenues) and foundry coke for use in automotive, agricultural and pipe foundries (21 percent). Chemicals (28 percent) are produced principally for the chemical, plastics, rubber, automotive and agricultural industries. Slag wool used in acoustical ceiling products; processed mineral fiber for use in friction materials, thermoplastic molding compounds, adhesives, paints and sealants; and various coke by-products comprise the balance of company sales.

Sloss operates 120 coke ovens and the largest slag wool plant in the world at its main complex in Birmingham, Alabama. The company's chemical operations are located at the Birmingham facility and at a smaller plant in Ariton, Alabama.

RECENT PERFORMANCE

Sales and revenues increased 8 percent over the prior year, generating a 20 percent increase in operating income. The demand for high-quality blast furnace coke remained strong during fiscal 1995 as steel industry plants operated consistently above 90 percent of capacity, resulting in improved pricing compared to previous years. A robust automotive market and an improved iron pipe industry resulted in a strong demand for foundry coke. Sloss chemicals are used in a variety of markets, most of which reflected the strength of the overall economic climate. Demand for slag wool for acoustical ceiling tile has remained weak as commercial construction continues at a slow pace.

OUTLOOK

Coke sales are currently at capacity, and a new six-year contract negotiated with a principal customer, National Steel Corporation, ensures that furnace coke output will remain sold-out through the year 2000. Sloss sells 60 percent of its foundry coke production to U.S. Pipe, another Walter Industries subsidiary, and supplements these intercompany sales with external sales to the merchant foundry coke market and through purchase agreements with other pipe producers.

Recent economic indicators project a strong market for automotive sales and greater demand in the steel sector in both domestic and foreign markets. If general economic expansion continues, the pipe industry

should experience a strong 1996. Coke pricing should also remain high as the age and condition of the world's coke ovens and rigid environmental standards fuel fears of a global shortage.

Sloss is a leading supplier of slag wool to commercial and residential acoustical ceiling tile manufacturers; however, significant new emphasis is being directed at developing alternative emerging markets, including applications in highway asphalts, fireproofing materials and inorganic roofing materials, which would provide an offset to commercial construction downcycles.

In chemicals, Sloss will continue to capitalize on opportunities for its custom chemical products. Sloss is currently researching and pilot-plant testing several specialty chemicals that, if proven successful, would significantly increase sales and operating income.

SOUTHERN PRECISION

OPERATIONS AND MARKET CHARACTERISTICS

Southern Precision, based in Irondale, Alabama, is a highly automated job shop operation geared as an engineering and service-driven business that supplies critical design castings and molds for the foundry industry. Its product line consists of two groups: Pattern Tooling and General Machining, and Resin-Coated Sand.

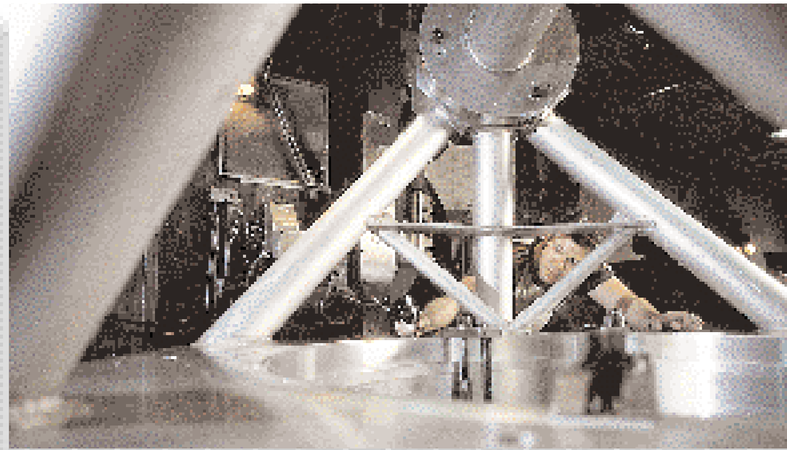
The Pattern Tooling and General Machining Group manufactures pattern equipment for the foundry industry, mold equipment for the plastic industry, aluminum castings and numerically controlled machining. Resin-coated sand is used for making shell cores and molds in the production of castings in the foundry industry.

RECENT PERFORMANCE

Revenues in 1995 increased 31 percent over the prior year on the strength of good demand for automotive pattern tooling, compression molds, general machining, and higher resin-coated sand shipments resulting from additional capacity and increased foundry industry production.

OUTLOOK

Service, engineering and design capabilities are Southern Precision's key success factors. Machining projects are accepted on an individual basis with the end product customized to the specific needs of the clients. The company has maintained most of its key customers for more than 20 years and is the largest pattern shop in the Southeast. Growth will be achieved through continuous innovations in foundry pattern and tooling. Southern Precision's sand capacity was increased 40 percent beginning in 1994 with



the lease and subsequent purchase of an additional Birmingham, Alabama-based sand-coating facility from Borden, Inc. As in the pattern operation, Southern Precision's success in the sand business stems from close customer relationships that enable the company to determine sand formulations that meet a customer's specific needs.

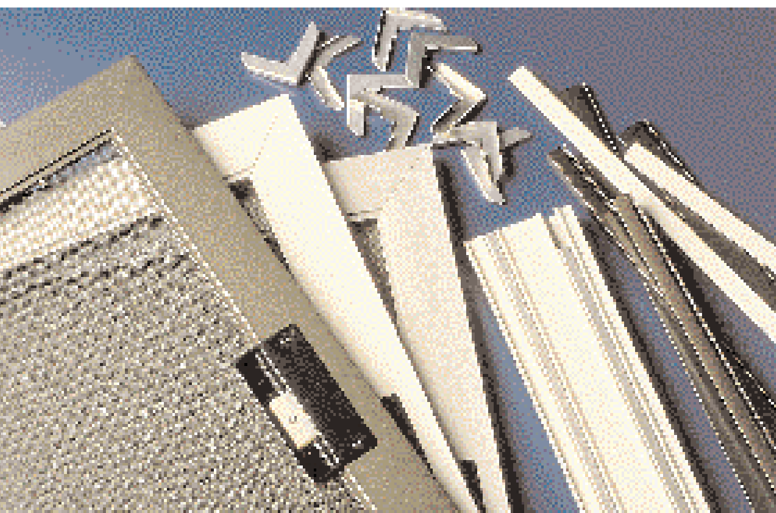
JW WINDOW COMPONENTS

OPERATIONS AND MARKET CHARACTERISTICS

JW Window Components manufactures and distributes a broad line of products for the window and patio door industry. These products consist of residential and commercial window screens and screen components (27 percent of 1995 sales), patio door screens (13 percent), insulated glass components (11 percent), window balances (44 percent), and other products, including weatherstripping, glazing

beads, glass frames and cladding (5 percent). The company is a recognized leader in the production of block and tackle sash balances.

JW Window's products are sold through a network of independent sales agents and are marketed primarily in the 37 eastern states, with additional sales in Puerto Rico, Canada, Europe, Asia and the Middle East.



Manufacturing locations are Elizabethton, Tennessee; Merrill, Wisconsin; and Sioux Falls, South Dakota. The Elizabethton plant, JW Window Components' newest manufacturing facility, came on line in the third quarter of fiscal 1995. It has allowed the company to consolidate operations and close its Hialeah, Florida plant and smaller Columbus, Ohio facility, resulting in substantially reduced delivery times and significant freight savings.

RECENT PERFORMANCE

Although sales increased 9 percent, the company incurred an operating loss in 1995 resulting from sharply higher raw material costs (aluminum) as well as relocation and start-up expenses associated with the shutdown of the Hialeah plant and move to Elizabethton.

OUTLOOK

Sales of the company's products depend on new residential construction and renovation. While revenues are expected to rise only modestly in 1996 given relatively stable housing activity, operating income should improve sharply with full year operations of the Elizabethton plant, coupled with anticipated price improvement, reduced costs and the introduction of new products to improve penetration in select market areas.

VESTAL MANUFACTURING

OPERATIONS AND MARKET CHARACTERISTICS

Vestal manufactures three product lines: building products, fireplace accessories and stoves, and castings for municipal and original equipment manufacturers. Its products, produced at a foundry and assembly complex in Sweetwater, Tennessee, are sold through a network of independent sales agents to hardware and building materials distributors, home centers and mass merchandisers. The building products and fireplace accessories segments, which together comprised nearly 70 percent of Vestal's revenues in 1995, are closely tied to residential construction activity.

RECENT PERFORMANCE

Sales in 1995 increased 11 percent to a new record level based on volume increases to existing customers as well as increased penetration into new markets. Operating income declined slightly because of several factors, including severe import competition, higher raw material prices that could not be passed on to customers, and relocation of its steel fabrication operations to a previously vacant facility adjacent to its existing plant.

OUTLOOK

For fiscal 1996, the plant relocation has been completed. Record sales levels were achieved in 1995, and Vestal's customer base has expanded. Price increases were instituted in the fiscal fourth quarter and appear to be sustainable. With continued strong demand for building material products tied to single-family home construction, and given general favorable economic conditions, an improved performance should be achieved in 1996.

CORPORATE OVERVIEW

COMMON STOCK OUTSTANDING AND PRINCIPAL OWNERSHIP

Pursuant to the Plan of Reorganization, 50,494,313 shares of new Walter Industries common stock were issued to certain former creditors and stockholders of the company and its subsidiaries following the March 17, 1995 effective date of the Plan. On September 13, 1995, an additional 494,313 shares were required to be issued to the company's former stockholders.

Principal shareholders pursuant to these distributions, as well as subsequent stock purchases, are as follows: The Celotex Settlement Fund Recipient (21.5 percent); Lehman Brothers Holdings, Inc. (15.4 percent); and certain affiliates of Kohlberg Kravis Roberts & Co., LP (KKR) (21.0 percent).

Also pursuant to the Plan of Reorganization, up to 3,880,140 additional shares of common stock will be distributed to an escrow account for the benefit of the company's former stockholders (including up to 3,553,380 shares to certain affiliates of KKR). To the extent that certain contingencies regarding federal income tax claims of the company are resolved satisfactorily, the escrowed shares will be distributed. To the extent the tax matters are not settled satisfactorily, the escrowed shares will be returned to the company and canceled. Until the tax matters are finally determined, the former stockholders, including the KKR affiliates, have the power to exercise voting rights with respect to the additional shares in escrow.

FINANCING ACTIVITIES

In connection with the Plan of Reorganization, the company issued $490 million of Series B Senior Notes Due 2000 as part of the distribution made in payment of claims of holders of certain unsecured indebtedness of the company and its subsidiaries. The interest rate on the Senior Notes is 12.19 percent.

Also in connection with the Plan of Reorganization, the company entered into the following financings:

(1) On March 16, 1995, Mid-State Homes sold certain mortgage instalment notes and its beneficial interest in Mid-State Trust II to Mid-State Trust IV in exchange for the net proceeds from the public issuance by Mid-State Trust IV of $959,450,000 of Asset Backed Notes. Interest on the notes is 8.33 percent.

(2) On March 3, 1995, Mid-State Trust V entered into a Variable Funding Loan Agreement which provides for a three-year $500 million credit facility secured by the instalment notes and mortgages it purchases from Mid-State Homes. Interest on borrowings under the facility is based on A-1 and P-1 commercial paper plus 3/4 percent.

(3) On February 27, 1995, the company and certain of its subsidiaries entered into a Bank Revolving Credit Facility providing for up to $150 million for working capital needs with a sub-limit for trade and standby letters of credit not in excess of $40 million and a sub-facility for swingline advances in an amount not in excess of $15 million. Interest at the company's option is the Citibank Base Rate plus 3/4 percent or LIBOR plus 2 1/4 percent.

CAPITAL OUTLAYS

Gross capital expenditures in 1995 amounted to $91 million compared with a $96 million program originally planned for the year. The two largest segments were $45 million spent for coal mining and degasification and $16 million for pipe operations.

The shortfall from plan was due to normal delays in the timing of projects and continuing efforts to control capital expenditures throughout the company.

An $80 million capital program is budgeted for fiscal 1996, including $38 million for coal and degasification and $14 million for pipe operations.

EMPLOYEE RELATIONS

Walter Industries and its subsidiaries employ approximately 7,900 at 20 manufacturing facilities and a network of sales and administrative offices nationwide.

In fiscal 1995, the company was involved in negotiations covering three labor agreements and approximately 520 hourly employees. There were no contract renewal work stoppages during the year.

Twelve contracts covering approximately 1,780 employees are scheduled for negotiation during fiscal 1996.

SUMMARY OF OPERATIONS

($ in thousands except per share amount)

	For the years ended May 31,				
	1995	1994	1993	1992	1991
Sales and revenues	$ 1,442,322	$ 1,328,524	$ 1,318,986	$ 1,366,581	$ 1,326,397
Cost of sales (exclusive of depreciation)	951,381	845,061	804,411	891,882	826,455
Depreciation, depletion and amortization	72,037	71,035	70,483	82,801	75,099
Interest and amortization of debt discount and expense	304,548	155,470	171,581	177,060	209,511
Income tax expense (benefit)	(170,450)	28,917	24,328	12,463	19,454
Income (loss) before discontinued operations and cumulative effect of accounting change	(358,645)	7,175	46,594	22,342	20,632
Net income (loss)	(358,645)	7,175	(58,014)	22,342	14,462
Net loss per share (a)	$ (7.10)				
Number of shares used in calculation of loss per share	50,494,313				

(a) Per share information for fiscal years 1991 through 1994 is not relevant given the significant change in the Company's capital structure following consummation of the Plan of Reorganization.

