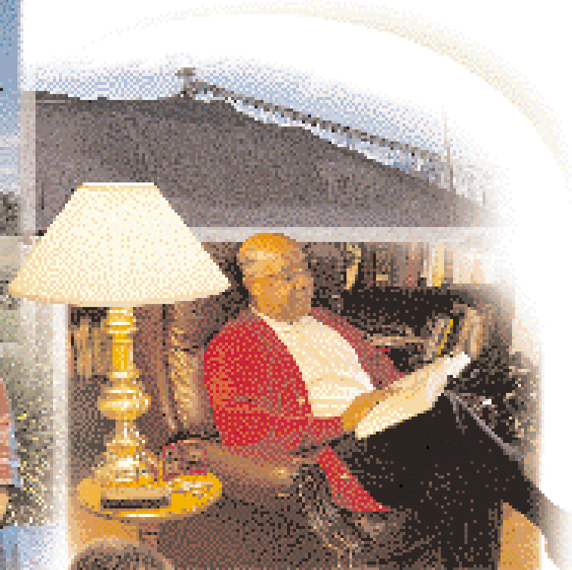
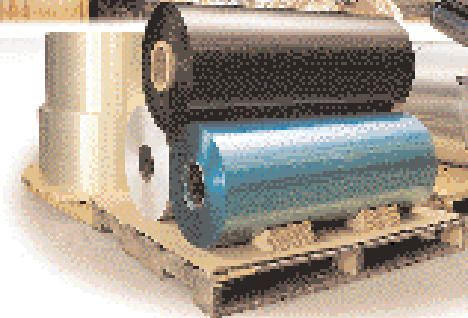
Walter Industries, Inc.





Reaching you where you live

ANNUAL REPORT 1996

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About The Cover:

A montage of images, carried throughout this report, illustrates the many ways that products from Walter Industries' core businesses provide essential services — such as shelter, water, and electricity — for families throughout America and parts of the world.

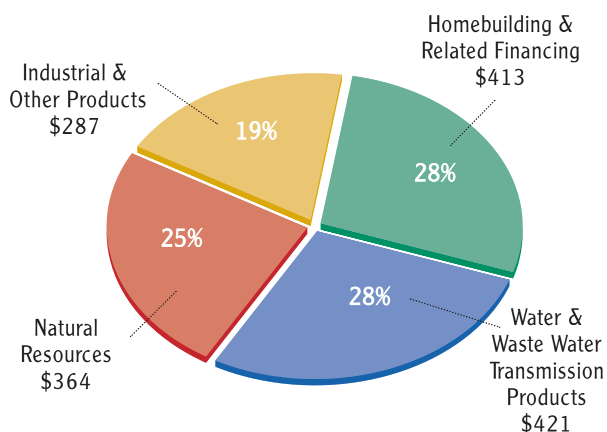
COMPANY PROFILE

Walter Industries, Inc. is a holding company whose four operating segments consist of homebuilding and related financing, water and waste water transmission products, natural resources, and industrial and other products. The Company's strategy is to focus on businesses that have strong competitive positions based on highly specialized operations and provide a balanced, diversified and complementary mix of revenues and profits. The Company was founded in 1946. The common stock of Walter Industries is traded on the Nasdaq National Market under the symbol "WLTR."

OPERATING GROUP RESULTS — FISCAL 1996

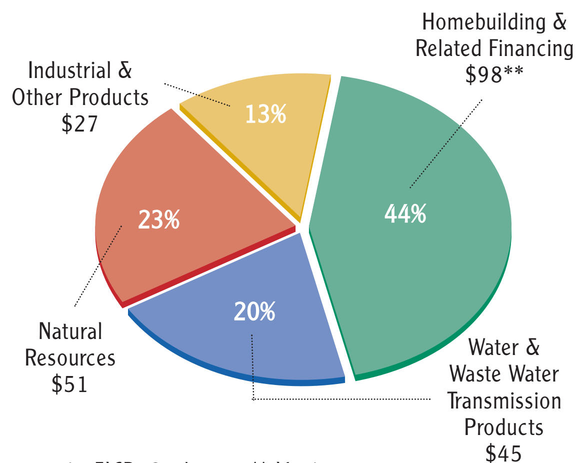
SALES AND REVENUES

($ in millions)



EBITDA*

($ in millions)



* Earnings Before Interest, Taxes, Depreciation & Amortization, and non-recurring FASB 121 charges ** After interest expense

TO OUR SHAREHOLDERS

In fiscal 1996, our first full year following reorganization, Walter Industries made significant progress in transitioning from a private to a publicly held company. Among our key accomplishments was the completion of a management succession that has put in place a new executive team to guide our future direction. We also refinanced high cost senior debt associated with the reorganization, providing substantial savings and strengthening our balance sheet. With these corporate actions, along with ongoing initiatives at the operating subsidiary level, we are positioning the Company for profitable growth.

We enter 1997 fully committed to renewing the entrepreneurial spirit and earnings momentum that characterized our Company over much of its 50-year history. Our long-term success will be built upon the strengths of the core businesses comprising our principal operating areas — homebuilding and related financing, natural resources, pipe and other industrial products. Each of these businesses enjoys a leadership role in its served markets. Furthermore, each has developed important competitive advantages, either by becoming a low-cost producer or by creating a proprietary position in a specialized market. Together, they give Walter Industries a breadth of opportunities and a balanced revenue and profit mix.

Operating and Financial Review

Financial results improved modestly for fiscal 1996 despite difficulties encountered with a fire in Jim Walter Resources' No. 5 mine, the cost of debt restructuring, and a one-time, non-cash charge for early adoption of a new accounting standard. Net sales and revenues were $1.49 billion, compared with $1.44 billion in fiscal 1995. Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) for the recent year increased to $330.9 million, from $322.3 million in fiscal 1995. It has been our practice since emerging from Chapter 11 to emphasize earnings on the basis of EBITDA to reflect the Company's operating performance before interest costs, goodwill amortization and non-recurring charges.

Our recent results included moderate progress in our Homebuilding and Related Financing segment and more significant gains in the Industrial and Other Products segment, primarily from our aluminum operations. These factors were partially offset by the fire at Mine No. 5 and various other geological problems that affected the third quarter for our Natural Resources group. Natural Resources rebounded in the fourth quarter, as did the Company as a whole, posting a 9% gain in EBITDA for the quarter.

Fiscal 1996 results included a pre-tax charge of $143.3 million ($101.1 million after tax) from adoption of Statement of Financial Accounting Standards No. 121 - "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" (FASB 121), mainly related to our coal operation. The past year's results also included an extraordinary after-tax charge of $5.4 million, or $0.10 per share, due to early repayment of 12.19% Senior Notes Due 2000 and replacement of a $150 million bank credit facility.

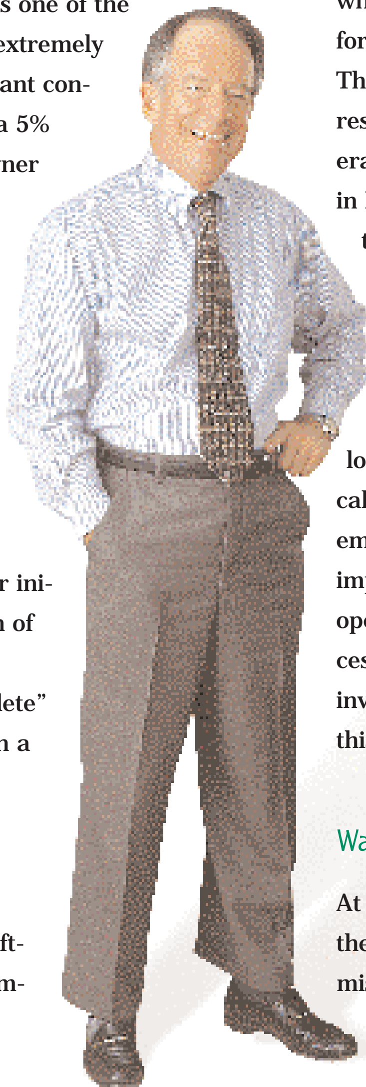
Elimination of the costly senior debt was a top priority for management last year. At the end of fiscal 1996, long-term debt, excluding funding for our home financing operations, stood at $419 million, down from $494 million a year earlier. Interest expense, which was $208.7 million for 1996, should decline sharply in fiscal 1997 as a result of our refinancing. We expect annualized interest savings of approximately $25 million, or $0.28 per share.

Continuing our practice of investing in the growth of our businesses, capital expenditures were approximately $84 million in fiscal 1996, versus $91 million for 1995. During the past five years, the Company's capital expenditures totaled some $385 million. We are proud of the fact that, even during the Company's period of bankruptcy reorganization, we invested aggressively in our future.

Homebuilding and Related Financing

Our homebuilding and related financing and insurance operations accounted for approximately 28% of total company net sales and revenues in 1996. Jim Walter Homes will celebrate its 50th anniversary in fiscal 1997, and since its inception has built more than 320,000 homes. We provide conventionally built (non-modular), partially finished homes with flexible completion options and attractive purchase price/financing packages targeted toward moderate income buyers. At year-end, Jim Walter Homes' backlog stood at 1,957 units, up 28% from the prior year. Our progress gives us confidence that we can restore our annual completions to a 5,000 unit level, from 3,760 in fiscal 1996. This level would enable us to enhance the use of our existing infrastructure of sales and servicing resources and building contractors, leading to greater profitability.

We view our mortgage portfolio as one of the finest in the industry, both as an extremely secure, sound asset and a significant contributor to our earnings. Despite a 5% decline in the number of homeowner accounts in the mortgage portfolio in fiscal 1996, primarily a result of heavy prepayment activity, the gross value held steady at $4.2 billion. This reflected an increase in the average balance per account, which offset the reduction in the number of accounts.



To support future growth, a major initiative last year was the reduction of our financing rate to 8.5% from a previous 10% for our "90% complete" homes. We began this program on a trial basis in December 1995 and advertised it nationally in March 1996. The result is that unit sales and average selling prices have increased, as our product mix shifted sharply in favor of the 90% complete option. In addition, we are selectively adding model display parks in promising new markets, refining our product offerings to provide a number of updated models, expanding the range of interior decor options, and investing in technology to improve the efficiency of our homebuilding and sales operations. Longer term, we will explore new financial service opportunities that would complement and build upon our expertise as servicer to more than 70,000 mortgage accounts. An important factor in our growth will be the commitment of Jim Walter Homes' employees, who have as a primary objective the goal of 100% customer satisfaction with each home we build and finance.

Natural Resources

Jim Walter Resources mines and sells Blue Creek coal, whose special properties make it extremely desirable for the power-generation and steel-making industries. This company also develops valuable methane gas reserves and has extensive operations in land and mineral resource management. Despite the fire experienced in Mine No. 5 last year, we took several actions to continue to build the value of this operation.

In the aftermath of the fire, which was confined to the mine's western side, we moved to accelerate development of a longwall mining area on the mine's east side. This should ensure a resumption of lower cost production early in the fourth quarter of fiscal 1997. At the same time, vigorous involvement by all employees will enable us to obtain further cost improvements in our mining process and maximize operating efficiency. We also are intensifying our successful methane gas production activities, and plan to invest $13 million during the next two years to expand this very profitable facet of our business.

Water and Waste Water Transmission Products

At U.S. Pipe, our focus is on cost-effectively producing the dominant product for water and waste water transmission — ductile iron pressure pipe. Operating results of this company declined slightly in fiscal 1996, pri-

marily as a result of last winter's unusually severe weather, unfavorable pricing for raw materials, and a slowdown in infrastructure spending because of the federal budget impasse. We continue to anticipate substantial demand from infrastructure replacement and new construction markets. Management is committed to capitalizing on U.S. Pipe's position as a national leader in the water and waste water transmission industry, and to building on its technological strength and ability to compete on a low-cost basis.

Industrial and Other Products

In this diverse group of industrial operations, our strategy has been to develop niches that focus our businesses on areas that can deliver high margins and solid growth, rather than the realm of commodity products. We continue to see opportunities to build on our emerging "winners," such as the specialty chemicals business of Sloss Industries. Similarly, we will expand the capacity of our JW Aluminum operation to meet the growing demand for value-added products—such as fin stock, cable wrap, and lithoprinting materials—through additional capital investment.

Management Strength

The management transition begun in 1995 was successfully completed in the current year. G. Robert Durham, Chairman and CEO, who very ably served Walter Industries through a difficult and trying five-year period, took a well-deserved retirement in May. James W. Walter, founder and Chairman for nearly 50 years, retired in October 1995, but remains Chairman Emeritus. Kenneth J. Matlock, Chief Financial Officer for 21 years, retired in December 1995.

In May, Richard E. Almy was elected Executive Vice President-Chief Operating Officer. He previously served as President of JW Aluminum, as well as interim president of JW Window Components. Dean M. Fjelstul was elected Senior Vice President-Finance, having previously served in various senior financial capacities at Honeywell and a public spin-off of that company, Alliant Techsystems. In January, Edward A. Porter joined the Company as Vice President-General Counsel and Secretary after serving for more than 15 years with National Gypsum Company. We are confident that each of these individuals will make important contributions to the future growth of Walter Industries.