ADDITIONAL FINANCIAL DATA

($ in thousands)

	For the years ended May 31,				
	1995	1994	1993	1992	1991
Gross capital expenditures	$ 91,317	$ 69,831	$ 71,708	$ 68,349	$ 69,046
Net property, plant and equipment	662,792	657,863	663,040	664,622	683,777
Total assets	3,245,153	3,140,892	3,223,234	3,171,266	3,276,211
Long-term senior debt	2,220,370	871,970	1,046,971	948,782	1,073,919
Liabilities subject to Chapter 11 proceedings	—	1,727,684	1,725,631	1,845,328	1,883,704
Stockholders equity (deficit)	360,774	(282,353)	(287,737)	(230,119)	(253,282)
Wages, salaries and employee benefits (b)	373,000	373,000	358,000	363,000	354,000
Employees at year-end	7,888	7,676	7,545	7,645	8,104

(b) Includes postretirement health benefits of $25,961, $25,585 and $23,474 in 1995, 1994 and 1993, respectively.

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

This discussion should be read in conjunction with the consolidated financial statements and notes thereto of Walter Industries, Inc. and subsidiaries, particularly the "Segment Information" on pages 49 and 50, which presents sales and operating income by operating group.

The Company emerged from bankruptcy on March 17, 1995. Accordingly, the Company's Consolidated Balance Sheet at May 31, 1995 and its Consolidated Statements of Operations and Retained Earnings (Deficit) for the year ended May 31, 1995 will not be comparable to the consolidated financial statements for prior periods.

RESULTS OF OPERATIONS

YEARS ENDED MAY 31, 1995 AND 1994

Net sales and revenues for the year ended May 31, 1995 were $113.8 million, or 8.6 percent, ahead of the prior year, with a 7.0 percent increase in volume and a 1.6 percent increase in pricing and/or product mix. The increase in net sales and revenues was the result of improved sales and revenues in all operating groups except Homebuilding and Related Financing.

Industrial and Other Products Group sales and revenues were $59.6 million, or 26.5 percent, greater than the prior year. Increased sales volumes of aluminum foil and sheet products, foundry coke, chemicals, patterns and tooling, resin-coated sand, window components and metal building and foundry products, combined with higher selling prices for aluminum foil and sheet products, furnace coke, window components and metal building and foundry products and a $3.6 million gain from the sale of JW Window Components, Inc.'s Hialeah, Florida facility were partially offset by reduced sales volumes of furnace coke and slag wool. The Group's operating income of $11.9 million was $1.9 million lower than the prior year. The decrease was the result of higher manufacturing costs in the window components business due to increased raw material costs, especially aluminum, a major raw material component; startup costs associated with the consolidation and relocation during 1995 of JW Window Components, Inc.'s Hialeah, Florida and Columbus, Ohio operations to Elizabethton, Tennessee; and reduced operating efficiencies, including startup problems associated with relocation of Vestal Manufacturing Company's steel fabrication operation in May 1994. These decreases were partially offset by increased income from aluminum foil and sheet, foundry coke, chemicals, patterns and tooling and resin-coated sand due to the sales increases, improved gross profit margins for furnace coke and the gain from the Hialeah facility sale.

Water and Waste Water Transmission Products Group sales and revenues were $55.0 million, or 15.4 percent, ahead of the prior year. The increase was the result of higher sales volumes and prices for ductile iron pressure pipe, valves and hydrants and castings. The order backlog for pressure pipe at May 31, 1995 was 121,548 tons, which represents approximately three months shipments compared to 111,907 tons at May 31, 1994. Operating income of $28.5 million exceeded the prior year by $2.8 million. The improved performance resulted from the increased sales prices and volumes, partially offset by higher raw material costs, especially scrap, a major raw material component.

Natural Resources Group sales and revenues were $12.8 million, or 4.0 percent, greater than the prior year. The increase resulted from greater sales volumes for coal and a $6.1 million gain from the sale of excess real estate, partially offset by lower sale prices for coal and methane gas and lower outside coal and gas royalty income. A total of 7.20 million tons of coal was sold in 1995 versus 6.56 million tons in 1994, a 9.8 percent increase. The increase in tonnage sold was the result of increased shipments to Alabama Power Company ("Alabama Power") and certain export customers, partially offset by lower shipments to Japanese steel mills. Increased shipments to Alabama Power were the result of a new agreement signed May 10, 1994 (the "New Alabama Power Contract") for the sale and purchase of coal, replacing the 1979 contract and the 1988 amendment thereto. Under the New Alabama Power Contract, Alabama Power will purchase 4.0 million tons of coal per year from Jim Walter Resources

during the period July 1, 1994 through August 31, 1999. In addition, Jim Walter Resources will have the option to extend the New Alabama Power Contract through August 31, 2004, subject to mutual agreement on the market pricing mechanism and certain other terms and conditions of such extension. The New Alabama Power Contract has a fixed price subject to an escalation based on the Consumer Price Index or another appropriate published index and adjustments for government impositions and quality. The New Alabama Power Contract includes favorable modifications of specification, shipping deviations and changes in transportation arrangements. The average price per ton of coal sold decreased $2.79 from $44.13 in 1994 to $41.34 in 1995 due to lower prices realized on shipments to Alabama Power, the Japanese steel mills and certain export customers. Blue Creek Mine No. 5 ("Mine No. 5") was shut down from November 17, 1993 through December 16, 1993 and from early April 1994 until May 16, 1994 as a result of a fire due to spontaneous combustion heatings. Representatives of Jim Walter Resources, the Mine Safety and Health Administration ("MSHA"), Alabama State Mine Inspectors and the United Mine Workers of America ("UMWA") agreed that the longwall coal panel being mined in Mine No. 5 at the time the fire recurred in April 1994 would be abandoned and sealed off. Development mining for the two remaining longwall coal panels in this section of the mine resumed on May 16, 1994 and mining on the first longwall panel resumed on January 17, 1995. Production was adversely impacted until such date; however, a portion of the increased costs is expected to be recovered from business interruption insurance and the Company has commenced litigation seeking to enforce such insurance (see Note 11 of Notes to Financial Statements). Operating income of $20.1 million exceeded the prior year by $21.2 million. The improved performance principally resulted from the increased sales volumes of coal, lower costs per ton of coal produced ($37.13 in 1995 versus $38.29 in 1994) and the gain on the sale of certain excess real estate, partially offset by decreases in selling prices for coal and methane gas and lower outside coal and gas royalty income.

Homebuilding and Related Financing Group sales and revenues were $17.4 million, or 4.1 percent, below the prior year. This performance reflects a 4.7 percent decrease in the number of homes sold, from 4,331 units in 1994 to 4,126 units in 1995, partially offset by an increase in the average selling price per home sold, from $38,300 in 1994 to $40,200 in 1995. The decrease in unit sales reflects continuing strong competition in virtually every Jim Walter Homes sales region. The higher average selling price in 1995 principally reflects a smaller percentage of the lower priced Affordable line homes sold. Jim Walter Homes' backlog at May 31, 1995 was 1,529 units (all of which are expected to be completed prior to the end of fiscal 1996) compared to 2,065 units at May 31, 1994. Time charge income (revenues received from Mid-State Homes' instalment note portfolio) decreased from $238.1 million in 1994 to $222.2 million in 1995. The decrease in time charge income is attributable to a reduction in the total number of accounts and lower payoffs received in advance of maturity, partially offset by an increase in the average balance per account in the portfolio. The Group's operating income of $76.5 million (net of interest expense) was $25.4 million below the prior year. This decrease resulted from the lower number of homes sold, reduced homebuilding gross profit margins resulting from discounts related to sales promotions on certain models, the decrease in time charge income and higher interest expense in 1995 ($131.6 million) as compared to that incurred in 1994 ($128.8 million), partially offset by the increase in the average selling price per home sold.

Cost of sales, exclusive of depreciation, of $951.4 million was 80.5 percent of net sales versus $845.1 million and 79.1 percent in 1994. The cost of sales percentage increase was primarily the result of lower gross profit margins on home sales, pipe products, window components and metal building and foundry products.

Selling, general and administrative expenses (exclusive of postretirement health benefits) of $130.6 million were 9.1 percent of net sales and revenues in 1995 versus $127.9 million and 9.6 percent in 1994.

Chapter 11 costs of $442.4 million in 1995 include $390 million in settlement of all asbestos-related veil-piercing claims and related legal fees and $52.4 million for professional fees, settlement of various disputed claims and other bankruptcy expenses.

Interest and amortization of debt discount and expense increased $149.1 million principally due to $141.4 million of additional interest and amortization of debt expense related to consummation of the Consensual Plan. The average rate of interest in

1995 was 10.19 percent (such rate calculated excluding $141.4 million of additional interest and amortization of debt discount and expense related to consummation of the Consensual Plan) versus 9.58 percent in 1994. The prime interest rate ranged from 7.25 percent to 9.0 percent in 1995 compared to a range of 6.0 percent to 7.25 percent in 1994. During the pendency of the Chapter 11 reorganization proceedings, the Company did not accrue interest on its pre-filing date unsecured debt obligations.

Amortization of excess of purchase price over net assets acquired (goodwill) decreased $8.5 million primarily due to lower payoffs received in advance of maturity on the instalment note portfolio.

The income tax benefit for 1995 was $170.5 million, which included recognition of tax benefits resulting from $583.8 million of additional expenses related to consummation of the Consensual Plan previously mentioned, compared to income tax expense of $28.9 million in 1994. On August 10, 1993, the Omnibus Budget Reconciliation Act of 1993 was signed into law raising the federal corporate income tax rate to 35 percent from 34 percent retroactive to January 1, 1993. The effect of the rate change resulted in a $2.8 million charge to deferred tax expense in 1994. See Note 8 of Notes to Financial Statements for further discussion of income taxes.

The net loss for 1995 and the net income for 1994 reflects all of the previously mentioned factors as well as the impact of slightly higher postretirement health benefits, partially offset by greater interest income from Chapter 11 proceedings.

YEARS ENDED MAY 31, 1994 AND 1993

Net sales and revenues for the year ended May 31, 1994 were $9.5 million, or .7 percent, greater than the prior year. The improved performance was the result of increased pricing and/or product mix as sales volumes were level with the prior year. The increase in net sales and revenues was the result of improved sales and revenues in all operating groups except the Natural Resources Group.

Homebuilding and Related Financing Group sales and revenues were $5.2 million, or 1.2 percent, greater than the prior year. This performance reflects a 3.5 percent increase in the average selling price per home sold, from $37,000 in 1993 to $38,300 in 1994, which was more than offset by a 9.5 percent decrease in the number of homes sold, from 4,784 units in 1993 to 4,331 units in 1994. The higher average selling price in 1994 reflects a price increase instituted on April 1, 1993 to compensate for higher lumber costs and a greater percentage of "90 percent complete" homes sold in 1994 versus the prior year. The decrease in unit sales resulted from strong competition in virtually every Jim Walter Homes sales region. Jim Walter Homes' backlog at May 31, 1994 was 2,065 units compared to 1,831 units at May 31, 1993. Time charge income (revenues received from Mid-State Homes' instalment note portfolio) increased from $218.7 million in 1993 to $238.1 million in 1994. The increase in time charge income is attributable to increased payoffs received in advance of maturity and to an increase in the average balance per account in the portfolio. The Group's operating income of $102.0 million (net of interest expense) exceeded the prior year by $13.1 million. This improvement resulted from the increase in the average selling price per home sold, the higher time charge income and lower interest expense in 1994 ($128.8 million) compared to that incurred in 1993 ($137.9 million), partially offset by the lower number of homes sold, reduced homebuilding gross profit margins and higher selling, general and administrative expenses. The lower gross profit margins were the result of higher average lumber prices, the effect of discounts relating to sales promotions on certain models instituted during the period February 1994 through May 1994 and the decision in October 1992 to reduce gross profit margins on five smaller basic shelter homes to generate additional sales.

Industrial and Other Products Group sales and revenues were $12.1 million, or 5.7 percent, ahead of the prior year. Increased sales volumes of aluminum foil, foundry coke, window components, metal building and foundry products, resin-coated sand and chemicals, combined with higher selling prices for furnace coke and window components, were partially offset by lower sales volumes of slag wool and patterns and tooling and lower selling prices for aluminum foil and sheet products. The Group's operating income of $13.9 million was $2.6 million greater than the prior year. The improved performance resulted from the sales increases and higher gross profit margins for furnace coke and slag wool, partially offset by reduced margins for chemicals, foundry coke, window components, metal building and foundry products, resin-coated sand and patterns and tooling.

Water and Waste Water Transmission Products Group sales and revenues were $26.0 million, or 7.8 percent, ahead of the prior year. The increase was the result of higher selling prices and volumes for ductile iron pressure pipe and valves and hydrants, greater castings sales volume and increased selling prices for fittings, partially offset by lower fittings volume. The order backlog of pressure pipe at May 31, 1994 was 111,907 tons compared to 121,173 tons at May 31, 1993. Operating income of $25.6 million exceeded the prior year period by $9.6 million. The improved performance resulted from the increased sales prices and volumes, partially offset by higher raw material costs, especially scrap (a major raw material component) and lower gross profit margins for castings.

Natural Resources Group sales and revenues were $31.6 million, or 9.0 percent, below the prior year. The decrease resulted from lower sales volumes and prices for coal and reduced methane gas selling prices, partially offset by increased methane gas sales volume and an increase in outside gas and timber royalty income. A total of 6.56 million tons of coal was sold in 1994 versus 7.18 million tons in 1993, an 8.6 percent decrease. The decrease in tonnage sold was the result of lower shipments to Alabama Power and Japanese steel mills. Reduced shipments to Alabama Power were the result of an agreement reached with Alabama Power to ship reduced tonnage for the contract year ending June 30, 1994. The average price per ton of coal decreased 1.6 percent, from $44.84 in 1993 to $44.13 in 1994, due to lower prices realized on shipments to Japanese steel mills and other export customers. As previously mentioned, Mine No. 5 was shut down from November 17, 1993 through December 16, 1993 and from early April 1994 until May 16, 1994 as a result of a fire due to spontaneous combustion heatings. Representatives of Jim Walter Resources, MSHA, Alabama State Mine Inspectors and the UMWA investigated the problem. Because the area of the suspected fire was inaccessible, a decision was made to drill vertical holes from the surface and flood the area with combinations of water, carbon dioxide, foam and cementitious mixtures to neutralize the fire. MSHA approved the resumption of operations at the mine on December 17, 1993. In early April 1994 the fire recurred and the mine was shut down. Representatives of Jim Walter Resources, MSHA, Alabama State Mine Inspectors and the UMWA agreed that the longwall coal panel being mined at the time the fire recurred would be abandoned and sealed off. Development mining for the two remaining longwall coal panels in this section of the mine resumed on May 16, 1994 and mining on the first longwall panel resumed on January 17, 1995. Production was adversely impacted until such date; however, a portion of the increased costs is expected to be recovered from business interruption insurance and the Company has commenced litigation seeking to enforce such insurance (see Note 11 of Notes to Financial Statements). The Group incurred an operating loss of $1.2 million in 1994 compared to operating income of $50.8 million in 1993. The lower performance reflects the decrease in sales volumes and prices for coal, lower methane gas selling prices, reduced coal mining productivity as a result of various geological problems in all mines during portions of the year which resulted in higher costs per ton of coal produced ($38.29 in 1994 versus $33.45 in 1993) and idle plant costs of $5.7 million associated with the Mine No. 5 shut downs, all of which more than offset the effect of increased methane gas sales volume and greater outside gas and timber royalty income.

Cost of sales in fiscal 1994, exclusive of depreciation, of $845.1 million was 79.1 percent of net sales versus $804.4 million and 75.0 percent in fiscal 1993. The cost of sales percentage increase was primarily the result of lower gross profit margins on home sales, coal, chemicals, foundry coke, castings, resin-coated sand, patterns and tooling, window components and metal building and foundry products, partially offset by improved margins on furnace coke, slag wool and pipe products.

Selling, general and administrative expenses (exclusive of postretirement health benefits) of $127.9 million were 9.6 percent of net sales and revenues in 1994 versus $124.6 million and 9.4 percent in 1993.

The Company adopted Statement of Financial Accounting Standards No. 106 “Employers’ Accounting for Postretirement Benefits Other Than Pensions” (“FAS 106”) in 1993 (see Note 12 of Notes to Financial Statements). Upon adoption, the Company elected to record the transition obligation of $166.4 million pre-tax ($104.6 million after tax) as a one-time charge against earnings rather than amortize it over a longer period. The annual accrual for postretirement health benefit costs in 1994 was $25.6 million versus $23.5 million in 1993.

Interest and amortization of debt discount and expense decreased $16.1 million. The decrease was principally the result of reductions in the outstanding debt balances on the Trust II Mortgage-Backed Notes and Trust III Asset Backed Notes and lower amortization of debt discount and expense, partially offset by higher interest rates. The average interest rate in 1994 was 9.58 percent versus 9.44 percent in 1993. The prime interest rate ranged from 6.0 percent to 7.25 percent in 1994 compared to a range of 6.0 percent to 6.5 percent in 1993. Interest in the amount of $724.3 million ($163.7 million in each of the years 1994 and 1993) on unsecured obligations was not accrued in the Consolidated Financial Statements since the date of the filing of petitions for reorganization. This amount was based on the balances of the unsecured debt obligations and their interest rates as of December 27, 1989 and did not consider fluctuations in the level of short-term debt and interest rates and the issuance of commercial paper that would have occurred to meet the working capital requirements of the Homebuilding and Related Financing Group.

Amortization of excess of purchase price over net assets acquired (goodwill) increased $9.1 million. The increase primarily resulted from adjustments to amortization of the goodwill due to greater payoffs received in advance of maturity on the installment note portfolio.

On August 10, 1993, the Omnibus Budget Reconciliation Act of 1993 was signed into law, raising the federal corporate income tax rate to 35 percent from 34 percent, retroactive to January 1, 1993. The effect of the rate change resulted in a $2.8 million charge to deferred tax expense. The rate change effect combined with reduced percentage depletion and increased amortization of goodwill (both permanent book/tax differences) resulted in an effective tax rate of 80.1 percent in 1994 versus an effective tax rate of 34.3 percent in 1993.

The net income for fiscal 1994 and the net loss for fiscal 1993 reflects all of the previously mentioned factors as well as the $4.5 million increase in Chapter 11 costs, partially offset by slightly higher interest income from Chapter 11 proceedings. The increase in Chapter 11 costs was due to the Veil-Piercing Suits (see Note 11 of Notes to Financial Statements) and the filing of two amended plans of reorganization.

FINANCIAL CONDITION

On December 27, 1989, the Company and 31 of its subsidiaries each filed a voluntary petition for reorganization under Chapter 11 with the Bankruptcy Court. On December 3, 1990, one additional subsidiary also filed a voluntary petition for reorganization under Chapter 11 with the Bankruptcy Court. Two other small subsidiaries did not file petitions for reorganization under Chapter 11. The filing of the voluntary petitions resulted from a sequence of events stemming primarily from an inability of the Company's interest reset advisors to reset interest rates on approximately $624 million of outstanding indebtedness, which indebtedness by its terms required that the interest rates thereon be reset to the rate per annum such indebtedness should bear in order to have a bid value of 101 percent of the principal amount thereof as of December 2, 1989. The reset advisors' inability to reset the interest rates was primarily attributable to two factors: (i) uncertainties arising from the then-pending asbestos-related veil-piercing litigation, including the possibility either that such litigation would lead to the prohibition of further asset sales and debt repayment or that substantial new asbestos-related claims might become assertible against the Company, which uncertainties materially hindered the ability of the Company and its subsidiaries to pursue a refinancing or sell assets to reduce debt, and (ii) general turmoil in the high yield bond markets at such time, both of which depressed the bid value of such notes.

On March 17, 1995, the Company and 32 of its subsidiaries emerged from bankruptcy. Pursuant to the Consensual Plan, the Company has repaid or will repay substantially all of its unsecured claims and senior and subordinated indebtedness subject to the Chapter 11 as follows:

- Trade creditors received 75 percent of their allowed claims plus interest in cash following the Effective Date of the Consensual Plan and are entitled to receive the remaining 25 percent six months following the Effective Date of the Consensual Plan with additional interest for such period at the prime rate. At May 31, 1995, the remaining amount to be distributed to trade creditors approximated $23.5 million;
- Revolving Credit and Working Capital bank claims and Series B and C Senior Note claims

received a combination of cash and Common Stock following the Effective Date of the Consensual Plan;

- Unsecured bondholders received, depending on elections made, either shares of Common Stock or a combination of cash, Senior Notes and shares of Common Stock, in either case having an aggregate reorganization value equal to their prepetition claims. In addition, Pre-LBO bondholders received shares of Common Stock having an aggregate reorganization value equal to $11.3 million in settlement of the fraudulent conveyance action commenced by the indenture trustees for the Pre-LBO bondholders;
- The asbestos-related veil-piercing claimants received cash, Senior Notes and Common Stock with an aggregate reorganization value of $375 million in settlement of all asbestos-related veil-piercing or fraudulent conveyance claims. In addition, the attorneys for the asbestos-related veil-piercing claimants received a cash payment of $15 million.

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 in the amounts of $110,560,883 with respect to fiscal years ended August 31, 1980 and August 31, 1983 through August 31, 1987; $31,468,189 with respect to fiscal years ended May 31, 1988 (nine months) and May 31, 1989; and $44,837,693 with respect to fiscal years ended May 31, 1990 and May 31, 1991. Objections to the proofs of claim have been filed by the Company and the various issues are being litigated in the Bankruptcy Court. The Company believes that such proofs of claim are substantially without merit and intends to defend such claims against the Company vigorously.

In connection with the Consensual Plan, on March 16, 1995, pursuant to approval by the Bankruptcy Court, Mid-State sold mortgage instalment notes having a gross amount of $2,020,258,000 and an economic balance of $826,671,000 to Trust IV. In addition, on such date Mid-State sold its beneficial interest in Trust II to Trust IV. Trust II had a total collateral value of $910,468,000 with $605,750,000 of Trust II Mortgage-Backed Notes outstanding. These sales were in exchange for the net proceeds from the public issuance by Trust IV of $959,450,000 of Trust IV Asset Backed Notes. See Notes 1 and 7 of Notes to Financial Statements.

On February 27, 1995, Mid-State established Trust V to provide funds to Mid-State for its current purchases of instalment notes receivable from Jim Walter Homes. On March 3, 1995, Trust V entered into the Variable Funding Loan Agreement. This agreement provides for a three-year $500 million credit facility secured by the instalment notes and mortgages Trust V purchases from Mid-State. See Notes 1 and 7 of Notes to Financial Statements.

The Senior Notes were issued by the Company pursuant to the Consensual Plan as part of the distribution made in payment of claims of holders of certain unsecured indebtedness of the Company and certain of its subsidiaries. See Notes 1 and 7 of Notes to Financial Statements.

The Company and certain of its subsidiaries have entered into the Bank Revolving Credit Facility, providing up to $150 million at any time outstanding for working capital needs with a sub-limit for trade and standby letters of credit in an amount not in excess of $40 million at any time outstanding and a sub-facility for swingline advances in an amount not in excess of $15 million at any time outstanding. See Notes 1 and 7 of Notes to Financial Statements.

The Senior Notes, the Bank Revolving Credit Facility and the Trust V Variable Funding Loan Agreement 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, make capital expenditures, pay dividends, create liens on assets, enter into 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 Bank Revolving Credit Facility, the Company is required to maintain specified financial ratios and comply with certain financial tests, including interest coverage, fixed charge coverage ratios, leverage ratios and minimum earnings before interest, taxes, depreciation and amortization expense, some of which become more restrictive over time. The Company believes it will meet these financial tests over the terms of these debt agreements.

LIQUIDITY AND CAPITAL RESOURCES

At May 31, 1995, cash and short-term investments were approximately $128 million. Principal sources of cash in 1995 were $959.5 million of proceeds from the issuance of the Trust IV Asset Backed Notes and cash flows from operations which were used, together with the issuance of Senior Notes and Common Stock, to repay Chapter 11 claimants pursuant to the terms of the Consensual Plan. Operating cash flows were also used for working capital requirements; for capital expenditures for business expansion, productivity improvement, cost reduction and replacements necessary to maintain the business; to retire long-term senior debt; and to provide a return to lenders. Borrowings under the Trust V Variable Funding Loan Agreement totaled $15 million at May 31, 1995.

Working capital is required to fund adequate levels of inventories and accounts receivable. Commitments for capital expenditures at May 31, 1995 are not material; however, it is estimated that gross capital expenditures of the Company and its subsidiaries for the year ending May 31, 1996 will approximate $80 million.

Because the Company's operating cash flow is significantly influenced by the general economy and, in particular, the level of construction, prior years' 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 Trust V Variable Funding Loan Agreement will provide Mid-State Homes with the funds needed to purchase the instalment notes and mortgages generated by Jim Walter Homes. It is contemplated that one or more permanent financings similar to the Trust II, III and IV financings will be required over the next four years in order to repay borrowings under the Variable Funding Loan Agreement. The Company also believes that under present operating conditions sufficient operating cash flow will be generated through fiscal year 1999 to make all required interest and principal payments and planned capital expenditures and meet substantially all operating needs and that amounts available under the Bank Revolving Credit Facility will be sufficient to meet peak operating needs. However, it is currently anticipated that sufficient operating cash flow will not be generated to repay at maturity the principal amount of the Senior Notes without refinancing a portion of such debt or selling assets. No assurance can be given that any refinancing will take place or that such sales of assets can be consummated.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS
WALTER INDUSTRIES, INC.