Outlook

The mandate for all management at the corporate and subsidiary level is to develop more fully the competitive advantages of our businesses, thus increasing returns on invested capital and ensuring sustainable, profitable growth throughout our Company. We are taking important steps to foster the quality environment necessary to fulfill this mandate, including the implementation of incentives in the form of stock ownership and direct compensation to reward improved performance. With a solid, incentivized management team, a strong portfolio of businesses in profitable market niches, and a sound operational footing, Walter Industries is beginning to progress toward its key objective of generating long-term profitability and increasing the value of your investment.

Sincerely,

Kenneth E. Hyatt

Chairman, President and Chief Executive Officer

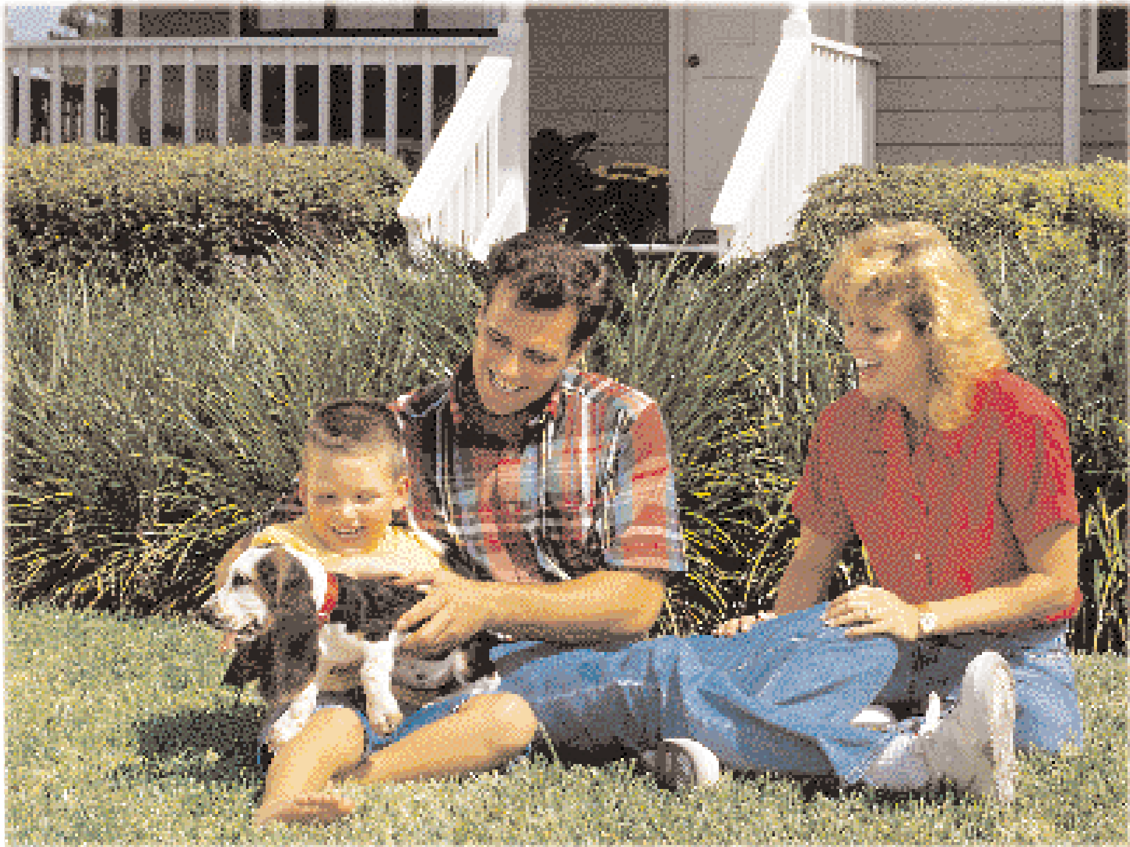
Homebuilding And Related Financing

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



Reaching you where you live

JIM WALTER HOMES

For 50 years, Jim Walter Homes has provided an affordable solution for moderate income families who want a home of their own. Today, we are the nation's leading "on-your-lot" homebuilder and the eighth largest builder of single-family, detached homes overall. Jim Walter Homes offers more than 30 models, built on-site to various stages of completion, and also provides full mortgage financing services.

Sales and Revenues
($ in millions)

Year	Amount
1996	$413.1
1995	$407.1

EBITDA*
($ in millions)

Year	Amount
1996	$97.8
1995	$79.9

* After interest expense

Few homebuilders can claim to have built homes for two generations of families. Jim Walter Homes has sold homes to *third* generation customers. Since 1946, the Company has built more than 320,000 homes and ranks as the nation's largest on-your-lot builder as well as the eighth largest U.S. homebuilder of single-family, detached homes overall. The concept has been an enduring one: helping moderate income families achieve their dream of owning a home by providing high quality, conventionally built homes, ranging up to 90% of completion. The customer provides the land, utility connections, landscaping, and a portion of the interior finishing. Jim Walter Homes also provides no-down payment, no-point, no-closing cost financing for almost all of its buyers.

Entering its 50th year, Jim Walter Homes continues to expand its geographic market base by opening model display parks in carefully selected locations, such as Indianapolis, Indiana (above).

Quality Homes, Affordable Financing

The keys to Jim Walter Homes' successful 50-year track record are the quality of its housing and the affordability of its home sales package. Many of today's value-priced homes are built on a factory floor, often in modular pieces to be assembled later on the lot. Jim Walter Homes maintains a commitment to building from the ground up: pouring footers, using the same high-quality lumber found in much more expensive homes, and maintaining specifications that often exceed prevailing building codes. Working with assigned customer service representatives, buyers inspect and approve all work at several stages in the building process.

Financing: A Key To Success

The financing offered by Jim Walter Homes is a key component of the group's overall success as well as an important competitive advantage. Walter Industries also offers homebuyers fire and extended coverage insurance through its Best Insurors insurance agency. Cardem reinsures a portion of this insurance.

Mid-State's operations consist of the purchase and securitization of mortgage notes generated by Jim Walter Homes from sales to its homebuying

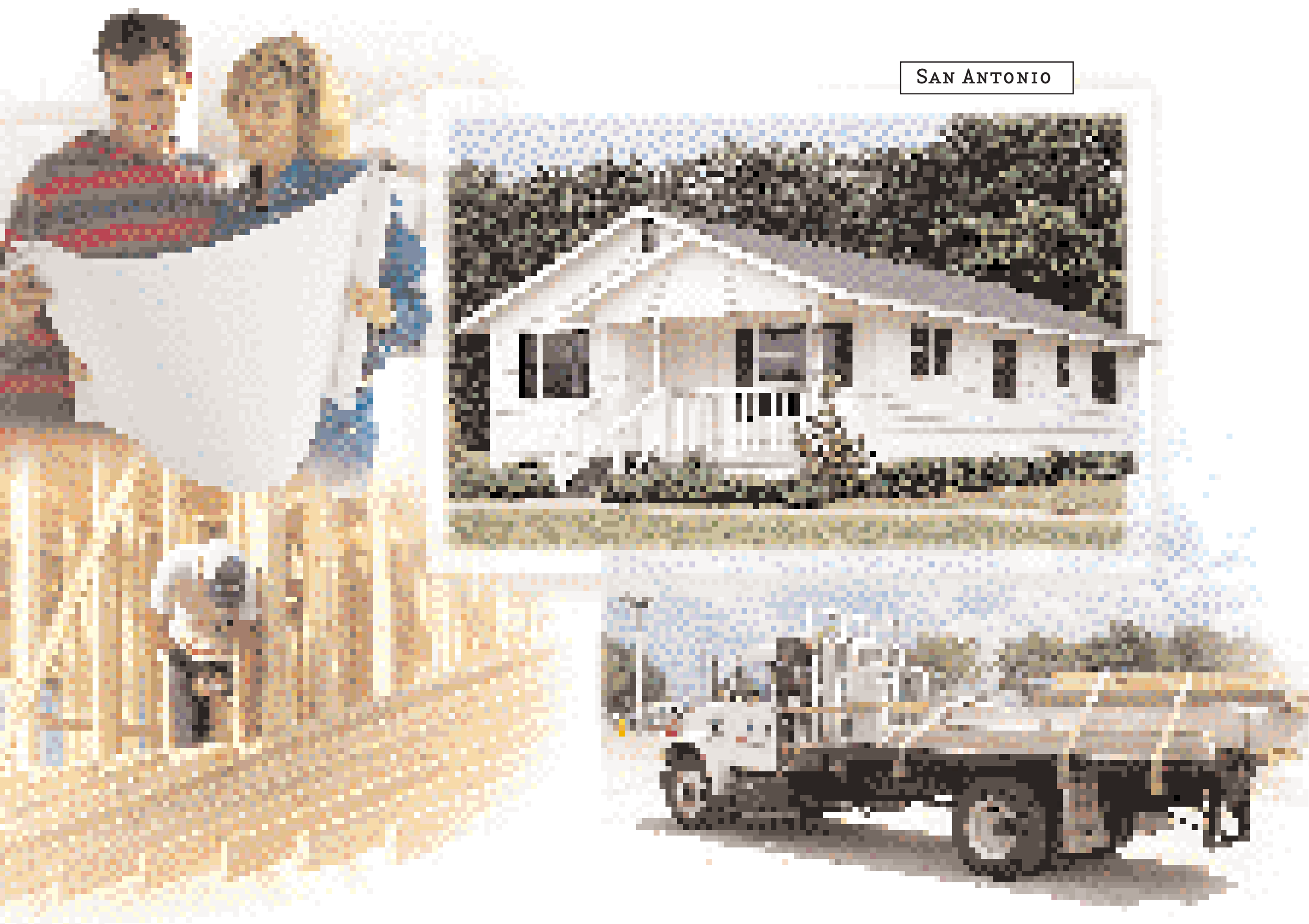
- Since 1946, Jim Walter Homes has built more than 320,000 homes, serving some families for two, and even three, generations.
- Using quality building products and meeting or exceeding all applicable building codes, Jim Walter Homes provides traditionally built homes constructed on-site from the ground up, which means lasting value not common in factory-built alternatives.
- Sales efforts reach a broad segment of the Sunbelt and southern portions of the Midwest, with more than 100 Jim Walter Homes model display parks and sales offices in 24 states.

customers, as well as management of a servicing portfolio in excess of $4.2 billion.

Jim Walter Homes offers customers an affordable, fixed-rate mortgage with no add-on costs. Competing builders in Jim Walter's market segment typically contract with local financial institutions, whose arrangements almost always include such charges as points, closing costs, and mortgage insurance that place added financial burden on the customer. At Jim Walter Homes, down payments are unnecessary since the buyer has already made an important financial commitment in the form of owning the property on which the home is to be built. Additionally, the Company adheres to a low risk strategy focusing on stringent credit quality standards — roughly one-third of initial applications are rejected and delinquencies are steady at less than 5%. Thus, Jim Walter Homes can offer an "all-in" financing cost that makes its financing attractive over a long term. This is notable in light of the fact that Jim Walter customers typically remain in their homes well beyond the national average.

Market Expansion Opportunities

Jim Walter Homes continues to selectively expand its market presence to new areas that fit its customer demographic profile. Its homebuyers typically live in rural areas and the suburbs of smaller cities, earning an average family income in the low $30,000 range. Jim Walter Homes reaches this customer segment through more than 100 model display parks serving 24 states throughout the Sunbelt and southern portions of the Midwest. New model parks, which contain up to six models representative of the Company's 30-plus model product range, have recently opened in Indianapolis, and, soon, Cincinnati. Other new markets under consideration include Wheeling, WV; Dayton, OH; Harrisburg, PA; and Wichita, KS.



In furthering its efforts to make the Jim Walter option more attractive to prospective customers, the Company is also looking inward. A key goal is to identify potential improvements to the sales process. This includes significantly shortening document processing procedures through improved automation and electronic linkage of the headquarters operation with sales offices and model parks across the Company's market area. Additionally, as part of its ongoing program to update its home models, Jim Walter Homes has begun selectively adding kitchen and bath amenities and decor options.

Performance and Outlook

The combined homebuilding and related financing group posted fiscal 1996 net sales and revenues of $413.1 million, versus $407.1 million one year ago. EBITDA (after interest expense) totaled $97.8 million, compared to $79.9 million in fiscal 1995.

Jim Walter Homes completed 3,760 units in fiscal 1996, down from 4,126 a year ago; however, strategic initiatives implemented during the year led to strengthening sales trends heading into fiscal 1997. The primary initiative was a reduction in the Company's financing rate, usually fixed at 10% for up to 30 years, to 8.5% for buyers of homes built to our most finished stage. Such homes now comprise 90% of completed units. The reduced rate helped drive a 7% increase in average selling price in the fiscal fourth quarter over the prior year, as customers took advantage of the interest savings to purchase larger homes with more finishing options, and moved Jim Walter Homes closer to its targeted run rate of 5,000 home completions per year. Entering fiscal 1997, the Company's backlog of confirmed orders was 1,957 homes, a 28% increase over the 1,529 homes in backlog entering fiscal 1996.

Water and Waste Water Transmission Products

U.S. PIPE
Ductile iron pressure pipe; valves, hydrants and fittings
Gray and ductile iron castings

Reaching you where you live

U.S. PIPE

To ensure a steady supply of water to and from our homes, America's cities and towns must invest heavily in infrastructure projects. For such a major expenditure, choosing a high-performance, long-lasting pipe is critical. United States Pipe and Foundry Company is the nation's largest manufacturer of ductile iron pressure pipe, long recognized as the most durable, reliable material for water and waste water transmission. U. S. Pipe produces the industry's most complete line of pipe, as well as a broad range of complementary fittings, valves and hydrants.