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations and retained earnings (deficit) and of cash flows present fairly, in all material respects, the financial position of Walter Industries, Inc. and its subsidiaries at May 31, 1995 and 1994, and the results of their operations and their cash flows for each of the three years in the period ended May 31, 1995 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.

Our report dated July 8, 1994 on the May 31, 1994 consolidated financial statements included a paragraph that raised substantial doubt about the Company's ability to continue as a going concern due to the Company and substantially all of its subsidiaries filing a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code. As discussed in Note 1, on March 2, 1995 the Bankruptcy Court confirmed the Company's Consensual Plan dated as of December 9, 1994, as modified on March 1, 1995, which resulted in the discharge of all claims against the Company that arose before December 27, 1989, other than those claims being litigated in the Bankruptcy Court, and substantially altered the rights and interests of equity security holders. The plan became effective on March 17, 1995 and the Company emerged from bankruptcy.

As discussed in Note 12 to the Financial Statements, the Company changed its method of accounting for postretirement benefits other than pensions in fiscal year 1993.

Price Waterhouse LLP

Price Waterhouse LLP

Tampa, Florida

July 12, 1995

WALTER INDUSTRIES, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENT OF OPERATIONS AND RETAINED EARNINGS (DEFICIT)

	For the years ended May 31,		
	1995	1994	1993
	(in thousands except per share amount)		
SALES AND REVENUES			
Net sales	$ 1,181,635	$ 1,068,387	$ 1,072,615
Time charges (Note 4)	222,221	238,097	218,696
Miscellaneous	30,838	17,383	23,160
Interest income from Chapter 11 proceedings (Note 1)	7,628	4,657	4,515
	1,442,322	1,328,524	1,318,986
COST AND EXPENSES			
Cost of sales	951,381	845,061	804,411
Depreciation, depletion and amortization (Note 5)	72,037	71,035	70,483
Selling, general and administrative	130,616	127,901	124,616
Postretirement health benefits (Note 12)	25,961	25,585	23,474
Provision for possible losses	4,485	4,611	4,236
Chapter 11 costs (Note 1)	442,362	14,254	9,802
Interest and amortization of debt discount and expense (Notes 1, 5 and 7)	304,548	155,470	171,581
Amortization of excess of purchase price over net assets acquired (Note 6)	40,027	48,515	39,461
	1,971,417	1,292,432	1,248,064
	(529,095)	36,092	70,922
Income tax benefit (expense) (Note 8):			
Current	80,754	(41,598)	(48,141)
Deferred	89,696	12,681	23,813
Income (loss) from operations before cumulative effect of accounting change	(358,645)	7,175	46,594
Cumulative effect of change in accounting principle - postretirement benefits other than pensions (net of income tax benefit of $61,823,000) (Note 12)	—	—	(104,608)
Net income (loss)	(358,645)	7,175	(58,014)
Retained earnings (deficit) at beginning of year	(434,520)	(441,695)	(383,681)
Retained earnings (deficit) at end of year	$(793,165)	$(434,520)	$(441,695)
Net loss per share (Note 9):			
- Primary	$(7.10)		

WALTER INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

	May 31,	
	1995	1994
	(in thousands)	
ASSETS		
Cash (includes short-term investments of $ 84,872,000 and $177,040,000) (Notes 3 and 13)	$ 128,007	$ 203,303
Short-term investments, restricted (Notes 3 and 13)	128,002	107,552
Instalment notes receivable (Notes 1, 4, 8 and 13)	4,256,866	4,176,040
Less - Provision for possible losses	(26,556)	(26,301)
Unearned time charges	(2,869,282)	(2,790,560)
Net	1,361,028	1,359,179
Trade receivables	160,584	135,431
Less - Provision for possible losses	(7,998)	(7,392)
Net	152,586	128,039
Federal income tax receivable (Note 8)	99,875	—
Other notes and accounts receivable	30,236	10,774
Inventories, at lower of cost (first in, first out or average) or market:		
Finished goods	111,792	95,270
Goods in process	29,593	27,090
Raw materials and supplies	53,453	48,533
Houses held for resale	1,599	1,686
Total inventories	196,437	172,579
Prepaid expenses	12,694	11,335
Property, plant and equipment, at cost (Note 5)	1,186,407	1,123,939
Less - Accumulated depreciation, depletion and amortization	(523,615)	(466,076)
Net	662,792	657,863
Investments	6,191	5,753
Deferred income taxes (Note 8)	16,544	—
Unamortized debt expense	34,167	31,656
Other assets	43,698	39,936
Excess of purchase price over net assets acquired (Notes 1 and 6)	372,896	412,923
	$ 3,245,153	$ 3,140,892

	May 31,	
	1995	1994
	(in thousands)	
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Bank overdrafts (Note 3)	$ 33,746	$ 29,879
Accounts payable (Note 1)	108,137	59,468
Accrued expenses	150,907	122,665
Income taxes payable (Note 8)	53,261	21,543
Deferred income taxes (Note 8)	—	73,152
Long-term senior debt (Notes 1, 7 and 13)	2,220,370	871,970
Accrued interest (Note 7)	37,854	258,032
Accumulated postretirement health benefits obligation (Note 12)	228,411	209,962
Other long-term liabilities	51,693	48,890
Liabilities subject to Chapter 11 proceedings (Notes 1 and 7)	—	1,727,684
Stockholders' equity (deficit) (Notes 1, 7, 9 and 10):		
Common stock, $.01 par value per share:		
Authorized - 200,000,000 shares and 50,000,000 shares		
Issued - 50,494,313 shares and 31,120,773 shares	505	311
Capital in excess of par value	1,159,384	155,293
Retained earnings (deficit), per accompanying statement	(793,165)	(434,520)
Excess of additional pension liability over		
unrecognized prior years service cost	(5,950)	(3,437)
Total stockholders' equity (deficit)	360,774	(282,353)
	$ 3,245,153	$ 3,140,892

WALTER INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS

	For the years ended May 31,		
	1995	1994	1993
OPERATIONS	(in thousands)		
Net income (loss)	$(358,645)	$ 7,175	$(58,014)
Charges to income not affecting cash:			
Settlement of Chapter 11 claims with debt and new Common Stock	444,752	—	—
Depreciation, depletion and amortization	72,037	71,035	70,483
Provision for deferred income taxes	(89,696)	(12,681)	(23,813)
Accumulated postretirement health benefits obligation (Note 12)	18,449	20,057	189,905
Adjustment to deferred taxes for accounting change (Note 12)	—	—	(61,823)
Provision for other long-term liabilities	294	280	(781)
Amortization of excess of purchase price over net assets acquired (Note 6)	40,027	48,515	39,461
Amortization of debt discount and expense	11,783	17,597	22,148
	139,001	151,978	177,566
Decrease (increase) in:			
Short-term investments, restricted	(20,450)	(1,932)	1,334
Instalment notes receivable, net (a)	(1,849)	27,680	(23,607)
Trade and other receivables, net	(44,009)	12,747	1,429
Federal income tax receivable	(99,875)	—	—
Inventories	(23,858)	(5,940)	627
Prepaid expenses	(1,359)	(3,433)	236
Increase (decrease) in:			
Bank overdrafts (Note 3)	3,867	11,958	(9,758)
Accounts payable	28,925	6,772	(1,692)
Accrued expenses	28,242	6,427	(1,682)
Income taxes payable	(15,348)	2,408	9,111
Accrued interest	24,156	47,833	32,605
Liabilities subject to Chapter 11 proceedings (Note 1):			
Accounts payable	—	1,438	811
Accrued expenses	—	(152)	4
Cash flows from operations	17,443	257,784	186,984
FINANCING ACTIVITIES			
Issuance of long-term senior debt (Notes 1 and 7)	974,450	2,000	256,128
Additions to unamortized debt expense	(17,153)	—	(4,794)
Retirement of long-term senior debt (Note 7)	(120,250)	(178,865)	(161,959)
Payment of liabilities subject to Chapter 11 proceedings	(604,044)(b)	—	(121,217)
Payment of accrued postpetition interest on Chapter 11 secured debt obligations	(244,334)	—	—
Cash flows from financing activities	(11,331)	(176,865)	(31,842)
INVESTING ACTIVITIES			
Additions to property, plant and equipment, net of normal retirements	(76,966)	(65,858)	(68,901)
(Increase) in investments	(438)	(185)	(128)
(Increase) in other assets	(4,004)	(1,943)	(1,617)
Cash flows from investing activities	(81,408)	(67,986)	(70,646)
Net increase (decrease) in cash and cash equivalents	(75,296)	12,933	84,496
Cash and cash equivalents at beginning of year	203,303	190,370	105,874
Cash and cash equivalents at end of year (Note 3)	$ 128,007	$ 203,303	$ 190,370

(a) Consists of sales and resales, net of repossessions and provision for possible losses, of $155,236,000, $153,776,000, and $172,707,000 and cash collections on account and payouts in advance of maturity of $153,387,000, $181,456,000 and $149,100,000, for the years ended May 31, 1995, 1994 and 1993, respectively.

(b) In addition, $490 million of Series B Senior Notes and 44,050,974 shares of new Common Stock were issued to satisfy a portion of the allowed claims of holders of secured and subordinated debt and settle a portion of the asbestos-related veil-piercing claims, and 6,443,339 shares of new Common Stock were issued to the former shareholders in cancellation of their original holdings.

WALTER INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

NOTE 1 - RECENT HISTORY

Walter Industries, Inc. (formerly Hillsborough Holdings Corporation) (the "Company") was organized in August 1987 by a group of investors led by Kohlberg Kravis Roberts & Co. ("KKR") for the purpose of acquiring Jim Walter Corporation, a Florida corporation ("Original Jim Walter"). Following its organization, the Company organized and acquired all of the outstanding capital stock of a group of direct wholly-owned subsidiaries (the "First Tier Subsidiaries"). The First Tier Subsidiaries (except JWC Holdings Corporation) and the Company organized and acquired all of the outstanding capital stock of Walter Industries, Inc. ("Old Walter Industries"). JWC Holdings Corporation, a Florida corporation and a First Tier Subsidiary ("JWC Holdings"), organized and acquired all of the outstanding shares of J-II Acquisition Corporation, a Florida corporation ("J-II"). Old Walter Industries and J-II, in turn, organized and acquired all of the outstanding capital stock of Hillsborough Acquisition Corporation ("HAC").

On September 18, 1987, HAC acquired approximately 95% of the outstanding common stock of Original Jim Walter at a price of $60 per share in cash, pursuant to an Agreement and Plan of Merger dated as of August 12, 1987 (the "Acquisition"). On January 7, 1988, the Company caused Original Jim Walter to be merged (the "Merger") into HAC (which changed its name to "Jim Walter Corporation") and the remaining 5% of its common stock was converted into the right to receive $60 in cash for each share. On that same date: (i) HAC distributed substantially all of its assets (principally excluding the stock of certain subsidiaries of Original Jim Walter engaged in building materials businesses) to Old Walter Industries in redemption of all of its shares of capital stock owned by Old Walter Industries; (ii) HAC merged into J-II; and (iii) J-II changed its name to "Jim Walter Corporation". On April 1, 1991, Old Walter Industries merged into Hillsborough Holdings Corporation thereby completing its previously adopted plan of liquidation. The Company changed its name to Walter Industries, Inc. in connection with such merger. Prior to September 18, 1987, the Company had no significant assets or liabilities and did not engage in any activities other than those related to the Acquisition. The purchase price of the shares of Original Jim Walter was approximately $2,425,000,000 plus expenses of the Acquisition and assumption of certain outstanding indebtedness. For financial statement purposes, the Acquisition has been accounted for as a purchase as of September 1, 1987 and, accordingly, the purchase price has been allocated based upon the fair value of assets acquired and liabilities assumed (see Note 6).

On December 27, 1989, the Company and 31 of its subsidiaries (including the subsidiary in the next sentence, the "Debtors") each filed a voluntary petition for reorganization under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Middle District of Florida, Tampa Division (the "Bankruptcy Court"). On December 3, 1990, one additional small subsidiary filed a voluntary petition for reorganization under the Bankruptcy Code. Two other small subsidiaries did not file petitions for reorganization.

The Debtors' Chapter 11 cases resulted from a sequence of events stemming primarily from an inability of the Company's interest reset advisors to reset interest rates on approximately $624 million of outstanding Senior Extendible Reset Notes and Senior Subordinated Extendible Reset Notes on which interest rates were scheduled to be reset effective January 2, 1990. The inability to reset the interest rates was primarily attributable to two factors: (i) uncertainties arising from the then-pending asbestos-related litigation, including the possibility either that such litigation would lead to the prohibition of further asset sales and debt repayment or that substantial new asbestos-related claims might become assertable against the Company, which uncertainties materially hindered the ability of the Company and its subsidiaries to pursue a refinancing or sell assets to reduce debt, and (ii) general turmoil in the high yield bond markets at such time, both of which depressed the bid value of such notes.

On December 9, 1994, the Supplement to Disclosure Statement For Amended Joint Plan of Reorganization Dated as of December 9, 1994 (the "Consensual Plan") was filed with the Bankruptcy Court. The Consensual Plan, as modified on March 1, 1995, was confirmed by the Bankruptcy Court on March 2, 1995, and became effective on March 17, 1995 (the "Effective Date"). Despite the confirmation and effectiveness of the Consensual Plan, the Bankruptcy Court continues to

have jurisdiction to, among other things, resolve disputed prepetition claims against the Company and other matters that may arise in connection with or relate to the Consensual Plan (see Note 8).

The essential terms of the Consensual Plan are as follows: Revolving Credit Bank Claims, Working Capital Bank Claims, Series B and C Senior Note Claims, and other unsecured creditors (i.e., trade creditors) received the full allowed amounts of their claims in cash plus interest at negotiated amounts including a portion in shares of new common stock ("Common Stock"). Subordinated Note Claims received, depending on elections made, either shares of Common Stock or a combination of cash, new debt securities and shares of Common Stock, in either case having an aggregate reorganization value equal to their prepetition claims. In addition, Pre-LBO Debenture Claims received shares of Common Stock having an aggregate reorganization value equal to $11.3 million in settlement of the fraudulent conveyance action commenced by the indenture trustees for the Pre-LBO Debentures. The asbestos-related veil-piercing claimants received cash, new debt securities and Common Stock with an aggregate reorganization value of $375 million in settlement of all asbestos-related veil-piercing or fraudulent conveyance claims. In addition, the attorneys for the asbestos-related veil-piercing claimants received a cash payment of $15 million. The Company's former stockholders received shares of Common Stock having a reorganization value equal to $150 million. In addition, the former stockholders will receive shares of Common Stock having a reorganization value of $11.3 million and have the right to receive additional shares of Common Stock upon realization of certain future tax benefits (see Note 9).

Pursuant to the Consensual Plan, trade creditors with prepetition allowed claims in excess of $1,000 received 75% of their allowed claims in cash following the Effective Date and are entitled to receive the remaining 25% six months following the Effective Date with additional interest for such period at the prime rate. At May 31, 1995, the remaining amount to be distributed to trade creditors approximated $23.5 million.

In connection with the Consensual Plan, on March 16, 1995, pursuant to approval by the Bankruptcy Court, Mid-State Homes, Inc. ("Mid-State"), a wholly-owned indirect subsidiary of the Company, sold mortgage instalment notes having a gross amount of $2,020,258,000 and an economic balance of $826,671,000 to Mid-State Trust IV ("Trust IV"), a business trust in which Mid-State owns all the beneficial interest. In addition, on such date Mid-State sold its beneficial interest in Mid-State Trust II ("Trust II") to Trust IV. Trust II had a total collateral value of $910,468,000 with $605,750,000 of Mortgage-Backed Notes outstanding. These sales were in exchange for the net proceeds from the public issuance by Trust IV of $959,450,000 of Asset Backed Notes. The assets of Trust IV are not available to satisfy claims of general creditors of Mid-State, or the Company and its subsidiaries. The liabilities of Trust IV for its publicly issued debt are to be satisfied solely from proceeds of the underlying instalment notes and are non-recourse to Mid-State and the Company and its subsidiaries.

On February 27, 1995, Mid-State established Mid-State Trust V ("Trust V"), a business trust in which Mid-State owns all the beneficial interest, to provide funds to Mid-State for its current purchases of instalment notes receivable from Jim Walter Homes, Inc. ("Jim Walter Homes").

As of March 3, 1995, Trust V entered into a Variable Funding Loan Agreement with Enterprise Funding Corporation, an affiliate of NationsBank N.A., as lender and NationsBank N.A. (Carolinas), as Administrative Agent. The agreement provides for a three-year $500 million credit facility secured by the instalment notes and mortgages Trust V purchases from Mid-State.

On February 27, 1995, the Company and certain of its subsidiaries entered into a Bank Revolving Credit Facility, providing up to $150 million at any time outstanding for working capital needs with a sub-limit for trade and standby letters of credit not in excess of $40 million and a sub-facility for swingline advances in an amount not in excess of $15 million.

The Company recorded approximately $583.8 million of additional expenses related to consummation of the Consensual Plan, including approximately $141.4 million of additional interest and amortization of debt discount and expense, $390 million in settlement of all asbestos-related veil-piercing claims and related legal fees and $52.4 million for professional fees, settlement of various disputed claims and other expenses, in the fiscal year ended May 31, 1995.

The following unaudited pro forma consolidated statement of operations was prepared to illustrate the estimated effects of the Consensual Plan and related financings as if they had occurred as of June 1, 1994.

PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS

(Unaudited)

	For the year ended May 31, 1995		
	As Reported	Adjustments	Pro Forma
	(in thousands except per share amount)		
Sales and revenues:			
Net sales	$ 1,181,635		$ 1,181,635
Time charges	222,221		222,221
Miscellaneous	30,838		30,838
Interest income from Chapter 11 proceedings	7,628	$(7,628)[1]	—
	1,442,322	(7,628)	1,434,694
Cost and expenses:			
Cost of sales	951,381		951,381
Depreciation, depletion and amortization	72,037		72,037
Selling, general and administrative	130,616		130,616
Postretirement health benefits	25,961		25,961
Provision for possible losses	4,485		4,485
Chapter 11 costs	442,362	(442,362)[2]	—
Interest and amortization of debt discount and expense	304,548	(81,364)[3]	223,184
Amortization of excess of purchase price over net assets acquired	40,027		40,027
	1,971,417	(523,726)	1,447,691
	(529,095)	516,098	(12,997)
Income tax benefit (expense)	170,450	(195,730)[4]	(25,280)
Net income (loss)	$(358,645)	$ 320,368	$(38,277)
Net loss per share			$(.75)[5]
Weighted average shares outstanding			50,988,626

Changes from the historical financial statement in the pro forma consolidated statement of operations consist of the following adjustments (in thousands):

(1) Interest income from Chapter 11 proceedings of $7,628, which would not have been realized assuming the Consensual Plan became effective June 1, 1994, has been eliminated.

(2) Chapter 11 costs of $442,362, which would not have been incurred assuming the Consensual Plan became effective June 1, 1994, have been eliminated.

(3) Interest and amortization of debt discount and expense has been reduced $81,364 to give retroactive effect as if all indebtedness to be repaid pursuant to the Consensual Plan was so done as of June 1, 1994 and the $490 million of Series B Senior Notes had been outstanding for the full year ended May 31, 1995. Borrowings under the Trust IV Asset Backed Notes were assumed to increase during the period June 1, 1994 through November 30, 1994 proportionately with the comparable period increase in the outstanding economic balance of the instalment notes sold by Mid-State to Trust IV on March 16, 1995. Borrowings under the Trust V Variable Funding Loan Agreement were based on 78% of Jim Walter Homes' credit sales during the six-month period December 1, 1994 through May 31, 1995. This time period is subsequent to the Trust IV cut-off date for purchases of instalment notes from Mid-State. No working capital borrowings were assumed under the Bank Revolving Credit Facility. Pro forma interest expense, however, includes letter of credit fees and unused working capital commitment fees.

(4) The provision for income taxes has been adjusted at the applicable statutory rates to give effect to the pro forma adjustments described above.

(5) Net loss per share has been computed based on the weighted average number of common shares outstanding (including 494,313 additional shares of Common Stock to be issued six months after the Effective Date of the Consensual Plan, but not including 3,880,140 additional shares that will be issued to an escrow account because such issuance is contingent upon future events and would be antidilutive).

NOTE 2 - PRINCIPLES OF CONSOLIDATION

The Company through its direct and indirect subsidiaries currently offers a diversified line of products and services for homebuilding, water and waste water transmission, residential and non-residential construction, and industrial markets. The consolidated financial statements include the accounts of the Company and all of its subsidiaries. All significant intercompany balances have been eliminated.

NOTE 3 - CASH AND RESTRICTED SHORT-TERM INVESTMENTS

Cash includes short-term investments with original maturities of less than one year. These investments are readily convertible to cash 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 bank overdrafts.

Restricted short-term investments include temporary investment of reserve funds and collections on instalment notes receivable owned by Trusts II, III, IV and V ($103,714,000). These funds are available only to pay expenses of the Trusts and principal and interest on indebtedness of the Trusts. Miscellaneous other segregated accounts restricted to specific uses ($24,288,000), are also included in restricted short-term investments.

NOTE 4 - INSTALMENT NOTES RECEIVABLE

The instalment notes receivable arise from sales of partially-finished homes to customers for time payments primarily over periods of twelve to thirty years and are secured by first mortgages or similar security instruments. Revenue and income from the sale of homes is included in income upon completion of construction and legal transfer to the customer. The buyer's ownership of the land and the improvements necessary to complete the home constitute a significant equity investment which the Company has access to should the buyer default on payment of the instalment note obligation. Of the gross amount of $4,256,866,000, an amount of $3,955,239,000 is due after one year. Instalment payments estimated to be receivable within each of the five years from May 31, 1995 are $301,627,000, $294,808,000, $289,012,000, $283,044,000 and $274,370,000, respectively, and $2,814,005,000 after five years. Time charges are included in equal parts in each monthly payment and are taken into income as collected. This method approximates the interest method since a much larger provision for loan losses and other expenses would be required if time charge income were accelerated. The aggregate amount of instalment notes receivable having at least one payment ninety or more days delinquent was 3.17% and 3.23% of total instalment notes receivable at May 31, 1995 and 1994, respectively.

Mid-State purchases instalment notes from Jim Walter Homes on homes constructed and sold by Jim Walter Homes and services such instalment mortgage notes. Trust II, Trust III and Trust IV are business trusts organized by Mid-State, which owns all of the beneficial interest in Trust III and Trust IV. 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 from the net proceeds from the issuance of the Trust II Mortgage-Backed Notes, the Trust III Asset Backed Notes and the Trust IV Asset Backed Notes described in Note 7. The assets of Trust II, Trust III and Trust IV, including the instalment notes receivable, are not available to satisfy claims of general creditors of the Company and its subsidiaries. The liabilities of Mid-State Trusts II, III and IV 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. Of the gross amount of instalment notes receivable at May 31, 1995 of $4,256,866,000 with an economic balance of $2,057,896,000, receivables owned by Trust II had a gross book value of $1,396,138,000 and an economic balance of $846,481,000, receivables owned by Trust III had a gross book value of $472,980,000 and an economic balance of $239,200,000 and receivables owned by Trust IV had a gross book value of $1,970,887,000 and an economic balance of $814,182,000. On February 27, 1995, Mid-State established Trust V (see Note 1). At May 31, 1995, receivables owned by Trust V had a gross book value of $254,871,000 and an economic balance of $92,466,000.

NOTE 5 - PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are summarized as follows (see Note 1 regarding purchase accounting):

	May 31,	
	1995	1994
	(in thousands)	
Land and minerals	$ 196,798	$ 200,337
Land improvements	20,140	18,941
Buildings and leasehold improvements	110,758	104,999
Mine development costs	125,903	123,761
Machinery and equipment	703,138	663,898
Construction in progress	29,670	12,003
Total	$ 1,186,407	$ 1,123,939

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. Depletion of minerals is provided based on estimated recoverable quantities.

The Company has capitalized interest on qualifying properties in accordance with Financial Accounting Standards Board Statement No. 34. Interest capitalized for the years ended May 31, 1995, 1994 and 1993 was immaterial. Interest paid in cash for the years ended May 31, 1995, 1994 and 1993 was $437,357,000, $91,293,000 and $117,853,000, respectively.

NOTE 6 - GOODWILL

The excess of purchase price over net assets acquired in connection with the Acquisition is being amortized over periods ranging up to twenty years. At May 31, 1995, the accumulated amortization of goodwill was approximately $402.1 million. The Company evaluates, on a regular basis, whether events and circumstances have occurred that indicate the carrying amount of goodwill may warrant revision or may not be recoverable. The Company measures impairment of goodwill based on estimated future undiscounted cash flows from operations of the related business unit. At May 31, 1995, the net unamortized balance of goodwill is not considered to be impaired.

NOTE 7 - DEBT

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

	May 31,	
	1995	1994
	(in thousands)	
Senior debt:		
Trust II Mortgage-Backed Notes	$ 584,000	$ 671,000
Trust III Asset Backed Notes	173,527	200,970
Trust IV Asset Backed Notes	953,843	—
Trust V Variable Funding Loan	15,000	—
Series B Senior Notes Due 2000	490,000	—
Bank Revolving Credit Facility	—	—
Other	4,000	—
	$ 2,220,370	$ 871,970

Long-term debt included as liabilities subject to Chapter 11 Proceedings at May 31, 1994 consisted of the following (see Note 1):

	(in thousands)
Revolving Credit Agreement	$ 228,249
Series B Senior Extendible Reset Notes	176,300
Series C Senior Extendible Reset Notes	5,000
Senior Subordinated Extendible Reset Notes	443,046
Subordinated Notes	350,000
13-1/8% Subordinated Notes	50,000
13-3/4% Subordinated Debentures	100,000
10-7/8% Subordinated Debentures (less unamortized discount of $7,513,000)	82,487
Other	7,080
	$ 1,442,162

The Trust II Mortgage-Backed Notes (see Note 4) were issued in five classes in varying principal amounts. Three of the classes have been fully repaid. The two remaining classes A3 and A4 bear interest at the rates of 9.35% and 9.625%, respectively. Interest on each class of notes is payable quarterly on each 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 A3 and Class A4 Notes in order of maturity. Maturities of the balance of these Mortgage-Backed Notes range from April 1, 1998 for the Class A3 Notes to April 1, 2003 for the Class A4 Notes. The Class A3 and Class A4 Notes are subject to special principal payments and the Class A4 Notes may be subject to optional redemption under specified circumstances. The scheduled principal amount of notes maturing in each of the five years from May 31,

1995 is $87,000,000, $87,000,000, $87,000,000, $64,600,000 and $64,600,000, respectively.