Sales and Revenues
($ in millions)

Year	Value
1996	$421.4
1995	$412.2

EBITDA
($ in millions)

Year	Value
1996	$44.8
1995	$45.0

Beneath the streets, sidewalks and yards of every neighborhood in America, the water we use is transported through vast networks of pipe. Many of those networks have been furnished by the nearly 100-year old United States Pipe and Foundry Company, Walter Industries' largest industrial subsidiary and the nation's leading producer of ductile iron pressure pipe.

In 1899, 14 different cast iron pipe foundries around the United States banded together to form what is today U.S. Pipe. The Company's products are as durable as the ductile iron from which they are made. Time and again, ductile iron proves its functionality and reliability versus concrete, steel, and newer pipe materials such as PVC and thermoplastics. Today, in an era when many American cities and municipalities must undertake replacement and improvement of aging infrastructure systems, ductile iron pipe is increasingly — and appropriately — recognized as the most effective long-term solution for water and waste water transmission.

Broad Product Range; Reputation For Innovation

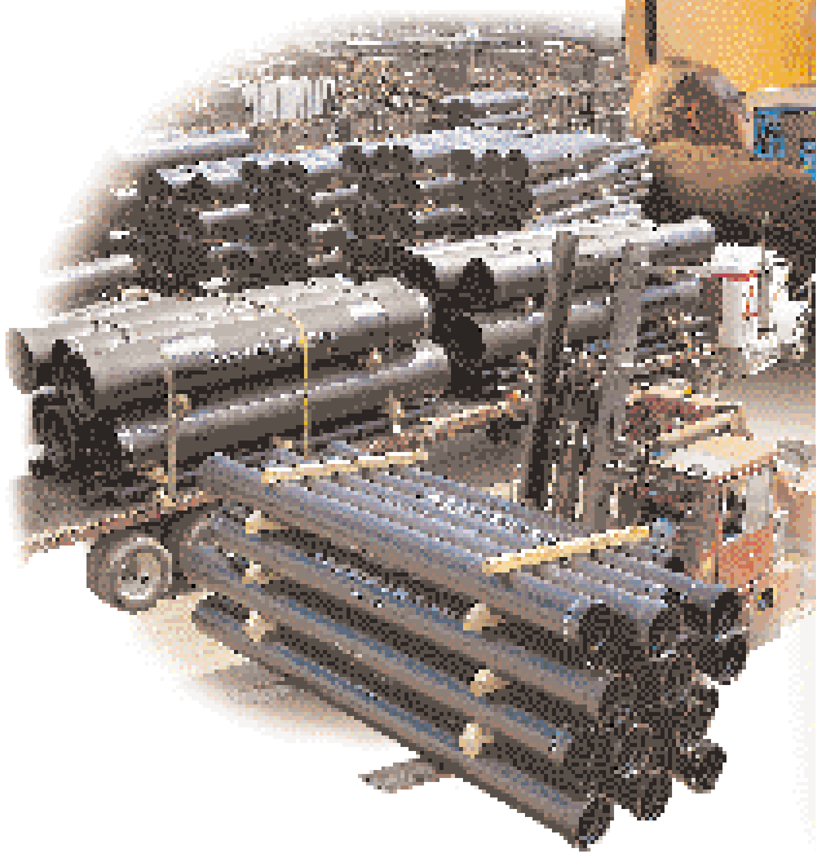
No other company offers as broad a product range or as solid a reputation for continued innovation and leadership. U.S. Pipe produces ductile iron pressure pipe in a complete range of diameters, from 4" to 64", and equivalent metric sizes at four plants. It also manufactures a complete line of complementary fittings, valves and hydrants at a fifth facility. In addition to these pressure pipe products, which comprise about 97% of sales, the Company also operates a castings division that produces gray and ductile iron castings primarily for the capital goods industry. The Company's Technical Services group has been instrumental in engineering industry-leading products such as the TR Flex® restrained joint and Metroseal® Resilient Seated gate valve. U.S. Pipe is also recognized as a market leader in specialty coating and lining technology.

U.S. Pipe conducts sales from 36 offices nationwide, reaching into every major city and hundreds of smaller municipalities. The Company also directs its international sales effort from its headquarters in Birmingham, Alabama. International markets currently contribute approximately 5% of U.S. Pipe's sales, but aggressive marketing efforts are under way as infrastructure

As part of "The Big Dig", a $10 billion public works project targeted for completion in 2004, the city of Boston, Massachusetts utilized U.S. Pipe's broad range of pipe sizes and complementary fittings when relocating a major saltwater cooling system.

- United States Pipe and Foundry Company supplies pipe to more than 2,000 customers in all 50 states and the District of Columbia.
- A break in a 94-year old water main in New York City in April 1996 caused millions of dollars in property damage, interrupted services, and snarled traffic for days. To ensure a long-term fix for this critical part of Manhattan's water system, the City turned to U.S. Pipe.
- U.S. Pipe's ductile iron pressure pipe provides the lowest total cost solution for potable and waste water transmission systems over a project's lifespan.

UNITED STATES PIPE AND FOUNDRY COMPANY



spending increases in certain overseas markets. The strongest export opportunities for the Company are in nearby markets such as South America and the Caribbean, where demand is strengthening and the cost of overseas transport of ductile iron pipe is more favorable.

A Well-Connected Company

In pursuing market opportunities, U.S. Pipe capitalizes on strong, multi-tiered industry connections. Sales channels are divided primarily among municipalities, through sealed bids (approximately 20%), water works distributors (30%) and contractors (50%). In addition to making final sales to these groups, the Company must first "sell itself" to engineers, who are often retained by governments to develop project specifications and recommend manufacturers of suitable materials. Municipalities and private water companies, for example, face stringent requirements with regard to durability, maximum flow capacity, stress resistance and maintenance of water quality. U.S. Pipe works closely with leading engineering firms on appropriate design configurations and is very well-positioned among all of the key decision-making constituencies in the purchase of pipe.

U.S. Pipe is focusing on improving its operations. The Company is already regarded as one of the lowest-cost producers in the business, but still has substantial efficiency opportunities. The pipe industry is very mature and has naturally high barriers to entry. As a result, no new pipe foundries have been built in the United States in more than 30 years. U.S. Pipe makes selective capital investments and is striving to achieve continuous process improvement through such means as the addition of computerized process controls throughout its plants and the evaluation of an innovative inventory tracking system that would ultimately lead to barcoding of pipe and fittings through the production process.

Performance and Outlook

In fiscal 1996, U.S. Pipe reported revenues of $421.4 million, versus $412.2 million in the prior year. EBITDA totaled $44.8 million in fiscal 1996 and $45.0 million in fiscal 1995. The Company's shipments decreased 1% to 542,000 tons, from 548,000 tons in 1995. Performance for the year was adversely affected by higher costs for scrap iron and alloys (the principal raw materials in ductile iron pipe) and difficult market conditions in the second half of the fiscal year. The lengthy disagreement over the federal budget, combined with unusually harsh winter weather conditions in much of the country, restrained infrastructure and private sector spending.

There are good indications that demand for pipe is increasing, and U.S. Pipe's earnings power has historically shown considerable strength in rising economic cycles. Available estimates target purchases of pipe reaching 9.2 billion feet by the end of the century, from the estimated 7.7 billion feet projected for 1996. The potable water market, which accounts for about 45% of all pipe sold in the United States, should continue to drive growth.

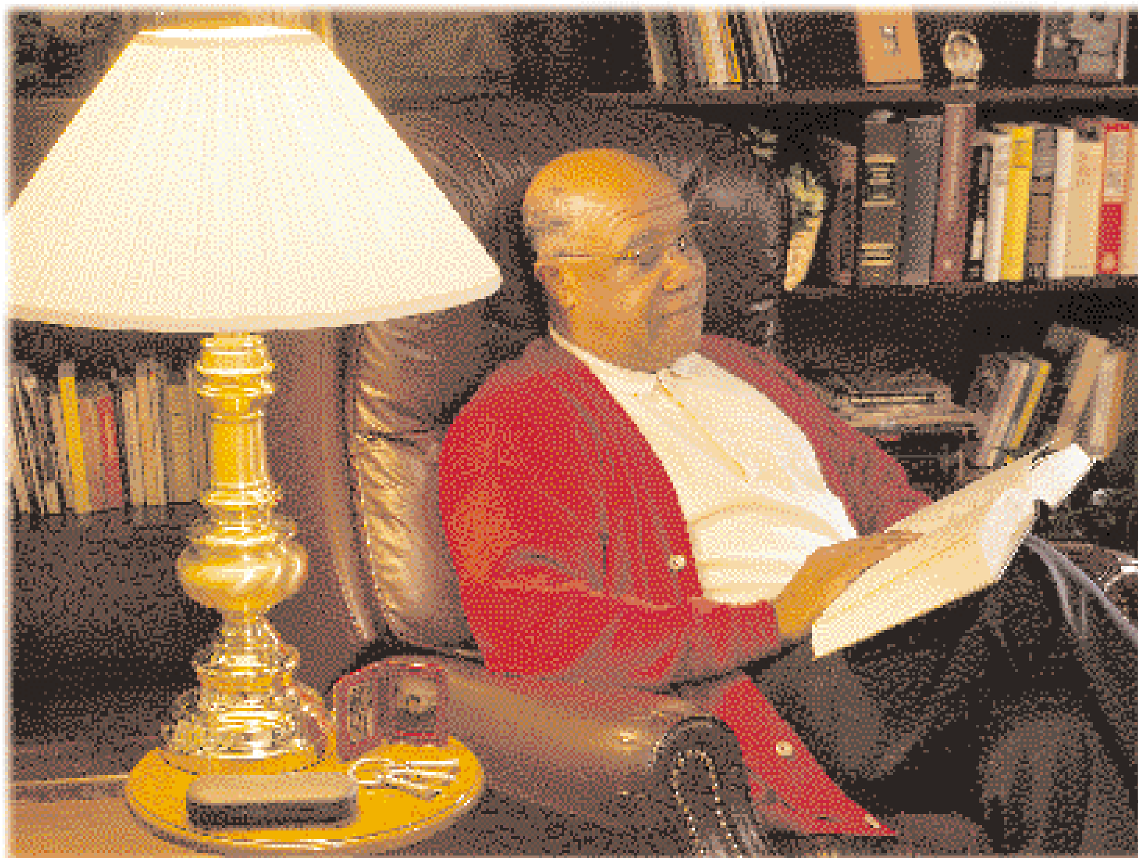
Ductile iron pipe is expected to be a major contributor to the overall shipment increases in the next several years. Although 4"-12" diameter pipe is currently the highest volume segment, faster growth is expected in the larger 16"- 42" sizes as older U.S. cities finally make up for delayed upgrades to their water and waste water transmission infrastructures. U.S. Pipe is one of only two ductile iron pipe producers at the upper end of this size range. Water mains in many Eastern cities, for example, can be as old as 100 years, and well-publicized failures in cities such as New York are becoming more frequent. Ductile iron is viewed as clearly the best material for water transport systems. Systems using ductile iron pipe are designed to take advantage of its superior properties.

In addition to the fact that the infrastructure market is overdue for growth, new residential construction by most estimates will continue to rise in coming years. In both markets, governments and developers are becoming convinced of what engineers, contractors, and U.S. Pipe have known for years: No other pipe material offers the strength and durability of ductile iron. Although initially more costly than PVC and other materials, the total cost of a ductile iron system — when length of life and installation conditions are considered — is ultimately the lowest available. U.S. Pipe's breadth of products, history of technological innovation and superior customer service make it the supplier of choice.

Natural Resources

JIM WALTER RESOURCES
Metallurgical and steam coal, methane gas production

UNITED LAND
Coal, timber, oil and gas royalties, land sales



Reaching you where you live

JIM WALTER RESOURCES

Though the consumer may never notice the difference, energy producers today are challenged to use cleaner, more efficient fuel sources. With its low sulfur, high BTU qualities, Blue Creek coal produced by Jim Walter Resources offers these advantages and is much in demand by the electric utility and steel-making industries. JWR is also known for its advanced longwall mining technology and an innovative methane gas recovery operation.

Sales and Revenues ($ in millions)

Year	Amount
1996	$364.1
1995	$332.3

EBITDA ($ in millions)

Year	Amount
1996	$51.2
1995	$61.5

From as deep as 2,200 feet beneath the Earth's surface, near Birmingham, Alabama, Jim Walter Resources (JWR) extracts high quality coal from the Blue Creek seam. Blue Creek coal is widely recognized for its characteristic low sulfur content, strong coking properties, and high BTU value. These properties are essential to two major industrial market segments — energy, for use in steam generation, and metallurgy, for steel-making — leading to strong demand for JWR's coal in both domestic and international markets. As a result, the Company has consistently been able to obtain multi-year contracts for a significant proportion of its volume, which totaled 7.9 million tons in fiscal 1996.

Jim Walter Resources' coal mines are among the deepest in North America, at 1,500 to 2,200 feet, versus 100 to 500 feet in depth for a typical strip or underground mine. Confronting the challenge of producing coal from deep, hard-to-reach mines, JWR has been a leading proponent of longwall mining technology. In the longwall method, a coal panel approximately 900 feet wide and 6,000 feet long is developed and then mined using self-contained equipment that both extracts the coal and provides roof support. This advanced approach is highly productive, as well as being better suited to the roof pressures and air circulation conditions resulting from the mines' great depth. The Company uses the standard continuous mining method to develop longwall panels, and this coal contributes approximately 25% of annual production.

The superior characteristics of JWR's Blue Creek reserves are highly desirable to industries searching for coal with low sulfur, high heat values or strong coking properties.

Unique Product, Unequaled Opportunities

While the unusual geology of Alabama's Warrior Basin creates mining challenges, it has also provided JWR with market opportunities. Not only is Blue Creek coal noted for its desirable metallurgical and thermal properties, but, with nearly 220 million tons of recoverable reserves, the Company can assure customers a stable supply over the long term. This has attracted customers in such diverse markets as the United States, Europe, Latin America and Asia to become regular users of JWR's coal. In fiscal 1996, approximately four million tons, or some 50% of annual production, was sold for use in the power generation market, with the remaining 3.9 million tons used for steel-making.

- More than 1.2 million households in Alabama draw their electricity from Alabama Power, which has a long-standing contract to purchase JWR's clean burning Blue Creek coal for its power-generation needs.
- Steelmakers in Argentina, Belgium, Brazil, France, Germany, Japan, Mexico, Turkey, the United Kingdom and the United States rely on the favorable coking properties of JWR's coal.
- The area covered by JWR's four coal mines and related natural resources operations covers 122 square miles of central Alabama.

The Company's longstanding relationship with one important customer, Alabama Power, is especially noteworthy. Alabama Power has been a customer for JWR's coal since the mid-1970s, and its current supply contract runs through 1999. As more rigorous acid rain regulations take effect after the year 2000, the low-sulfur content of Blue Creek coal should increase demand by existing and potential power-generating customers.

With worldwide recognition of the qualities of Blue Creek coal, JWR has found strong demand for its production. The Company has developed an operating strategy designed to fully exploit its valuable mining assets by producing the maximum tonnage that is economically feasible in a given year, and then basing its marketing strategy on developing a broad base of customers for a given level of production.

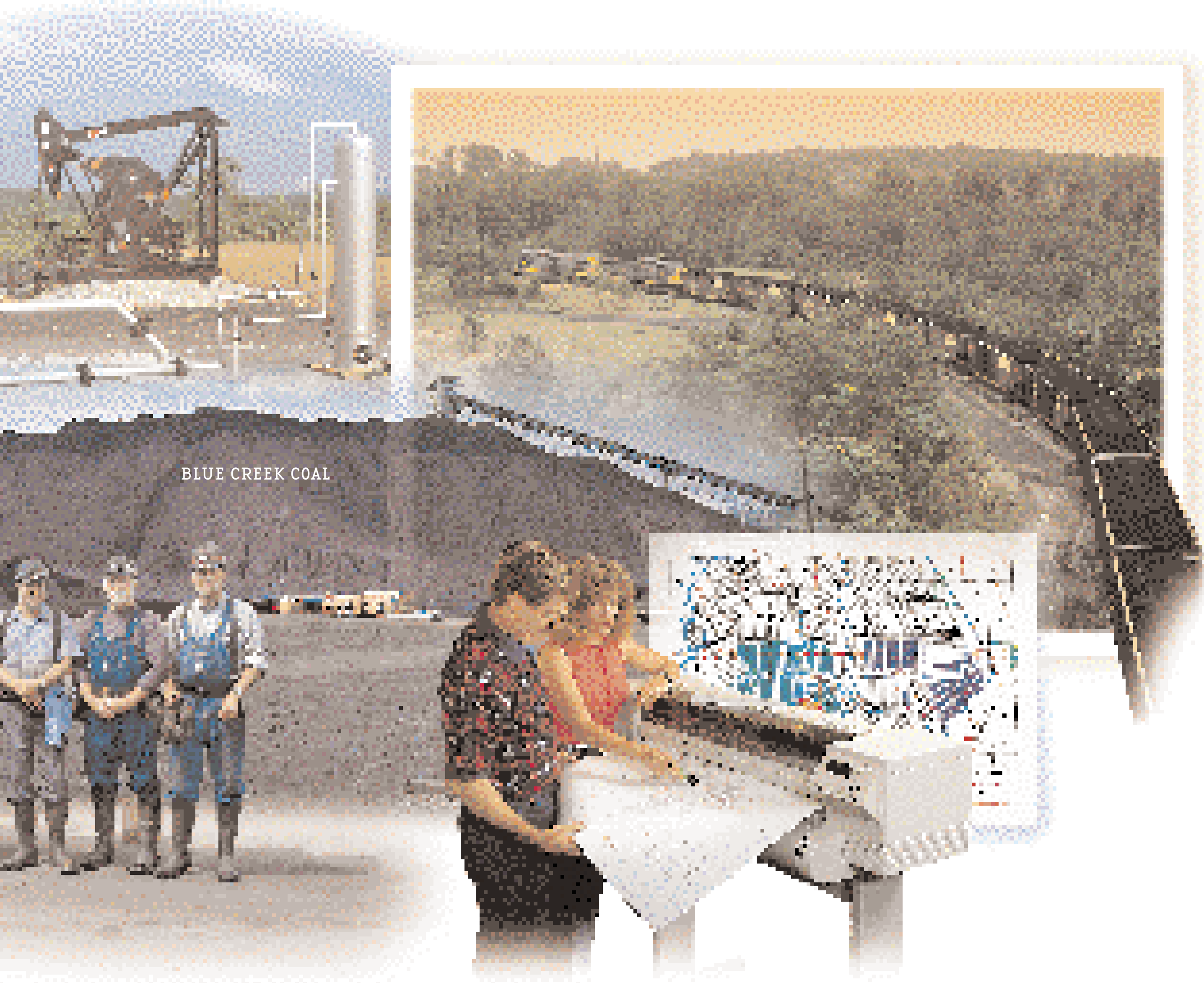
The Mining Division's ability to market its coal is supported by convenient access to a variety of transportation modes, including railroad cars, barges and trucks. Shipping to overseas customers is facilitated by the warm-water Port of Mobile, whose McDuffie Terminal is equipped for state-of-the-art coal handling. JWR also has invested in various support functions, including a preparation plant for each mine, which enhances quality control and allows the coal to be processed to meet a variety of specialized customer requirements. The Company also operates a pilot plant that is testing coal-water mixtures that may replace fuel oil in industrial and utility boilers.

Bringing Methane to Market

Another highly valuable aspect of JWR's natural resources business is its substantial coal bed methane gas production, which is managed by the Company's De-Gas Division. The geology of the Blue Creek seam generates a substantial volume of methane gas. Once again demonstrating its talent for converting challenges into opportunities, JWR turned the process of degasification — required to reduce the high concentration of methane in its mines — into a profitable business. The Company and SONAT, Inc. formed a joint venture to recover and market the methane gas, and pioneered the technology to recover the gas in a manner that would be commercially attractive. All gas produced is sold to Southern Natural Gas Company, a SONAT subsidiary, under a contract extending to 2001. Today, De-Gas extracts roughly 40 million cubic feet of methane per day, making it one of the largest and most successful coal seam degasification businesses in the world.

Performance and Outlook

The 7.9 million tons of coal produced by JWR in fiscal 1996 compares with 7.6 million tons for the prior year, a 4% increase achieved despite the interruption of production at Mine No. 5 stemming from an underground fire during the third quarter. Approximately 1.2 million tons of production were lost as a result of the fire. JWR's average selling price per ton in 1996 was $42.85, versus $41.34 for 1995. This increase reflected higher prices in the worldwide metallurgical market. Natural Resources sales and revenues for fiscal 1996 were



$364.1 million, compared with $332.3 million in 1995. EBITDA was $51.2 million, versus $61.5 million in fiscal 1995. These results reflected the impact on production levels and costs of the hot spot conditions, including $16 million of firefighting and idle plant costs.

De-Gas was an important contributor to JWR's results, adding $23 million to net sales and revenues, with JWR benefiting from 340 operating wells in 1996, compared with 268 for the prior year. United Land Corporation, a natural resources subsidiary that owns and manages land, mineral rights and surface rights, generated $14.6 million from coal and timber royalties, as well as gains from sales of excess real estate.

Looking toward the new fiscal year, JWR anticipates a continuation of the current coal production volume. Now that the area affected by the fire has been sealed off, a new coal panel is being developed in the eastern portion of Mine No. 5 with different and favorable geological characteristics. This panel is expected to be in production by the fourth quarter of fiscal 1997. Production also will be affected by a geological fault in an isolated longwall panel at Mine No. 4, which will require progressive modifications to the plan for working that mine. Pricing for JWR's coal should be favorably impacted by further firming in the metallurgical market. With regard to the De-Gas Division, the Company, as part of its joint venture with SONAT, is in the midst of a three-year plan for expanding its operations and expects to drill approximately 100 new wells in the next 12-18 months. This should increase methane gas production to the 50 million cubic feet per day level by the end of fiscal 1998.

Industrial and other Products

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, weather-stripping, sash balances

VESTAL
Building products, fire-places and accessories, castings for municipal and original equipment manufacturers

Reaching you where you live

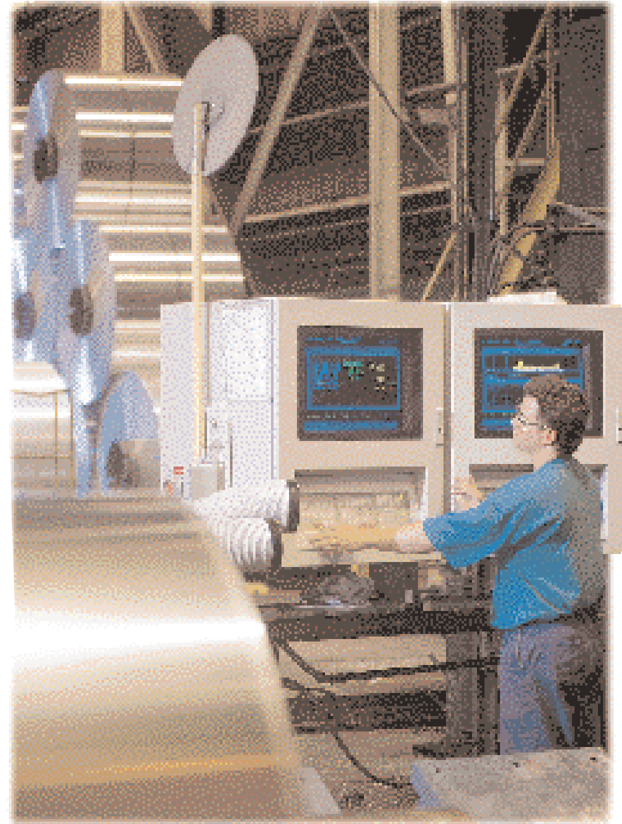
OTHER INDUSTRIAL BUSINESSES

Many products used by consumers every day have their roots in basic industry. Walter Industries' portfolio of industrial businesses has enabled the Company to build profitable niches in such diverse areas as specialized aluminum foil for air conditioning equipment and telecommunications cable; specialty chemicals found in products ranging from dietary supplements to automobile tires; slag wool for highway asphalt; and precision-tooled patterns and molds used to manufacture basic household products as well as sophisticated satellite components.

Sales and Revenues ($ in millions)	
1996	$286.8
1995	$284.2

EBITDA ($ in millions)	
1996	$27.4
1995	$21.0

Walter Industries manages a unique portfolio of industrial companies that reach consumers in ways they might never imagine. These companies are also similar to the rest of Walter's operations in that they target specialized business opportunities. Walter's foremost industrial businesses include JW Aluminum Company, a niche producer of aluminum products that is one of the U.S.'s largest providers of fin stock used in heating and air conditioning equipment and a leading player in several other niche market segments; and Sloss Industries, a major coke producer as well as the operator of a state-of-the-art slag wool plant and a developer and contract manufacturer of specialty chemicals. Other businesses include Southern Precision, a highly automated, engineering-driven job shop that provides castings and molds to the foundry industry; JW Window Components, a broad-line manufacturer of window and patio door component products for the new construction and replacement markets; and Vestal Manufacturing, a foundry operation specializing in building products, fireplace accessories and stoves, and OEM castings.