The Trust III Asset Backed Notes (see Note 4) bear interest at 7-5/8%, 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 (see Notes 1 and 4) 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 less amounts paid for interest on the notes and Trust IV expenses.

On March 3, 1995, Mid-State Trust V entered into the three-year $500 million Variable Funding Loan Agreement described in Note 1. It is contemplated that this facility will be an evergreen three-year facility with periodic paydowns from the proceeds of permanent financings similar to those done by Mid-State Trusts II, III and IV. Accordingly, the $15 million of borrowings outstanding at May 31, 1995 has been classified as long-term debt. Interest is based on the cost of A-1 and P-1 rated commercial paper plus 3/4%. Commitment fees on the unused facility are .55%.

The Series B Senior Notes Due 2000 ("Senior Notes") were issued by the Company pursuant to the Consensual Plan as part of the distribution made in payment of claims of holders of certain unsecured indebtedness of the Company and certain of its subsidiaries (see Note 1). Interest on the Senior Notes is payable semi-annually on September 15 and March 15 of each year at the rate of 12.19%. The Senior Notes may be redeemed at any time at the option of the Company, in whole or in part, at a redemption price of 101% of the principal amount thereof, plus accrued and unpaid interest, if any, to the date of redemption, provided that no partial redemption may occur which results in less than $150 million aggregate principal amount of the Senior Notes being outstanding. Additionally, the Company is obligated in certain circumstances to apply net cash proceeds from certain asset sales to either redeem or offer to purchase notes at a price equal to 100% of the principal amount thereof, plus accrued and unpaid interest, if any, to the date of redemption or purchase, provided that no such redemption or purchase may occur which results in less than $150 million aggregate principal amount of Senior Notes outstanding. The Senior Notes rank pari passu with all other senior indebtedness of the Company. The Senior Notes are secured by the capital stock of most of the Company's subsidiaries.

The Bank Revolving Credit Facility is a three-year non-amortizing senior working capital revolving credit facility pursuant to which borrowings not in excess of $150 million may be outstanding at any time, with a sub-limit for trade and standby letters of credit in an amount not in excess of $40 million at any time outstanding and a sub-facility for swingline advances in an amount not in excess of $15 million at any time outstanding. The facility is secured by assets of certain subsidiaries of the Company. Subject to certain exceptions, the net cash proceeds from the sale of collateral must be applied to permanently reduce the facility. Under the facility, each borrower guarantees the obligations of each other borrower, subject to certain limitations. Interest at the option of the borrowers through November 30, 1995 is at (i) the Citibank Base Rate plus 3/4% or (ii) a LIBOR rate plus 2-1/4%. The fee for outstanding letters of credit is 1-3/4%. Thereafter, interest shall be determined by the Performance Level in effect from time to time ranging from 1/4% to 1% over the Citibank Base Rate, 1-3/4% to 2-1/2% over the LIBOR rate and 1-1/4% to 2% for letters of credit. A commitment fee of 1/2 of 1% per annum is required based upon the unutilized commitment. As of May 31, 1995, there were no borrowings outstanding under this facility; however, letters of credit in the aggregate face amount of $22,727,000 have been issued thereunder.

The Senior Notes, the Bank Revolving Credit Facility and the Trust V Variable Funding Loan Agreement 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, make capital expenditures, pay dividends, create liens on assets, enter into 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 Bank Revolving Credit Facility, the Company is required to maintain specified financial ratios and comply with certain financial tests, including minimum interest coverage, fixed charge coverage ratios and maximum leverage ratios, some of which become more restrictive over time.

NOTE 8 - INCOME TAXES

Income tax expense (benefit) is made up of the following components: (in thousands)

	May 31, 1995		May 31, 1994		May 31, 1993	
	Current	Deferred	Current	Deferred	Current	Deferred
United States	$(80,445)	$(88,815)	$ 38,712	$(11,716)	$ 44,093	$(22,682)
State and local	(309)	(881)	2,886	(965)	4,048	(1,131)
Total	$(80,754)	$(89,696)	$ 41,598	$(12,681)	$ 48,141	$(23,813)

Federal income tax paid in fiscal 1995, 1994 and 1993 was approximately $30.6 million, $37.1 million and $35.9 million. State income taxes paid in fiscal 1995, 1994 and 1993 were approximately $4.0 million, $2.1 million and $3.1 million, respectively.

The Company complies with Statement of Financial Accounting Standards No. 109 ("FAS 109"), "Accounting for Income Taxes". 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 which 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.

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

	For the years ended May 31,		
	1995	1994	1993
Statutory tax rate	(35.0)%	35.0%	34.0%
Effect of:			
Adjustment to deferred taxes	—	5.3	—
State and local income tax	(.2)	3.3	2.7
Percentage depletion	(.5)	(1.7)	(8.3)
Enacted tax rate change	—	9.4	—
Amortization of net investment tax credit	—	—	(.3)
Nonconventional source fuel credit	—	(10.8)	(7.7)
Amortization of excess of purchase price over net assets acquired	2.7	47.1	19.0
Benefit of capital loss carryforward	(1.5)	(8.5)	(4.7)
Effect of rate change and loss of credits on loss carryback	2.3	—	—
Other, net	—	1.0	(.4)
Effective tax rate	(32.2)%	80.1%	34.3%

On August 10, 1993, the Omnibus Budget Reconciliation Act of 1993 was signed into law raising the federal corporate income tax rate to 35% from 34%, retroactive to January 1, 1993. FAS 109 requires that deferred tax liabilities and assets be adjusted in the period of enactment for the effect of an enacted change in the tax laws or rates. The effect of the change was $2,833,000 and such amount is included in the provision for deferred income taxes for the year ended May 31, 1994. Deferred tax liabilities (assets) are comprised of the following:

	May 31,	
	1995	1994
	(in thousands)	
Instalment sales method for instalment notes receivable in prior years	$ 43,312	$ 52,549
Depreciation	116,625	117,053
Difference in basis of assets under purchase accounting	23,894	27,269
Capital loss carryforward	(7,977)	(12,600)
Tax credit carryforward	(31,488)	—
Accrued expenses	(81,855)	(43,716)
Postretirement benefits other than pensions	(87,032)	(80,003)
Valuation allowance	7,977	12,600
Total deferred tax (asset) liability	$(16,544)	$ 73,152

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

The Company has a capital loss carryforward of approximately $22.8 million which expires in fiscal 1997. The Company has established a valuation allowance of approximately $8.0 million to offset the deferred tax asset related to the carryforward since the Company cannot predict whether capital gains sufficient to offset the carryforward will be realized in the two-year carryforward period.

As a result of the loss incurred in the 1995 fiscal year, the Company has recorded a federal income tax receivable of approximately $99.9 million. The Company has also recorded as an asset, in the

deferred tax accounts, the benefit of an alternative minimum tax credit carryover of approximately $31.5 million.

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. The Reorganization created an ownership change; however, the Company believes that the annual limitation will not affect the realization of the capital loss carryforward and the alternative minimum tax credit carryforward.

The Company allocates federal income tax expense (benefit) to its subsidiaries based on their separate taxable income (loss).

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 in the amounts of $110,560,883 with respect to fiscal years ended August 31, 1980 and August 31, 1983 through August 31, 1987, $31,468,189 with respect to fiscal years ended May 31, 1988 (nine months) and May 31, 1989 and $44,837,693 with respect to fiscal years ended May 31, 1990 and May 31, 1991. Objections to the proofs of claim have been filed by the Company and the various issues are being litigated in the Bankruptcy Court. The Company believes that such proofs of claim are substantially without merit and intends to defend such claims against the Company vigorously.

NOTE 9 - STOCKHOLDERS' EQUITY

As of the Effective Date, the outstanding old common stock issued in connection with the Acquisition was cancelled and all stock option plans were terminated. Pursuant to the Consensual Plan, the Company is authorized to issue 200,000,000 shares of Common Stock, $.01 par value. All 50,494,313 shares outstanding at May 31, 1995 were issued in connection with the Consensual Plan.

Pursuant to the Consensual Plan, 494,313 additional shares of Common Stock will be issued to all former stockholders as of the Effective Date six months after the Effective Date of the Consensual Plan. In addition, up to 3,880,140 additional shares of Common Stock will be issued to an escrow account six months after the Effective Date of the Consensual Plan. 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 all 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 cancelled.

Primary net loss per share has been computed using the weighted average number of common shares outstanding, assuming the new capital structure had been effective as of June 1, 1994. In management's opinion, per share information for fiscal years 1994 and 1993 is not relevant given the significant change in the Company's capital structure which occurred as a result of the Company's reorganization pursuant to the Consensual Plan (see Note 1).

NOTE 10 - STOCK OPTIONS

The Company has reserved 3,000,000 shares of its Common Stock for issuance under the 1995 Long-Term Incentive Stock Plan of Walter Industries, Inc. This plan was established pursuant to the Consensual Plan which provided that 6% of the shares to be outstanding on the Effective Date could be so reserved. As of May 31, 1995, no options had been granted.

NOTE 11 - LITIGATION AND OTHER MATTERS

Veil-Piercing Suits

Beginning in early 1989, the Company and certain of its officers, directors and shareholders were named as co-defendants in a number of lawsuits brought by persons ("Asbestos Claimants") claiming that the Company should be held liable for all asbestos-related liabilities of The Celotex Corporation ("Celotex") and/or its parent, Jim Walter Corporation ("JWC"). The stock of a predecessor of JWC (Original Jim Walter) was acquired by a company known as Hillsborough Acquisition Corporation ("HAC"), a former subsidiary of the Company, pursuant to a 1988 leveraged buyout ("LBO"). Asserting a variety of theories of derivative liability, including piercing the corporate veil, the suits alleged, among other things, that Original Jim Walter was liable for all asbestos-related liabilities of Celotex and that the distribution by HAC of substantially all of its assets to the Company pursuant to the LBO was therefore a fraudulent conveyance (the "Veil-Piercing Suits").

On December 27, 1989, the Company and certain of its subsidiaries filed for protection (the "Bankruptcy Case"), under Chapter 11 of Title 11 of the United

States Bankruptcy Code in the United States Bankruptcy Court for the Middle District of Florida, Tampa Division, which stayed all Veil-Piercing Suits pursuant to the automatic stay. On January 2, 1990, the Company filed a declaratory judgment action ("Adversary Proceeding") against all Asbestos Claimants who had filed Veil-Piercing Suits seeking a ruling that the Company could not be held liable for any asbestos-related liabilities of Celotex or JWC on any grounds, asserting that the corporate veil separating Original Jim Walter and Celotex was intact, and asserting that the LBO could not be deemed a fraudulent conveyance.

On April 18, 1994, the Bankruptcy Court ruled in favor of the Company on all of the claims asserted in the Adversary Proceeding. The ruling was affirmed by the District Court for the Middle District of Florida on October 13, 1994. Thereafter, a settlement (the "Veil-Piercing Settlement") was entered into among the Company, certain of its creditors, Celotex, JWC and representatives of the Asbestos Claimants pursuant to which all the Veil-Piercing Suits would be dismissed and the Company and its officers, directors and relevant stockholders would be released from all liabilities relating to the LBO or associated with asbestos-related liabilities of Celotex or JWC. The Veil-Piercing Settlement is embodied in the Consensual Plan that was confirmed by the Bankruptcy Court pursuant to an order signed on March 2, 1995. The Consensual Plan binds all known and unknown claimants and enjoins such persons or entities from bringing any suits against the Company in the future for asbestos or LBO-related claims. Dismissal of the Veil-Piercing Suits is in process and all of these suits will be dismissed in the near future pursuant to the terms of the Veil-Piercing Settlement and the Consensual Plan.

South Carolina Class Actions

On December 6, 1994, three South Carolina homeowners filed an amended petition in the United States District Court for the District of South Carolina, Columbia Division, (the "South Carolina District Court") seeking to certify a class against Jim Walter Homes and Mid-State for alleged violations of a South Carolina statute, which provided, among other things, that homeowners, under certain circumstances, were to be informed that they could employ attorneys to represent them in the closing of the purchase of their homes. The petition sought to certify a class of homeowners who purchased their homes subsequent to the filing of the Bankruptcy Case.