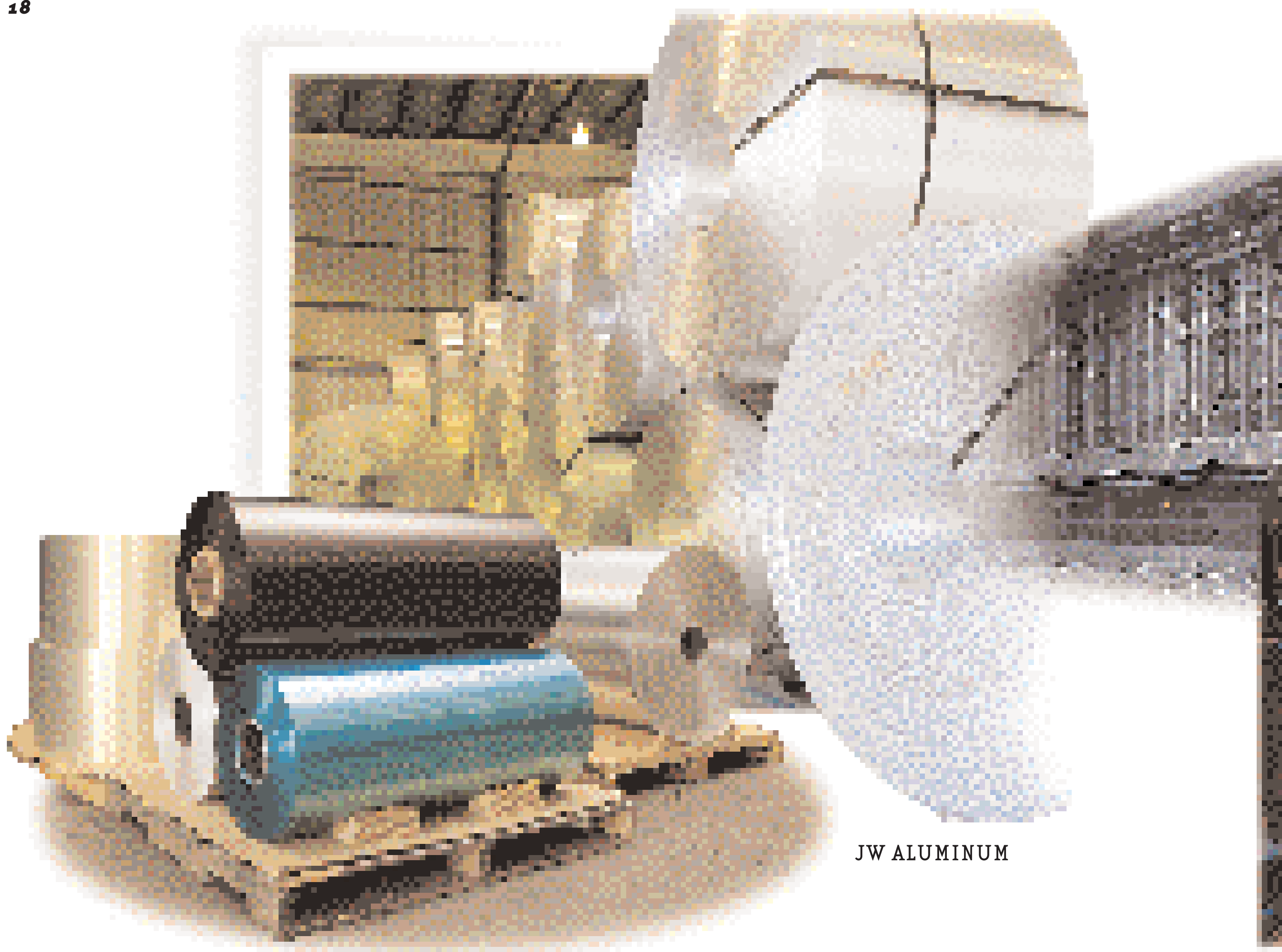
JW Aluminum uses technology to remain a leader in such niche markets as fin stock, used in heating and air conditioning equipment.

A Sophisticated Niche Producer

JW Aluminum, founded in 1980, is one of Walter Industries' strongest-performing subsidiaries. The Company operates as an independent aluminum mini-mill and is recognized as a leading developer of continuous casting technology for niche applications. It operates three cold rolling mills, is a technology leader in such areas as coatings development, and has recently been awarded ISO 9001 quality certification. Additionally, the aluminum operations use the latest metallurgical techniques to attain an optimal mix of prime and scrap aluminum for the casting process, thus minimizing raw material costs.

JW Aluminum has carved out a profitable niche as a dominant source in several highly specialized market segments. In addition to fin stock, the Company is a leading producer of coated foil for the foam board insulation industry, and is the leader in the development of continuous cast coil for lithoplate applications and cable wrap for the telecommunications industry. By pursuing a strategy of aggressive cost control, JW Aluminum is optimizing returns on its most valuable cold rolling assets and continues to work closely with its customers in the devel-

- JW Aluminum is the nation's leading producer of coated fin stock and supplies a rapidly growing segment of the heating and air conditioning market.
- An anti-oxidant developed by Sloss Industries' specialty chemicals group is now found in all of the automobile tires manufactured annually in the United States.
- Sloss Industries' 120 coking ovens in North Birmingham, Alabama run at 100% capacity year-round, and its capacity is virtually sold out into the foreseeable future.
- JW Window Components' broad product offering and strategically located manufacturing facilities position the company as a key supplier to the window and patio door market.



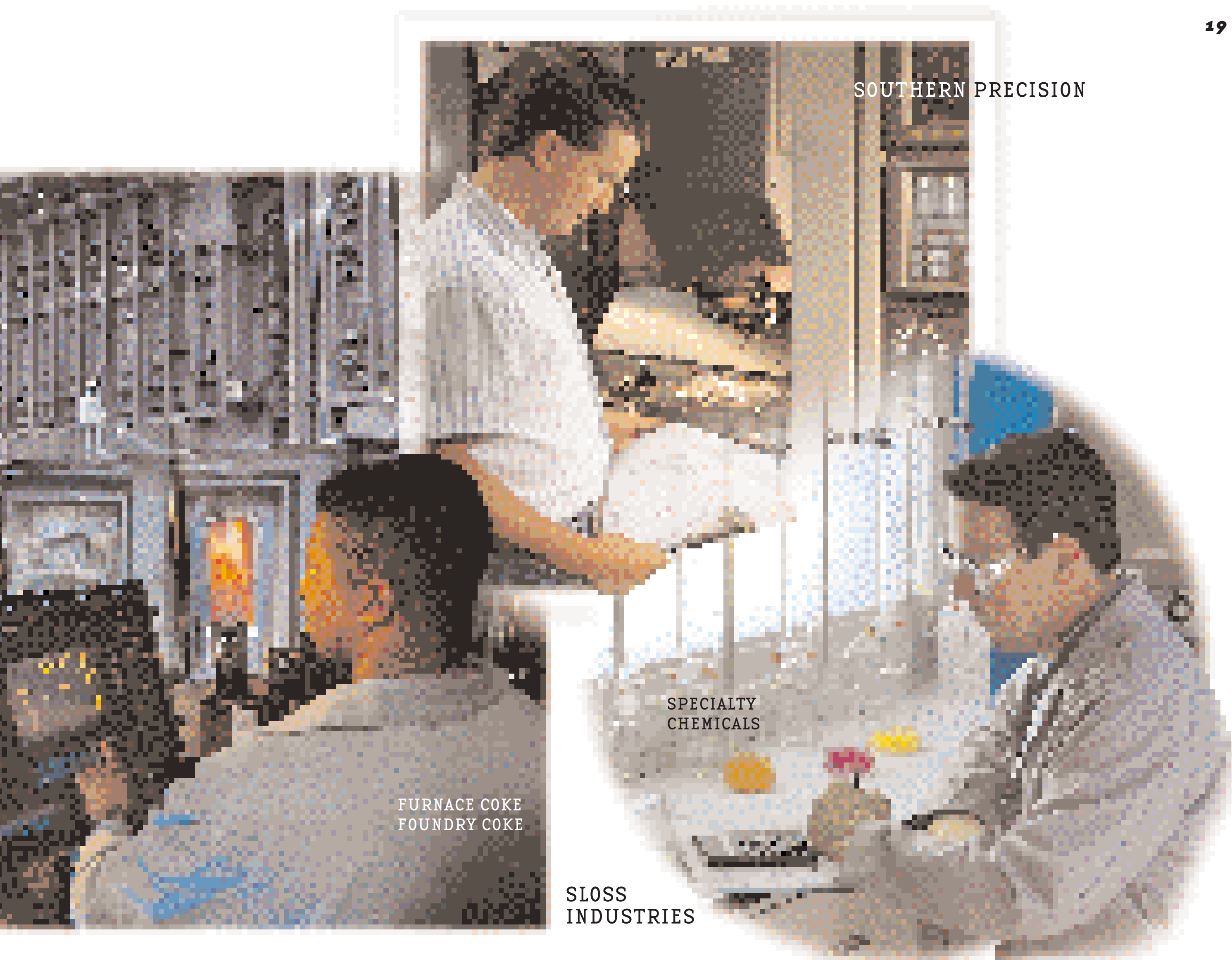
JW ALUMINUM

opment of new products and processes. JW Aluminum's success is marked by continuous sales growth since its inception, and, in the five fiscal years ended in 1996, a doubling of sales and five-fold increase in operating income. Return on assets has tripled during this period.

Diversity and Ingenuity

Sloss Industries also operates in several attractive niches. The 120-oven coking operation located at its North Birmingham, Alabama facility operates at 100% capacity year-round, with capacity split evenly between furnace coke, primarily used by steelmakers, and foundry coke, used in other industrial applications such as pipemaking. In fact, U.S. Pipe purchases all of its coke from Sloss. Sloss's furnace coke capacity is committed through the end of the century, and its base of foundry coke customers, anchored by U.S. Pipe, ensures a solid presence in the foundry coke market. With worldwide coke capacity declining, and with all of its coke production capacity virtually sold out, Sloss' coking operations represent a stable source of revenues and profits. Sloss also utilizes its coke by-products. For example, coke oven gas produced in the coking process is harnessed and used for fuel in Sloss' power generation facility. Sloss is able to satisfy all of its own internal needs for steam and electricity at its Birmingham complex and supply the electricity for a nearby U.S. Pipe plant. Together, coke and coke-related by-products account for 60% of Sloss's annual revenues.

Sloss' slag wool plant melts blast furnace slag and spins it into a fiber. Slag wool has long been the main component of commercial ceiling tiles. Although the advent of less expensive ceiling materials has reduced demand for slag wool, the fiber still represents 11% of the Company's sales. Sloss is drawing on its record of innovation to find new uses for the product, including as an



ingredient in a new asphalt system for highway paving, now popular in Europe, that has been successfully introduced in Georgia using Sloss-supplied slag wool. Sloss is also experimenting with other new applications for slag wool to further utilize capacity and supply a wider variety of markets. Sloss' slag wool plant is in an excellent competitive position and is poised to capitalize on any new high-volume application that can potentially contribute significant operating profits.

The remaining 29% of Sloss' sales — and one-third of its operating profits — are derived from its specialty chemical operations. With its strong scientific staff, the Company has developed a niche as a contract manufacturer. Sloss also works closely with major customers in industries such as petrochemicals and rubber to develop advanced, end-product enhancing materials. For example, Sloss is now the sole supplier to a major U.S. tire maker of a new, proprietary anti-oxidant, producing 2.5 million pounds of the chemical per year. As a chemical manufacturer, Sloss targets the small-batch niche, producing yearly volumes ranging from 250,000 to 5 million pounds per year. These volumes are typically unattractive to major chemical producers, but Sloss can react quickly to smaller volumes and make them profitable through its expertise at refining a customer-developed chemical compound into a process that is efficient for manufacturing.

Performance and Outlook

Walter Industries' combined industrial businesses generated revenues of $286.8 million and EBITDA of $27.4 million in fiscal 1996, compared to $284.2 million and $21.0 million, respectively, in the prior year. About 48% of group revenue was contributed by JW Aluminum, which shipped approximately 123 million pounds for the year. Another 28% of sales was attributable to Sloss

Industries. Sloss is expected to continue as a steady contributor because of its coke production, with a strong upside from the specialty chemicals business and from potential new applications for slag wool.

JW Aluminum is implementing a significant capital improvement program over the upcoming five years to optimize profitability at its sole facility. A 1997 expansion program will include $7.5 million for a new caster, other equipment upgrades and improvements, and operational initiatives in keeping with the Company's longstanding strategy to maximize return on assets and maintain low costs. JW Aluminum is targeting fin stock as its largest volume market in coming years and has identified growth opportunities in lithoplate, electrolytic condensers/capacitors, and other niche products.

Looking ahead in Walter Industries' other industrial businesses, substantial growth is anticipated at JW Window Components following the challenging task of relocating its principal manufacturing facility. JWWC maintains a respected industry position in products such as block and tackle sash balances, window insulation materials and screen frames. In addition, development of innovative new products, such as the pneu-lift balance targeted to commercial window manufacturers, will create expanded market potential. The Company is evaluating its entire product line to emphasize improved operating performance.

Vestal Manufacturing's revenues for fiscal 1996 fell slightly below the prior year's record levels. Operating income was affected by start-up costs associated with the relocation of its steel fabricating facilities, a move that was finalized during the past year and will benefit future results.

Southern Precision Corporation continues to achieve above-average returns on the strength of its highly specialized machine pattern tooling and resin-coated sand operations and, in fiscal 1997, will benefit from the past year's consolidation of two sand plant operations into a single, expanded facility.

Corporate Overview

BUSINESS OF THE COMPANY

The Company, through its direct and indirect subsidiaries, currently operates in four business segments: homebuilding and related financing, water and waste water transmission products, natural resources, and industrial and other products. The Homebuilding and Related Financing Group sells, constructs on the customer's site, and finances standardized partially finished homes. The Water and Waste Water Transmission Products Group is one of the largest domestic manufacturers of ductile iron pressure pipe and fittings, as well as related products. The Natural Resources Group engages in coal mining and a commercial methane degasification program. Individual units within the Industrial and Other Products Group produce furnace and foundry coke, specialty chemicals and slag wool; specialized aluminum sheet and foil products; window components; fireplace products and accessories; and castings and molds for the foundry industry.

COMMON STOCK OUTSTANDING AND PRINCIPAL OWNERSHIP

Pursuant to the Company's 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 issued to the company's former stockholders.

Also pursuant to the Plan, on September 13, 1995, an additional 3,880,140 shares of common stock were distributed to an escrow account for the benefit of the Company's former stockholders. 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 have the power to exercise voting rights with respect to the additional shares in escrow.

Principal shareholders pursuant to these distributions, as well as subsequent stock purchases, are as follows: The Celotex Settlement Fund Recipient (19.9%); Lehman Brothers Holdings, Inc. (14.3%); and certain affiliates of Kohlberg Kravis Roberts & Co., LP (26%). These percentages are the current voting percentages and assume full distribution of the escrow shares.

FINANCING ACTIVITIES

On January 22, 1996, the Company completed a $550 million financing with a syndicate of banks. Proceeds from the financing, together with $75 million drawn under the Mid-State Trust V Variable Funding Loan Agreement, were used to redeem $490 million of 12.19% Senior Notes and replace an existing $150 million bank credit facility, both incurred as a result of the Company's emergence from Chapter 11 reorganization in March 1995. Annualized interest savings of approximately $25 million will be realized as a result of this financing.

The financing consists of three components:

- $365 million Revolving Credit Facility with a six-year maturity;
- $125 million Term Loan A which amortizes over a six-year period; and
- $60 million Term Loan B which carries minimal amortization over six years with sizeable payments required in the seventh year.

Interest on the Revolving Credit Facility and Term Loan A is based on a performance-based "pricing grid" which currently reflects a rate of LIBOR plus 1-1/4%. Interest on Term Loan B is set at LIBOR plus 2%, provided, however, that the rate may be increased to 2-1/4% under certain circumstances. At the Company's option, interest can also be set at an alternative base rate which is the higher of NationsBank Prime Rate or 1/2% per annum above the Federal Funds Rate.

CAPITAL OUTLAYS

Gross capital expenditures in 1996 amounted to $84 million compared with a $80 million program originally planned for the year. The increase from plan resulted from a decision to place Jim Walter Resources' No. 5 coal mine on development status during the fiscal third quarter following the mine fire discussed elsewhere in this report. A $100 million capital program is budgeted for fiscal 1997, including $16 million for Mine No. 5 development.

EMPLOYEE RELATIONS

Walter Industries and its subsidiaries employ approximately 7,750 at 20 manufacturing facilities and a network of sales and administrative offices nationwide.

In fiscal 1996, the Company was involved in negotiations covering 12 labor agreements and approximately 1,750 hourly employees. There were no contract renewal work stoppages during the year.

Three contracts covering approximately 270 employees are scheduled for negotiation during fiscal 1997.

Summary of Operations

($ in thousands except per share amounts)	For the years ended May 31,				
	1996	1995	1994	1993	1992
Sales and revenues	$ 1,485,635	$ 1,442,322	$ 1,328,524	$ 1,318,986	$ 1,366,581
Cost of sales (exclusive of depreciation)	987,354	951,381	845,061	804,411	891,882
Depreciation, depletion and amortization	74,341	72,037	71,035	70,483	82,801
Interest and amortization of debt discount and expense	208,690	304,548	155,470	171,581	177,060
Income tax expense (benefit)	(55,155)	(170,450)	28,917	24,328	12,463
Income (loss) before extraordinary item and cumulative effect of accounting change	(79,292)	(358,645)	7,175	46,594	22,342
Net income (loss)	(84,696)	(358,645)	7,175	(58,014)	22,342
Per share data (a):					
Loss before extraordinary item	$ (1.56)	$ (7.10)			
Extraordinary item	(.10)	—			
Net loss	$ (1.66)	$ (7.10)			
Number of shares used in calculation of loss per share	50,988,195	50,494,313			

(a) Per share information for fiscal years 1992 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,				
	1996	1995	1994	1993	1992
Gross capital expenditures	$ 83,523	$ 91,317	$ 69,831	$ 71,708	$ 68,349
Net property, plant and equipment	541,536	662,792	657,863	663,040	664,622
Total assets	3,091,377	3,245,153	3,140,892	3,223,234	3,171,266
Long-term senior debt	2,211,296	2,220,370	871,970	1,046,971	948,782
Liabilities subject to Chapter 11 proceedings	—	—	1,727,684	1,725,631	1,845,328
Stockholders' equity (deficit)	276,694	360,774	(282,353)	(287,737)	(230,119)
Wages, salaries and employee benefits (b)	401,000	391,000	373,000	358,000	363,000
Employees at year-end	7,755	7,888	7,676	7,545	7,645

(b) Includes postretirement health benefits of $27,129, $25,961, $25,585 and $23,474 in 1996, 1995, 1994 and 1993, respectively.

Management's Discussion and Analysis of Results of Operations And Financial Condition

The Company emerged from bankruptcy on March 17, 1995 pursuant to the Amended Joint Plan of Reorganization Dated as of December 9, 1994, as modified on March 1, 1995 (as so modified the "Consensual Plan"). Accordingly, the Company's Consolidated Statement of Operations and Retained Earnings (Deficit) for the year ended May 31, 1996 are not comparable to the Consolidated Statement of Operations and Retained Earnings (Deficit) for prior periods.

This discussion should be read in conjunction with the consolidated financial statements and notes thereto of Walter Industries, Inc. and subsidiaries, particularly Note 1 of Notes to Financial Statements on pages 35 and 36 which presents an unaudited pro forma consolidated statement of operations for the year ended May 31, 1995 to illustrate the estimated effects of the Consensual Plan and related financings as if they had occurred as of June 1, 1994; and Note 15 of Notes to Financial Statements on pages 49 and 50, which presents sales and operating income by operating group.

RESULTS OF OPERATIONS

YEARS ENDED MAY 31, 1996 AND PRO FORMA 1995

Net sales and revenues for the year ended May 31, 1996 were $50.9 million, or 3.6%, ahead of the prior year with a 3.0% increase in pricing and/or product mix and a .6% increase in volume. The increase in net sales and revenues was the result of improved sales and revenues in all operating groups.

Homebuilding and Related Financing Group sales and revenues were $6.0 million, or 1.5%, ahead of the prior year. This performance reflects a 5.2% increase in the average net selling price per home sold, from $40,200 in 1995 to $42,300 in 1996, partially offset by an 8.9% decrease in the number of homes sold, from 4,126 units in 1995 to 3,760 units in 1996. The higher average net selling price reflects a greater percentage of "90% complete" homes sold in the current year and a price increase instituted February 1, 1995 to compensate for higher building material costs. The decrease in unit sales resulted from extremely competitive conditions in virtually every Jim Walter Homes sales region. The relatively low mortgage interest rate environment and higher availability of mortgage financing for home buyers in recent years adversely affected Jim Walter Homes' sales volumes. In an effort to generate additional unit sales, Jim Walter Homes in December 1995 reduced its financing rate to 8.5% from 10% for its "90% complete" homes on a trial basis and, in March 1996, began formally advertising the lower rate. Jim Walter Homes' backlog at May 31, 1996 was 1,957 units (all of which are expected to be completed prior to the end of fiscal 1997) compared to 1,529 units at May 31, 1995, a 28% increase. Time charge income (revenues received from Mid-State Homes instalment note portfolio) increased from $222.2 million in 1995 to $231.1 million in 1996. The increase is attributable to increased payoffs received in advance of maturity and to an increase in the average balance per account in the portfolio, partially offset by a reduction in the total number of accounts. Operating income of $63.3 million (net of interest expense) was $18.5 million greater than the prior year. This performance was due to the higher time charge income, improved homebuilding gross profit margins resulting from the higher average net selling price per home sold and lower lumber costs and lower interest expense in 1996 ($128.2 million) as compared to that incurred in 1995 ($131.6 million), partially offset by the lower number of homes sold.

Water and Waste Water Transmission Products Group sales and revenues were $9.2 million, or 2.2%, ahead of the prior year. The increase was the result of higher sales prices, partially offset by reduced volumes for ductile iron pressure pipe, fittings and castings. Sales volumes were negatively impacted by severe winter weather conditions and delays in federal funding for planned water and sewer pipeline projects. The order backlog at May 31, 1996 was 121,734 tons, which represents approximately three months shipments compared with 121,548 tons at May 31, 1995. Operating income of $14.0 million was $2.3 million below the prior year. The lower performance resulted from the lower sales volumes, higher raw material costs, especially for scrap iron and alloys which are major raw material components, partially offset by the higher sales prices.

Natural Resources Group sales and revenues exceeded the prior year by $31.9 million, or 9.6%. The increase resulted from greater sales volumes for coal and methane

gas, a higher average selling price for coal, higher outside gas and timber royalty income and a $3.7 million gain (in 1996) from the sale of gas royalty interests in certain mineral properties. Gains from sales of certain excess real estate were $6.1 million in each year. A total of 7.61 million tons of coal was sold in 1996 versus 7.20 million tons in 1995, a 5.7% increase. The increase in tonnage sold was the result of greater shipments to certain export customers, partially offset by lower shipments to Alabama Power Company ("Alabama Power") and Japanese steel mills. The average price per ton of coal sold increased $1.51 from $41.34 in 1995 to $42.85 in 1996 due to higher prices realized in the worldwide metallurgical market and to Alabama Power. 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. As a result of the fire, the Company and Jim Walter Resources claimed compensable losses in the amount of $25 million under their business interruption insurance coverage. When the insurers refused to pay their pro rata part of the claim the Company commenced litigation seeking to enforce such insurance. The insurers issued policies insuring various percentages of the risk. The Company has entered into settlements with several insurers, who, in the aggregate have paid approximately $11.7 million to date, reducing the contract claims in the lawsuit to $12.7 million. The Company and Jim Walter Resources continue to pursue the litigation against the remaining carriers, and a trial is tentatively scheduled for October 21, 1996. (See Note 12 of Notes to Financial Statements.) In late November 1995 Mine No. 5 experienced another fire due to the unexpected recurrence of spontaneous combustion heatings and the mine was shut down. Efforts to contain and extinguish the fire were successful; however, conditions dictated the mine be shut down for several weeks. The affected coal panels on the western side of the mine have been sealed off and development work is under way on the eastern side of Mine No. 5. Longwall production on the east side is expected to commence in the fourth quarter of fiscal 1997. Jim Walter Resources' three other mines remain in full production. The Group incurred an operating loss of $106.5 million in 1996 as compared to operating income of $21.4 million in 1995. The lower performance reflects a $120.4 million write-down of fixed assets to estimated fair market values at two coal mines reflecting the Company's adoption of Statement of Financial Accounting Standards No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" ("FASB 121") (see Note 5 of Notes to Financial Statements) and firefighting and idle plant costs of $16 million, principally associated with the fire at Mine No. 5, partially offset by the increased sales volumes of coal and methane gas, the higher average sales price for coal, higher gas and timber royalty income, the $3.7 million gain (in 1996) from the sale of certain gas royalty interests and slightly lower costs per ton of coal produced ($36.12 in 1996 versus $37.13 in 1995).

Industrial and Other Products Group sales and revenues were $2.6 million, or .9%, greater than the prior year. Increased selling prices for furnace and foundry coke, aluminum foil products, window components and metal building and foundry products combined with greater sales volumes of furnace and foundry coke, resin-coated sand and patterns and tooling were partially offset by lower aluminum sheet products selling prices and volumes and reduced sales volumes of window components and metal building and foundry products. The Group's operating loss in 1996 was $9.5 million as compared to operating income of $9.3 million in 1995. This performance reflects a $22.9 million FASB 121 write-off of excess of purchase price over net assets acquired (goodwill) (see Note 5 of Notes to Financial Statements) and the window components business experiencing lower sales volume, higher raw material costs and reduced efficiencies due to prolonged start-up problems associated with the consolidation and relocation of JW Window Components' Hialeah, Florida and Columbus, Ohio operations to Elizabethton, Tennessee. These decreases were partially offset by increased margins realized on aluminum sheet and foil products, furnace coke and resin-coated sand.

Cost of sales, exclusive of depreciation, of $987.4 million was 80.9% of net sales in 1996 versus $951.4 million and 80.5% in 1995. The cost of sales increase was pri-

marily the result of lower gross profit margins for pipe products, window components, patterns and tooling and metal building and foundry products combined with the firefighting and idle plant costs principally associated with the fire at Mine No.5. These increases were partially offset by improved profit margins on home sales, aluminum foil and sheet products, furnace coke and resin-coated sand.

Selling, general and administrative expenses of $135.8 million were 9.1% of net sales and revenues in 1996 versus $130.6 million and 9.1% in 1995.

Interest and amortization of debt expense was $208.7 million in 1996 versus $223.2 million, on a pro forma basis in 1995, reflecting lower outstanding debt balances and reduced interest rates resulting from the financing completed on January 22, 1996. The average rate of interest in 1996 was 9.10% as compared to 9.79% on a pro forma basis, in 1995. The prime interest rate ranged from 8.25% to 9.0% in 1996 compared to a range of 7.25% to 9.0% in 1995.

The Company's effective tax rate in 1996 and on a pro forma basis in 1995 differed from the statutory tax rate due to amortization of goodwill and the FASB 121 write-off of goodwill of $22.9 million (in 1996) which are not deductible for tax purposes. In addition, in the fiscal 1996 fourth quarter, the Company recorded approximately $27 million of non-recurring tax benefits resulting from utilization of a capital loss carry forward, the Company's election to carry forward its net operating loss (thereby avoiding the effect of a rate difference and loss of certain tax credits), and other miscellaneous tax adjustments. See Note 9 of Notes to Financial Statements for further discussion of income taxes.