On January 18, 1995, counsel for the South Carolina homeowners filed in the Bankruptcy Case a Notice of Class Demand for Recoupment or, in the Alternative, Class Claim for Administrative Expense Priority and/or Class Claim for Setoff for an estimated amount in excess of $122 million. At the same time, counsel for the South Carolina homeowners also filed an objection to the Consensual Plan asserting that payment of the Administrative Claim would render the Consensual Plan not feasible.

Following extensive negotiations among counsel for the South Carolina homeowners, the Debtors and the various creditor committees and constituencies, a stipulation and settlement agreement (the "Homeowners Settlement Agreement") was entered into. After two noticed hearings, the Bankruptcy Court entered a preliminary order on February 28, 1995 and a final order on May 16, 1995 approving the Homeowners Settlement Agreement, as amended, and authorized the Debtors to take such action and to execute such documents as are necessary to consummate the agreement. On May 25, 1995, the South Carolina District Court held a Fairness Hearing and found that the proposed settlement as set forth in the Homeowners Settlement Agreement was fair, reasonable and adequate and in the best interests of the settlement class. The settlement, which related to the postpetition claims of the South Carolina homeowners, essentially provided for (i) a reduction in the mortgage notes covering the property owned by the homeowners in the aggregate principal amount of approximately $15.5 million (less the allocated portion of any class members who "opt out" of the class); (ii) cash disbursements of $1,000 each (with an aggregate cap of $300,000) to certain classes of former homeowners who no longer have mortgage balances; (iii) waiver of the first two months' mortgage payments after implementation of the settlement; and (iv) legal fees and expenses for the South Carolina homeowners' counsel in an amount as determined by the South Carolina District Court, but not to exceed $3 million. The South Carolina District Court in entering its order and final judgment on May 25, 1995, among other things, authorized and approved the consummation of the Homeowners Settlement Agreement in accordance with its terms and conditions, which included the release and satisfaction of all actions, claims and demands against the Company, its past and present directors, officers, employees, and others, including Jim Walter Homes and Mid-State (except claims for construction defects and claims for breach of express

written warranties made by Jim Walter Homes), and approved payment of fees, costs and expenses in the amount of $3 million to the homeowners' South Carolina counsel.

On February 28, 1995, Jim Walter Homes and Mid-State filed an adversary action for declaratory judgment against all South Carolina homeowners who purchased their homes between July 1, 1982 and December 27, 1989, and who might assert prepetition claims against Jim Walter Homes and Mid-State for alleged violation of the above mentioned South Carolina statute. The complaint seeks, among other things, a declaration that Jim Walter Homes and Mid-State did not violate the above mentioned South Carolina statute or, for other enumerated reasons, should not be responsible for any damages alleged to the South Carolina homeowners. The Debtors and homeowners have negotiated a proposed settlement with prospective counsel for the South Carolina prepetition claimants which will require a cash payment of approximately $3 million, which after application of these settlement proceeds to pay existing arrearages on the homeowners' mortgages, will result in a net cash outlay of approximately $1,050,000. In addition, legal fees of approximately $360,000 will be paid. The proposed settlement is subject to the Bankruptcy Court's approval upon submission of an appropriate motion.

Texas Litigation

Since May 1991, Jim Walter Homes and Mid-State, together with Trust II and certain other parties (collectively, the "Debtor/Mid-State Parties"), have been involved in various lawsuits, primarily in the Bankruptcy Court, with approximately 750 owners of houses constructed by Jim Walter Homes in south Texas. The homeowners seek damages based upon alleged construction defects, common law fraud, and violations of the Texas Deceptive Trade Practices Act, the Texas Consumer Credit Code, federal and state debt collections statutes and the Racketeering Influence Corruptions and Practices Act. Although Jim Walter Homes and Mid-State believe that the litigation is substantially without merit, a settlement agreement ("Settlement Agreement") has been reached with the attorney for the homeowner claimants. The anticipated settlement figure will be approximately $3,600,000 in account balance reductions (of which approximately $1,250,000 represents a principal reduction), plus an approximate aggregate of $27,500 cash to certain clients and $2,900,000 as attorney's fees (of which $900,000 may be deferred and payable over the next five years). The consummation of the Settlement Agreement is subject to various conditions, including approval by all of the parties thereto. It also contains provisions allowing claimants to "opt out" or not participate in the agreement and for the Debtor/Mid-State Parties to avoid the settlement in its entirety if, in their judgment, the number of claimants who opt out is so large as to make the settlement of little value. It also has a provision for the attorney for the homeowner claimants to indemnify and hold harmless Jim Walter Homes, Mid-State, Trust II, and the other parties, from any and all claims, demands, causes of actions, lawsuits and settlements by the homeowners. Further, it provides for the Bankruptcy Court to retain jurisdiction over any claims which are not resolved by the Settlement Agreement.

At a hearing in the Bankruptcy Court, held on June 27, 1995, on Debtors' Motion to Approve Compromise and Settlement Agreement, the Bankruptcy Court instructed the Debtors to prepare an Order to be sent to the creditors of the Company, providing that any objections to the settlement be filed with the Bankruptcy Court by July 12, 1995.

Suit by the Company and Jim Walter Resources, Inc. for Business Interruption Losses

On May 31, 1995 the Company and Jim Walter Resources, Inc. ("JWR") commenced a lawsuit in the Circuit Court for Tuscaloosa County, Alabama (Civil Action No. CV-95-625) against certain insurers claiming damages for loss from interruption of JWR's business resulting from a fire on or about November 17, 1993 in JWR's underground coal mine No. 5, which caused the mining of coal to become impossible because of blockage of corridors and passageways resulting from efforts to extinguish or control the fire. After JWR believed that it had taken the necessary steps to extinguish or control the fire, it resumed its longwall mining. JWR learned, however, that the intensity of the fire, which it believed to have been isolated and controlled, increased substantially, making it necessary to seal off portions of the mine and to lose permanently the corridors and passageways without which the longwall panel currently being mined could not be completed. JWR's longwall mining was interrupted until another longwall panel could be prepared. In addition to the mining of coal, JWR produced natural gas from wells drilled into the mine, production from which was lost because of the loss of the longwall panel. As a proximate consequence of the fire on

November 17, 1993, the Company and JWR claimed losses compensable under the business interruption coverage of the policies in excess of $25 million, for which judgment was demanded, together with interest and costs.

Additionally, the complaint is for a declaratory judgment concerning the insurers' contention that the risk which caused the loss was not insured because it was not fortuitous, but was spontaneous combustion known to occur in JWR's mines. Further, the insurers contend the Company failed to disclose the risk of loss from spontaneous combustion and that the policies are void or voidable because of such failure. Plaintiffs seek declaratory judgment in their favor on these contentions and that each defendant is liable to plaintiffs for its pro rata part of plaintiffs' business interruption loss.

The suit is in its initial stages, but the Company and JWR believe the claim is meritorious and intend to pursue it vigorously.

Litigation Related to Chapter 11 Distributions to Certain Holders of Subordinated Notes and/or Debentures

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 shares of Common Stock. Such elections (the "Subordinated Note Claim Election") were to be made on the ballots used for voting on the Creditors' Plan. A balloting agent was retained to receive and separately tabulate ballots cast on the Creditors' Plan and the Debtors' Fifth Amended Joint Plan of Reorganization (the "Company's Plan"). Voting on the Company's Plan and the Creditors' Plan took place during the period August 12, 1994 through September 23, 1994.

Subsequent to September 23, 1994, the balloting agent filed with the Bankruptcy Court two (2) separate voting certifications. The voting certification with respect to the Creditors' Plan not only set forth the voting results but also listed the names of subordinated bondholders who made the Subordinated Note Claim Election.

The Consensual Plan ultimately confirmed by the Bankruptcy Court (which technically constituted a modification of the Creditors' Plan), (a) kept in place the Subordinated Note Claim Election provisions and prior elections, (b) contained as Exhibit 8 a schedule prepared by the balloting agent which set forth the names of the subordinated bondholders who made the Subordinated Note Claim Election (the "Exhibit 8 Schedule"), and (c) contained a new election (the "Class U-4 Exchange Election") which provided that those subordinated bondholders who made the Subordinated Note Claim Election were eligible to make the Class U-4 Exchange Election whereby they could essentially "exchange" shares of Common Stock for new senior notes which Lehman Brothers Inc. was otherwise entitled to receive.

In February 1995, the balloting agent filed a voting certification with the Bankruptcy Court which listed those subordinated bondholders who made the Class U-4 Exchange Election (the "Exchange Election Schedule").

In preparing to make distributions to subordinated bondholders, it came to the attention of the Company that the Exhibit 8 Schedule and the Exchange Election Schedule were inaccurate. As a result, the Company reviewed all ballots that the balloting agent claimed to be in its possession and determined that discrepancies existed between the Exhibit 8 Schedule and Exchange Election Schedule and certain of the ballots cast by subordinated bondholders.

On or about April 5, 1995, the Company filed a motion with the Bankruptcy Court seeking to amend the Exhibit 8 Schedule and the Exchange Election Schedule. On April 28, 1995, an order reflecting the Bankruptcy Court's decision was entered (the "April 28 Order").

Four bondholders each filed a motion with the Bankruptcy Court seeking a stay of the April 28 Order pending appeal to the United States District Court in Tampa, Florida (the "District Court"). On May 10, 1995 the Bankruptcy Court denied each of the stay motions. Two of such bondholders then each filed emergency motions for a stay pending appeal with the District Court. On May 11, 1995 the District Court issued an order denying the emergency motions.

On May 14, 1995, one of such bondholders filed a petition for a writ of mandamus with the Eleventh Circuit Court of Appeals which was denied on May 15, 1995.

Appeals from the April 28 Order were filed with the District Court by six bondholders. The appeals raise similar issues and ultimately seek the same relief - reversal of the April 28 Order as it applies to appellants and the modification of the consideration that appellants are to be provided under the Consensual Plan, so that a portion of their distribution would be comprised of Qualified Securities, instead of Common Stock of the Company.

The Company has filed motions to consolidate the appeals and intends to file motions to dismiss as moot the appeals of the appellants. At this time the Company is unable to predict whether or not the appeals will be dismissed, or the ultimate outcome of such appeals.

Chapter 11 Adversary Proceeding Filed by Certain Holders of Series B & C Senior Notes

On June 15, 1995, certain holders of Series B & C Notes (the "Noteholders") commenced an adversary proceeding in the Bankruptcy Court against the Company, as Disbursing Agent, and its subsidiaries (the "Debtors") seeking payment of interest for the period from the Effective Date (March 17, 1995) until the date distribution was received by such Noteholders. The Debtors believe there is no merit to the complaint and intend to vigorously oppose the relief requested therein. Given the early stage of this proceeding, the Debtors cannot predict the ultimate outcome of the litigation.

Environmental Matters

A Company subsidiary, United States Pipe and Foundry Company ("U.S. Pipe"), was issued a revised New Jersey Pollutant Discharge Elimination System ("NJPDES") Permit in May 1991 relating to its facility in Burlington, New Jersey, authorizing the discharge of storm water runoff to the Delaware River. U.S. Pipe filed a timely appeal of the Permit to challenge certain effluent limitations. In July 1992, the New Jersey Department of Environmental Protection ("NJDEP") issued to U.S. Pipe an Administrative Order and Notice of Civil Administrative Penalty Assessment ("Order"), assessing a penalty in the amount of $545,000 for alleged failure to comply with the effluent limitations in the Permit. U.S. Pipe filed a timely appeal of the Order.

Extensive negotiations with the NJDEP were undertaken over the next three years. On May 16, 1995, U.S. Pipe entered into an Administrative Consent Order ("ACO") with NJDEP settling both the permit appeal and the penalty case. Under the ACO, U.S. Pipe will pay a civil penalty of $187,000 over a twelve-month period to resolve all outstanding alleged permit violations through the date of the ACO. In addition, U.S. Pipe will conduct studies of its Burlington facility and will design and build a storm water treatment system to improve the quality of storm water discharged to the Delaware River. During the time that U.S. Pipe conducts these activities, it will not be required to meet effluent limitations, but is obligated to monitor and report the quality of storm water discharges. By executing the ACO, U.S. Pipe withdraws its appeals of the Permit and the Order. The ACO is presently undergoing public review and comment; if no significant changes are made to the ACO as a result of public input, the agreement should be finalized in July.

The cost to construct the storm water treatment system required under the ACO has not yet been ascertained but is estimated by the engineers to range from $500,000 to $1,000,000. Work on this project is expected to take three years or more.