As previously mentioned, on January 22, 1996, the Company completed a $550 million financing with a syndicate of banks led by NationsBank National Association (South). The financing consisted of a $365 million revolving credit facility, a six-year $125 million term loan and a $60 million seven-year term loan. Proceeds from the financing together with $75 million drawn under the Mid-State Trust V Variable Funding Loan Agreement were used to redeem in full $490 million aggregate amount of 12.19% Series B Senior Notes Due 2000 (the "Senior Notes") at a redemption price of 101% of the principal amount thereof plus accrued and unpaid interest thereon to the date of redemption and to replace an existing $150 million bank credit facility, both incurred as a result of the Company's emergence from bankruptcy in March 1995. The Company recorded an extraordinary loss of $8.3 million ($5.4 million net of income tax benefit) consisting of a redemption premium and write-off of unamortized debt expense related to the early repayment of the Senior Notes and the $150 million bank credit facility. (See Note 8 of Notes to Financial Statements.)

The net loss for the year ended May 31, 1996 was $84.7 million compared to a net loss of $38.3 million, on a pro forma basis, in 1995 reflecting all of the previously mentioned factors as well as the impact of higher postretirement health benefits in 1996.

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%, greater than the prior year, with a 7.0% increase in volume and a 1.6% 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%, 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' Hialeah, Florida facility were partially offset by reduced sales volumes of furnace coke and slag wool. The Group's operating income of $9.3 million was $2.0 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, start-up costs associated with the consolidation and relocation during 1995 of JW Window Components' Hialeah, Florida and Columbus, Ohio operations to Elizabethton, Tennessee, and reduced operating efficiencies, including start-up problems associated with the relocation of Vestal Manufacturing's steel fabrication operation in May 1994. These decreases were partially offset by increased income for 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%, ahead of the prior year. The increase was the result of higher sales volumes and prices for ductile iron pressure pipe, valves, hydrants and castings. The order backlog for pressure pipe at May 31, 1995 was 121,548 tons, compared to 111,907 tons at May 31, 1994. Operating income of $16.2 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%, 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 sales 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% increase. The increase in tonnage sold was the result of increased shipments to 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. 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. 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 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. As a result of the fire, the Company and Jim Walter Resources claimed compensable losses in the amount of $25 million under their business interruption insurance coverage. When the insurers refused to pay their pro rata part of the claim, the Company commenced litigation seeking to enforce such insurance. (See Note 12 of Notes to Financial Statements). Operating income of $21.4 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%, below the prior year. This performance reflects a 4.7% 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 was due to 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 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 $44.8 million (net of interest expense) was $16.9 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% of net sales versus $845.1 million and 79.1%

in 1994. The cost of sales percentage increase was primarily the result of lower gross profit margins on homes sales, pipe products, window components and metal building and foundry products.

Selling, general and administrative expenses of $130.6 million were 9.1% of net sales and revenues in 1995 versus $127.9 million and 9.6% 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% (such rate calculated excluding $141.4 million additional interest and amortization of debt discount and expense related to the consummation of the Consensual Plan) versus 9.58% in 1994. The prime interest rate ranged from 7.25% to 9.0% in 1995 compared to a range of 6.0% to 7.25% in 1994. During the pendency of the Chapter 11 cases, 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% from 34% retroactive to January 1, 1993. The effect of the rate change resulted in a $2.8 million charge to deferred tax expense in 1994.

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

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 small 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 bid value of 101% 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 its subsidiaries emerged from bankruptcy. Pursuant to the Consensual Plan, the Company has repaid substantially all of its unsecured claims and senior and subordinated indebtedness subject to the Chapter 11 reorganization proceedings.

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 vigorously defend such claims against the Company.

Since May 31, 1995, total debt has decreased $9.1 million resulting from redemption of the Senior Notes ($490.0 million), early repayments on the Credit Facilities debt ($30.0 million), quarterly principal payments on the Credit Facilities ($4.0 million), Mid-State Trust II Mortgage-Backed Notes ($87.0 million), Mid-State Trust III Asset Backed Notes ($25.9 million) and Mid-State Trust IV Asset Backed Notes ($51.6 million) and scheduled retirements of other long-term debt ($.6 million), partially offset by the issuance of long-term debt from the Credit Facilities financing ($450.0 million) and the Mid-State Trust V Variable Funding Loan Agreement ($230.0 million).

The Credit Facilities contain a $365 million revolving credit facility which includes a sub-facility for trade and other standby letters of credit in an amount up to $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. At May 31, 1996, $23.0 million of letters of credit were outstanding under this facility.

The Credit Facilities and the Mid-State 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, 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 Credit Facilities, the Company is required to maintain specified financial ratios and comply with certain financial tests, including interest coverage, fixed charge coverage ratios and maximum leverage ratios, some of which become more restrictive over time. The Company was in full compliance with these covenants at May 31, 1996 and believes it will meet these financial tests over the remaining terms of these debt agreements.

Liquidity and Capital Resources

At May 31, 1996, cash and short term investments, net of bank overdrafts, were approximately $53.7 million. Operating cash flows for the year ended May 31, 1996, together with proceeds from the Credit Facilities financing, issuance of long-term debt under the Mid-State Trust V Variable Funding Loan Agreement and the use of available cash balances, were primarily used for working capital requirements, payment of liabilities resulting from the Chapter 11 reorganization and previously accrued in fiscal year ended May 31, 1995, retirement of long-term senior debt, interest payments and capital expenditures.

Working capital is required to fund adequate levels of inventories and accounts receivable. Commitments for capital expenditures at May 31, 1996 are not material; however, it is estimated that gross capital expenditures for the Company and its subsidiaries for the year ending May 31, 1997 will approximate $100 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 Mid-State 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, Inc. It is contemplated that one or more permanent financings similar to the Mid-State Trust II, III and IV financings will be required over the next several years to repay borrowings under the Mid-State Trust V Variable Funding Loan Agreement. The Company believes that under present operating conditions sufficient operating cash flow will be generated to make all required interest and principal payments and planned capital expenditures and meet substantially all operating needs and that amounts available under the Credit Facilities will be sufficient to meet peak operating needs.

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, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended May 31, 1996 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.

Price Waterhouse LLP

Price Waterhouse LLP

Tampa, Florida

July 12, 1996

Consolidated Statement Of Operations And Retained Earnings (Deficit)

	For the years ended May 31,		
	1996	1995	1994
	(in thousands except per share amounts)		
SALES AND REVENUES:			
Net sales	$ 1,220,397	$ 1,181,635	$ 1,068,387
Time charges (Note 4)	231,104	222,221	238,097
Miscellaneous	34,134	30,838	17,383
Interest income from Chapter 11 proceedings (Note 1)	—	7,628	4,657
	1,485,635	1,442,322	1,328,524
COST AND EXPENSES:			
Cost of sales	987,354	951,381	845,061
Depreciation, depletion and amortization (Note 6)	74,341	72,037	71,035
Selling, general and administrative	135,840	130,616	127,901
Postretirement health benefits (Note 13)	27,129	25,961	25,585
Provision for possible losses	4,367	4,485	4,611
Chapter 11 costs (Note 1)	—	442,362	14,254
Interest and amortization of debt discount and expense (Notes 6 and 8)	208,690	304,548	155,470
Amortization of excess of purchase price over net assets acquired (Note 7)	39,096	40,027	48,515
Long-lived asset impairment (Note 5)	143,265	—	—
	1,620,082	1,971,417	1,292,432
	(134,447)	(529,095)	36,092
Income tax benefit (expense) (Note 9):			
Current	(621)	80,754	(41,598)
Deferred	55,776	89,696	12,681
Income (loss) before extraordinary item	(79,292)	(358,645)	7,175
Extraordinary item - loss on debt repayment (net of income tax benefit of $2,910,000) (Note 8)	(5,404)	—	—
Net income (loss)	(84,696)	(358,645)	7,175
Retained earnings (deficit) at beginning of year	(793,165)	(434,520)	(441,695)
Retained earnings (deficit) at end of year	$ (877,861)	$ (793,165)	$ (434,520)
Net loss per share (Note 10):			
Loss before extraordinary item	$ (1.56)	$ (7.10)	
Extraordinary item	(.10)	—	
Net loss	$ (1.66)	$ (7.10)	

Consolidated Balance Sheet

	May 31, 1996	May 31, 1995
	(in thousands)	
ASSETS		
Cash (includes short-term investments of $64,338,000 and $84,872,000) (Notes 3 and 14)	$ 81,881	$ 128,007
Short-term investments, restricted (Notes 3 and 14)	175,432	128,002
Instalment notes receivable (Notes 4, 8 and 14)	4,208,252	4,256,866
Less - Provision for possible losses	(26,138)	(26,556)
Unearned time charges	(2,851,961)	(2,869,282)
Net	1,330,153	1,361,028
Trade receivables	178,847	160,584
Less - Provision for possible losses	(8,180)	(7,998)
Net	170,667	152,586
Federal income tax receivable (Note 9)	—	99,875
Other notes and accounts receivable	21,055	30,236
Inventories, at lower of cost (first in, first out or average) or market		
Finished goods	124,456	111,792
Goods in process	32,798	29,593
Raw materials and supplies	51,674	53,453
Houses held for resale	2,517	1,599
Total inventories	211,445	196,437
Prepaid expenses	11,937	12,694
Property, plant and equipment, at cost (Notes 5 and 6)	888,991	1,186,407
Less - Accumulated depreciation, depletion and amortization	(347,455)	(523,615)
Net	541,536	662,792
Investments	6,646	6,191
Deferred income taxes (Note 9)	155,171	16,544
Unamortized debt expense (Note 8)	29,548	34,167
Other assets	44,971	43,698
Excess of purchase price over net assets acquired (Notes 1, 5 and 7)	310,935	372,896
	$ 3,091,377	$ 3,245,153

	May 31,	
	1996	1995
	(in thousands)	
LIABILITIES AND STOCKHOLDERS' EQUITY		
Bank overdrafts (Note 3)	$ 28,194	$ 33,746
Accounts payable	74,330	108,137
Accrued expenses	120,477	150,907
Income taxes payable (Note 9)	56,238	53,261
Long-term senior debt (Notes 4, 8 and 14)	2,211,296	2,220,370
Accrued interest (Note 8)	28,819	37,854
Accumulated postretirement health benefits obligation (Note 13)	247,827	228,411
Other long-term liabilities	47,502	51,693
Stockholders' equity (Notes 1, 10 and 11):		
Common stock, $.01 par value per share:		
Authorized - 200,000,000 shares		
Issued - 54,868,335 shares and 50,494,313 shares	549	505
Capital in excess of par value	1,159,332	1,159,384
Retained earnings (deficit), per accompanying statement	(877,861)	(793,165)
Excess of additional pension liability over unrecognized prior years service cost	(5,326)	(5,950)
Total stockholders' equity	276,694	360,774
	$ 3,091,377	$ 3,245,153

Consolidated Statement of Cash Flows

	For the years ended May 31,		
	1996	1995	1994
	(in thousands)		
OPERATIONS			
Income (loss) before extraordinary item	$ (79,292)	$ (358,645)	$ 7,175
Charges to income not affecting cash:			
Settlement of Chapter 11 claims with debt and new Common Stock	—	444,752	—
Depreciation, depletion and amortization	74,341	72,037	71,035
Provision for deferred income taxes	(55,776)	(89,696)	(12,681)
Accumulated postretirement health benefits obligation (Note 13)	19,416	18,449	20,057
Provision for other long-term liabilities	(4,034)	294	280
Amortization of excess of purchase price over net assets acquired (Note 7)	39,096	40,027	48,515
Amortization of debt discount and expense	7,250	11,783	17,597
Long-lived asset impairment (Note 5)	143,265	—	—
	144,266	139,001	151,978
Decrease (increase) in:			
Short-term investments, restricted (Note 3)	(47,430)	(20,450)	(1,932)
Instalment notes receivable, net (a)	30,875	(1,849)	27,680
Trade and other receivables, net	(8,900)	(44,009)	12,747
Federal income tax receivable (Note 9)	99,875	(99,875)	—
Inventories	(15,008)	(23,858)	(5,940)
Prepaid expenses	757	(1,359)	(3,433)
Deferred income taxes (Note 9)	(79,941)	—	—
Increase (decrease) in:			
Bank overdrafts (Note 3)	(5,552)	3,867	11,958
Accounts payable	(7,361)	28,925	6,772
Accrued expenses	7,054	28,242	6,427
Income taxes payable (Note 9)	2,977	(15,348)	2,408
Accrued interest	(9,033)	24,156	47,833
Liabilities subject to Chapter 11 proceedings (Note 1)	—	—	1,286
Cash flows from operations	112,579	17,443	257,784
FINANCING ACTIVITIES			
Issuance of long-term senior debt (Note 8)	680,000	974,450	2,000
Additions to unamortized debt expense	(6,045)	(17,153)	—
Extraordinary item - loss on debt repayment	(5,404)	—	—
Charge to income not affecting cash:			
Write-off of unamortized debt expense	3,414	—	—
Provision for deferred income tax	(2,910)	—	—
Retirement of long-term senior debt (Note 8)	(689,074)	(120,250)	(178,865)
Payment of liabilities subject to Chapter 11 proceedings	(63,932)	(604,044)(b)	—
Payment of accrued postpetition interest on Chapter 11 secured debt obligations	—	(244,334)	—
Fractional share payments	(8)	—	—
Cash flows used in financing activities	(83,959)	(11,331)	(176,865)
INVESTING ACTIVITIES			
Additions to property, plant and equipment, net of normal retirements	(73,485)	(76,966)	(65,858)
(Increase) in investments and other assets	(1,261)	(4,442)	(2,128)
Cash flows used in investing activities	(74,746)	(81,408)	(67,986)
Net increase (decrease) in cash and cash equivalents	(46,126)	(75,296)	12,933
Cash and cash equivalents at beginning of year	128,007	203,303	190,370
Cash and cash equivalents at end of year (Note 3)	$ 81,881	$ 128,007	$ 203,303

(a) Consists of sales and resales, net of repossessions and provision for possible losses, of $148,749,000, $155,236,000 and $153,776,000 and cash collections on account and payouts in advance of maturity of $179,624,000, $153,387,000 and $181,456,000, for the years ended May 31, 1996, 1995 and 1994, 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.