The Company is a party to a number of other lawsuits arising in the ordinary course of its business. 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 12 - 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. Total pension expense for the years ended May 31, 1995, 1994 and 1993, was $8.2 million, $9.7 million and $16.5 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 net pension costs for Company administered plans are as follows:

	For the years ended May 31,		
	1995	1994	1993
	(in thousands)		
Service cost-benefits earned during the period	$ 5,817	$ 5,334	$ 5,233
Interest cost on projected benefit obligation	16,174	16,333	15,634
Actual loss (return) on assets	4,304	(19,352)	(18,131)
Net amortization and deferral	(21,377)	3,145	3,174
Net pension costs	$ 4,918	$ 5,460	$ 5,910

The following table sets forth the funded status of Company administered plans:

	May 31, 1995 Plans in which		May 31, 1994 Plans in which	
	Assets exceed accumulated benefits	Accumulated benefits exceed assets	Assets exceed accumulated benefits	Accumulated benefits exceed assets
Actuarial present value of accumulated benefit obligations:				
Vested benefits	$ 134,589	$ 47,474	$ 133,348	$ 41,353
Non-vested benefits	5,849	1,207	5,599	1,604
	$ 140,438	$ 48,681	$ 138,947	$ 42,957
Plan assets at fair value, primarily stocks and bonds	$ 169,635	$ 31,023	$ 187,443	$ 27,012
Projected benefit obligations	169,984	49,681	166,386	42,957
Plan assets in excess of (less than) projected benefit obligations	(349)	(18,658)	21,057	(15,945)
Unamortized portion of transition (asset) obligation at June 1, 1986	(10,507)	4,785	(11,281)	5,002
Unrecognized net loss from actual experience different from that assumed	20,545	6,610	808	2,903
Prior service cost not recognized	696	2,269	836	2,487
Contribution to plans after measurement date	—	667	879	819
Prepaid (accrued) pension cost	10,385	(4,327)	12,299	(4,734)
Additional liability	—	(12,664)	—	(10,393)
Prepaid pension cost (pension liability) recognized in the balance sheet	$ 10,385	$(16,991)	$ 12,299	$(15,127)

The projected benefit obligations were determined using an assumed discount rate of 8% in fiscal 1995 and 1994 and, where applicable, an assumed 5% rate of increase in future compensation levels. The assumed long-term rate of return on plan assets is 8%.

Under the labor contract with the United Mine Workers of America, Jim Walter Resources 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 $48.7 million at May 31, 1995. However, although the net liability can be estimated, its components, the relative position of each employer with respect to actuarial present value of accumulated benefits and net assets available for benefits, are not available to the Company.

The Company adopted Statement of Financial Accounting Standards No. 106, "Employers'

Accounting for Postretirement Benefits Other Than Pensions" in fiscal 1993. Upon adoption, the Company elected to record the transition obligation of $166.4 million pre-tax ($104.6 million after tax) as a one-time charge against earnings, rather than amortize it over a longer period. This obligation is primarily related to the health benefits for eligible retirees. Postretirement benefit costs were $26.0 million in 1995, $25.6 million in 1994 and $23.5 million in 1993. Amounts paid for postretirement benefits were $7.5 million in 1995, $5.5 million in 1994 and $6.5 million in 1993.

The net periodic postretirement benefit cost includes the following components:

	For the years ended May 31,		
	1995	1994	1993
	(in thousands)		
Service cost	$ 8,491	$ 9,302	$ 8,495
Interest cost	17,470	16,283	14,979
Net periodic postretirement benefit cost	$ 25,961	$ 25,585	$ 23,474

The accumulated postretirement benefits obligation at May 31, 1995 and 1994 are as follows:

	May 31,	
	1995	1994
	(in thousands)	
Retirees	$ 92,550	$ 72,779
Fully eligible, active participants	30,129	26,234
Other active participants	111,084	122,228
Accumulated postretirement benefit obligation	233,763	221,241
Unrecognized net loss	(5,352)	(11,279)
Postretirement benefit liability recognized in the balance sheet	$ 228,411	$ 209,962

The principal assumptions used to measure the accumulated postretirement benefit obligation include a discount rate of 8% in fiscal 1995 and 1994 and a health care cost trend rate of 10% declining to 5.5% over a ten year period and remaining level thereafter in fiscal 1995 and a health care cost trend rate of 13% declining to 6% over an eleven year period in fiscal 1994. A one percent increase in trend rates would increase the accumulated postretirement benefit obligation by 17% and increase net periodic postretirement benefit cost for 1995 by 20%.

Certain subsidiaries of the Company maintain profit sharing plans. The total cost of these plans for the years ended May 31, 1995, 1994 and 1993 was $3.0 million, $3.1 million and $3.0 million, respectively.

NOTE 13 - 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 allowed 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. Furthermore, FAS 107 fair value disclosures do not purport to be the amount which could be attained in immediate settlement of the financial instrument. Fair value estimates are not necessarily more relevant than historical cost values and have limited usefulness in evaluating long-term assets and liabilities held in the ordinary course of business. Accordingly, 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 (including short-term investments) and short-term investments, restricted — The carrying amounts reported in the balance sheet approximates fair value.

Instalment notes receivable — The estimated fair value of instalment notes receivable at May 31, 1995 was in the range of $2.0 billion to $2.1 billion. The estimated fair value is based upon valuations prepared by an investment banking firm as of January 31, 1995 adjusted to reflect increases in value for the addition of net new mortgages to May 31, 1995. 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 debt at May 31, 1995 was $2.332 billion based on current yields for comparable debt issues or prices for actual transactions.

NOTE 14 - SEGMENT INFORMATION

Due to the divestiture of several building materials subsidiaries in recent years, the Company has restructured certain of its segment information. Prior years' information has been restated.

	For the years ended May 31,		
	1995	1994	1993
		(in thousands)	
Sales and Revenues:			
Homebuilding and related financing	$ 407,119	$ 424,530	$ 419,378
Industrial and other products	284,230	224,673	212,606
Water and waste water transmission products	412,237	357,189	331,214
Natural resources (e)	332,251	319,410	351,017
Corporate	6,485	2,722	4,771
Consolidated sales and revenues (a)(f)	$ 1,442,322	$ 1,328,524	$ 1,318,986
Contributions to Operating Income:			
Homebuilding and related financing	$ 76,525	$ 101,954	$ 88,902
Industrial and other products	11,902	13,851	11,301
Water and waste water transmission products	28,454	25,641	16,040
Natural resources	20,072	(1,175)	50,807
	136,953	140,271	167,050
Less-Unallocated corporate interest and other expense (b)	(666,048)	(104,179)	(96,128)
Income taxes	170,450	(28,917)	(24,328)
Income (loss) from operations (c)	$(358,645)	$ 7,175	$ 46,594
Depreciation, Depletion and Amortization:			
Homebuilding and related financing	$ 3,336	$ 3,093	$ 3,113
Industrial and other products	9,073	9,821	9,390
Water and waste water transmission products	16,520	16,063	15,764
Natural resources	41,434	40,326	40,714
Corporate	1,674	1,732	1,502
Total	$ 72,037	$ 71,035	$ 70,483
Gross Capital Expenditures:			
Homebuilding and related financing	$ 4,192	$ 3,210	$ 6,284
Industrial and other products	24,692	10,054	8,605
Water and waste water transmission products	15,538	14,426	12,821
Natural resources	46,214	40,224	42,941
Corporate	681	1,917	1,057
Total	$ 91,317	$ 69,831	$ 71,708
Identifiable Assets:			
Homebuilding and related financing	$ 1,789,582	$ 1,832,919	$ 1,907,199
Industrial and other products	213,836	173,618	171,672
Water and waste water transmission products	480,617	490,004	493,297
Natural resources	465,680	450,468	475,533
Corporate (d)	295,438	193,883	175,533
Total	$ 3,245,153	$ 3,140,892	$ 3,223,234

(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 the Industrial and Other Products Group to the Water and Waste Water Transmission Products Group of $13,373,000, $11,480,000 and $10,298,000 and sales of the Natural Resources Group to the Industrial and Other Products Group of $5,397,000, $5,650,000 and $7,121,000 in 1995, 1994 and 1993, respectively.

(b) Excludes interest expense incurred by the Homebuilding and Related Financing Group of $131,560,000, $128,828,000 and $137,945,000 in 1995, 1994 and 1993, respectively. The balance of unallocated expenses is attributable to all groups and cannot be reasonably allocated to specific groups.

(c) Includes postretirement health benefits of $25,961,000, $25,585,000 and $23,474,000 in 1995, 1994 and 1993. A breakdown by segment is as follows:

	For the years ended May 31,		
	1995	**1994**	**1993**
	(in thousands)		
Homebuilding and related financing	$ 2,295	$ 2,170	$ 1,991
Industrial and other products	3,610	3,662	3,284
Water and waste water transmission products	4,362	4,391	4,136
Natural resources	15,004	14,681	13,437
Corporate	690	681	626
Total	$ 25,961	$ 25,585	$ 23,474

(d) Primarily cash and corporate headquarters buildings and equipment.

(e) Includes sales of coal of $297,650,000, $289,279,000 and $321,834,000 in 1995, 1994 and 1993, respectively. Jim Walter Resources' coal supply contract with Alabama Power Company that had been in effect since January 1, 1979, as amended, was superceded by a new contract executed May 10, 1994. The new contract is effective from July 1, 1994 through August 31, 1999 with Jim Walter Resources' option to extend such contract through August 31, 2004, subject to mutual agreement on the market pricing mechanism and other terms and conditions of such extension. Sales to Alabama Power Company in the years ended May 31, 1995, 1994 and 1993 were 13%, 11% and 12% of net sales and revenues, respectively.

(f) Export sales, primarily coal, were $129,071,000, $155,966,000 and $183,188,000 in 1995, 1994 and 1993, respectively. Export sales to any single geographic area do not exceed 10% of consolidated net sales and revenues.

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.

Price Waterhouse 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 assuring 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 responsibilities in the area of financial control and reporting. 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 and the adequacy of internal accounting controls and the quality of financial reporting.

The management of your company recognizes its responsibility to conduct Walter Industries, Inc.'s business 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.

G. Robert Durham
President and
Chief Executive Officer

Kenneth J. Matlock
Executive Vice President and
Chief Financial Officer

William H. Weldon
Senior Vice President-Finance and
Chief Accounting Officer

CORPORATE DIRECTORY

OFFICERS

G. Robert Durham
President and
Chief Executive Officer

Frank A. Hult
Vice President and Controller

Donald M. Kurucz
Vice President and Treasurer

Kenneth J. Matlock
Executive Vice President and
Chief Financial Officer

Robert W. Michael
Senior Vice President and
Group Executive; President,
Jim Walter Homes, Inc.

William N. Temple
Senior Vice President and
Group Executive; President,
United States Pipe and Foundry
Company

David L. Townsend
Vice President-Human Resources
and Public Relations

John F. Turbiville
Vice President-Legal and Secretary

James W. Walter
Chairman

William H. Weldon
Senior Vice President-Finance and
Chief Accounting Officer

William Kendall Baker
Assistant Treasurer

Stephen H. Foxworth
Assistant Treasurer

Thomas G. Ketcham
Assistant Controller

S. Louise Russell
Assistant Secretary

Mary C. Snow
Assistant Secretary

Joseph W. Spransy
Assistant Secretary

DIRECTORS

Howard L. Clark, Jr. [2,3,6]
Vice Chairman,
Lehman Brothers, Inc.
New York, New York

G. Robert Durham
President and
Chief Executive Officer,
Walter Industries, Inc.
Tampa, Florida

James B. Farley [1,2,3,5,6]
Retired Chairman and
Chief Executive Officer,
Mutual of New York
New York, New York

Eliot M. Fried [1,2,3,6]
Managing Director,
Lehman Brothers, Inc.
New York, New York

James L. Johnson [1,3,4,5,6]
Chairman Emeritus,
GTE Corporation
Stamford, Connecticut

Kenneth J. Matlock
Executive Vice President and
Chief Financial Officer,
Walter Industries, Inc.
Tampa, Florida

Robert I. Shapiro [1,4,5]
Managing Director,
Lehman Brothers, Inc.
New York, New York

Michael T. Tokarz [1,2,3,4,6]
General Partner,
Kohlberg Kravis Roberts & Co.
New York, New York

James W. Walter [2]
Chairman,
Walter Industries, Inc.
Tampa, Florida

(1) Audit Committee
(2) Finance Committee
(3) Compensation Committee
(4) Environmental, Health and Safety Committee
(5) Tax Oversight Committee
(6) Nominating Committee

COMMON STOCK

Trading
Nasdaq OTC Bulletin Board,
pending listing on the
Nasdaq National Market
Trading Symbol: WLTR

Transfer Agent and Registrar
Harris Trust and Savings Bank
311 West Monroe
Chicago, Illinois 60690
(312) 461-4602

12.19% SERIES B SENIOR NOTES DUE 2000

Trading
National OTC

Trustee
United States Trust Company
of New York
114 West 47th Street
New York, New York 10036
(800) 548-6565

LEGAL COUNSEL

Shackleford, Farrior, Stallings & Evans, P.A.
501 E. Kennedy Blvd., Suite 1400
Tampa, Florida 33601

INDEPENDENT ACCOUNTANTS

Price Waterhouse LLP
400 North Ashley St., Suite 2800
Tampa, Florida 33601

ANNUAL MEETING

The Annual Meeting of Stockholders of Walter Industries will be held Tuesday, October 17, 1995 at 10 a.m. in the 12th floor auditorium of Citicorp Headquarters, 399 Park Avenue, New York, New York.

INVESTOR CONTACT

For further information about Walter Industries and its subsidiaries, please contact:
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