Notes to Financial Statements

NOTE 1 - RECENT HISTORY

Walter Industries, Inc. (the “Company”) was organized in 1987 for the purpose of acquiring Jim Walter Corporation (“Original Jim Walter”). The Company’s financial statements reflect the allocation of the purchase price of Original Jim Walter based upon the fair value of the assets acquired and the liabilities assumed. On December 27, 1989, the Company and most of its subsidiaries each filed a voluntary petition for reorganization under Chapter 11 of Title 11 of the United States Code in the United States Bankruptcy Court for the Middle District of Florida, Tampa Division (the “Bankruptcy Court”). The Company emerged from bankruptcy on March 17, 1995 (the “Effective Date”) pursuant to the Amended Joint Plan of Reorganization Dated as of December 9, 1994, as modified on March 1, 1995 (as so modified the “Consensual Plan”). Despite the confirmation and effectiveness of the Consensual Plan, the Bankruptcy Court continues to have jurisdiction over, among other things, the resolution of disputed prepetition claims against the Company and other matters that may arise in connection with or relate to the Consensual Plan. The following unaudited pro forma consolidated statement of operations for fiscal 1995 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 (all amounts 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 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 issued six months after the Effective Date of the Consensual Plan, but not including 3,880,140 additional shares which have been issued to an escrow account because such issuance is contingent upon future events and would be anti-dilutive).

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, coal mining and related degasification, residential and non-residential construction, and industrial markets. The consolidated financial statements include the accounts of the Company and all of its subsidiaries. Preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Actual results could differ from those estimates. All significant intercompany balances have been eliminated.

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 (i) temporary investment of reserve funds and collections on instalment notes receivable owned by Mid-State Trusts II, III, IV and V ($110,436,000) which are available only to pay expenses of the Trusts and principal and interest on indebtedness of the Trusts, (ii) certain funds held by Trust II that are in excess of the amount required to be paid for expenses, principal and interest on the Trust II Mortgage-Backed Notes but which are subject to retention ($43,161,000) and (iii) miscellaneous other segregated accounts restricted to specific uses ($21,835,000).

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 $4,208,252,000 an amount of $3,914,150,000 is due after one year. Instalment payments estimated to be receivable within each of the five years from May 31, 1996 are $294,102,000, $288,698,000, $283,371,000, $275,512,000 and $266,809,000, respectively, and $2,799,760,000 after five years. Of the gross amount of instalment notes receivable of $4,208,252,000, 19%, 11% and 11% are secured by homes located in the states of Texas, Florida and Mississippi, respectively. 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 3.14% and 3.17% of total instalment notes receivable at May 31, 1996 and 1995, respectively.

Mid-State Homes, Inc. ("Mid-State") purchases instalment notes from Jim Walter Homes, Inc. ("Jim Walter Homes") on homes constructed and sold by Jim Walter Homes and services such instalment mortgage notes. Mid-State Trust II ("Trust II"), Mid-State Trust III ("Trust III") and Mid-State Trust IV ("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 with 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. 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 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, 1996 of $4,208,252,000 with an economic balance of $2,016,665,000, receivables owned by Trust II had a gross book value of $1,166,386,000 and an economic balance of $723,481,000, receivables owned by Trust III had a gross book value of $416,780,000 and an economic balance of $217,247,000 and receivables owned by Trust IV had a gross book value of $1,786,406,000 and an economic balance of $759,234,000. Mid-State Trust V ("Trust V"), a business trust in which Mid-State holds all the beneficial interest, was organized to hold instalment notes receivable as collateral for borrowings to provide temporary financing to Mid-State for its current purchases of instalment notes and mortgages from Jim Walter Homes. At May 31, 1996, receivables owned by Trust V had a gross book value of $835,454,000 and an economic balance of $315,422,000.

NOTE 5 - LONG-LIVED ASSET IMPAIRMENT

The Financial Accounting Standards Board issued in March 1995 Statement of Financial Accounting Standards No. 121 - "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" ("FASB 121") which becomes effective for fiscal years beginning after December 15, 1995 (fiscal year 1997 for the Company). The Company elected to adopt FASB 121 during the third quarter of fiscal 1996 as a result of significant adverse changes in the results of operations during fiscal 1996 principally in the Natural Resources business segment as a result of a fire due to the unexpected recurrence of spontaneous combustion heatings at Jim Walter Resources' Mine No. 5 at the end of the fiscal second quarter and various geological problems at the three other coal mines during portions of the year that led to the conclusion that there was an impairment of fixed assets within the Natural Resources segment.

FASB 121 established standards for determining when impairment losses on long-lived assets have occurred and how impairment losses should be measured. The Company is required to review long-lived assets and certain intangibles, to be held and used, for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. In performing such a review for recoverability, the Company is required to compare the expected future cash flows to the carrying value of long-lived assets and identifiable intangibles. If the sum of the expected future undiscounted cash flows is less than the carrying amount of such assets and intangibles, the assets are impaired and the assets must be written down to their estimated fair market value.

After performing a review for asset impairment at each of the Company's business segments and applying the principles of measurement contained in FASB 121, the Company recorded a charge against earnings of

$143,265,000 before tax ($101,125,000 after tax). The charge includes a $120,400,000 pre-tax ($78,260,000 after tax) write-down of fixed assets at two coal mines in the Natural Resources segment to their estimated fair market values. Fair market values were based principally on expected future discounted cash flows. In addition, a $22,865,000 write-off of excess of purchase price over net assets acquired was recorded in the Industrial and Other Products segment, substantially all of which was at JW Window Components, Inc. Adoption of this standard had no impact on cash flow.

NOTE 6 - PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are summarized as follows (see Notes 1 and 5):

	May 31,	
	1996	**1995**
	(in thousands)	
Land and minerals	$ 150,708	$ 196,798
Land improvements	18,143	20,140
Buildings and leasehold improvements	98,452	110,758
Mine development costs	47,930	125,903
Machinery and equipment	548,562	703,138
Construction in progress	25,196	29,670
Total	$ 888,991	$1,186,407

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 Statement of Financial Accounting Standards No. 34. Interest capitalized for the years ended May 31, 1996, 1995 and 1994 was immaterial. Interest paid in cash for the years ended May 31, 1996, 1995 and 1994 was $220,959,000, $437,357,000 and $91,293,000, respectively.

NOTE 7 - EXCESS OF PURCHASE PRICE OVER NET ASSETS ACQUIRED

The excess of purchase price over net assets acquired in connection with the acquisition of Original Jim Walter is being amortized over periods ranging up to twenty years. The Company evaluates on a regular basis, whether events or circumstances have occurred that indicate the carrying amount of goodwill may warrant revision or may not be recoverable. The Company measures impairment of goodwill based upon estimated future undiscounted cash flows from operations of the related business unit (see Note 5). At May 31, 1996, the accumulated amortization of goodwill was approximately $443.3 million. At May 31, 1996, the net unamortized balance of goodwill is not considered to be impaired.

NOTE 8 - DEBT

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

	May 31,	
	1996	**1995**
	(in thousands)	
Senior debt:		
Walter Industries, Inc.		
Revolving Credit Facility	$ 235,000	$ —
Bank Credit Facility	—	—
Term Loan A	121,250	—
Term Loan B	59,750	—
Series B Senior Notes Due 2000	—	490,000
Other	3,350	4,000
	419,350	494,000
Mid-State Trusts		
Trust II Mortgage-Backed Notes	497,000	584,000
Trust III Asset Backed Notes	147,669	173,527
Trust IV Asset Backed Notes	902,277	953,843
Trust V Variable Funding Loan	245,000	15,000
	1,791,946	1,726,370
Total	$2,211,296	$2,220,370

On January 22, 1996, the Company completed a $550 million financing with a syndicate of banks led by NationsBank National Association (South). The financing consisted of a $365 million revolving credit facility ("Revolving Credit Facility"), a $125 million six-year term loan ("Term Loan A") and a $60 million seven-year term loan ("Term Loan B") (collectively the "Credit Facilities"). Proceeds from the financing, together with $75 million drawn under the Trust V Variable Funding Loan Agreement were used to redeem in full $490 million aggregate amount of Series B Senior Notes Due 2000 (the

"Senior Notes") at a redemption price of 101% of the principal amount thereof plus accrued and unpaid interest thereon to the date of redemption and to replace the existing $150 million bank credit facility, both issued in connection with the Company's emergence from bankruptcy in March 1995. The Company recorded an extraordinary loss of $8,314,000 ($5,404,000 net of income tax benefit) consisting of a redemption premium and the write-off of unamortized debt expense related to the early repayment of the Senior Notes and the $150 million bank credit facility. The Credit Facilities are secured by a pledge of intercompany notes and stock of certain subsidiaries of the Company. Net cash proceeds from certain asset sales must be applied to permanently reduce the Credit Facilities and beginning with fiscal year ending May 31, 1997, 50% of the excess cash flow (as defined in the Credit Facilities) must be used to permanently reduce Term Loan A and Term Loan B.

The Revolving Credit Facility is a six-year, non-amortizing facility which includes a sub-facility for trade and other standby letters of credit in an amount up to $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. Interest, at the option of the Company, is at (i) the greater of (a) the Prime Rate or (b) the Federal Funds Effective Rate plus 1/2%, or (ii) a LIBOR rate plus an Applicable Margin of 3/4% to 1-3/4% (based upon a leverage ratio pricing grid). At May 31, 1996, the weighted average interest rate was 6.74%. A commitment fee ranging from 1/4% to 1/2% per annum (based upon a leverage ratio pricing grid) is payable on the daily average unutilized commitment. The fee for outstanding letters of credit is priced at the Applicable Margin less 3/8%. At May 31, 1996, there were no swingline borrowings outstanding under this facility; however, letters of credit in the aggregate face amount of $23,042,000 have been issued thereunder.

Term Loan A interest, at the option of the Company is at (i) the greater of (a) the Prime Rate or (b) the Federal Funds Effective Rate plus 1/2%, or (ii) a LIBOR rate plus 3/4% to 1-3/4% (based upon a leverage ratio pricing grid). Scheduled principal payments to be made in each of the five years from May 31, 1996 are $15,000,000, $16,250,000, $21,250,000, $25,000,000 and $25,000,000, respectively. At May 31, 1996, the weighted average interest rate was 6.64%

Term Loan B interest is at LIBOR plus 2% to 2-1/4% (based upon a leverage ratio pricing grid). At May 31, 1996, the interest rate was 7.39%. Scheduled principal payments in each of the five years from May 31, 1996 are $1,000,000.

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, 1996 is $87,000,000, $87,000,000, $64,600,000, $64,600,000 and $64,600,000, respectively.

The Trust III Asset Backed Notes (see Note 4) bear interest at 7.625%, constitute a single class and have a final maturity date of April 1, 2022. Payments are made quarterly on January 1, April 1, July 1 and October 1, based on collections on the underlying collateral less amounts paid for interest on the notes and Trust III expenses.

The Trust IV Asset Backed Notes (see Note 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 and distributions from Trust II, less amounts paid for interest on the notes and Trust IV expenses.

On March 3, 1995, Trust V entered into the three-year, $500 million Variable Funding Loan Agreement with Enterprise Funding Corporation, an affiliate of NationsBank National Association, as lender, and NationsBank National Association (Carolinas), as Administrative Agent. 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 Trusts II, III and IV. The facility currently matures on March 3, 1999. Accordingly, the $245 million of borrowings outstanding at May 31, 1996 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 Company uses interest rate swaps that are relatively straightforward and involve little complexity as hedge instruments to manage interest rate risks. At the present time the Company has two types of interest rate risks: (i) current risk on interest rates related to debt which has floating rates and (ii) risk of interest rates and proceeds in refinancing from short-term to long-term certain indebtedness secured by the fixed rate instalment notes receivable generated by its homebuilding business. At May 31, 1996, Trust V had in place a swap agreement with a notional amount of $216 million under which it pays a fixed interest rate of 5.25% and receives interest based on commercial paper rates. This swap is in effect until June 30, 1997, accretes monthly and is designed to offset the interest rate risk of the Trust V Variable Funding Loan Agreement. Also at May 31, 1996, Trust V had in place forward swaps totaling $100 million notional amount which will start June 30, 1997 and run for 10 years at a blended monthly fixed rate of 7.25%. At that time Trust V would begin to receive interest based on prevailing commercial paper rate levels. It is the Company's intent to terminate those forward swaps when a long-term fixed rate financing is put in place for a portion of the instalment notes receivable portfolio. The gain or loss at termination will be deferred and amortized over the life of the new financing.

The Credit Facilities contain a number of significant covenants that, among other things, restrict the ability of the Company and its subsidiaries to dispose of assets, incur additional indebtedness, pay dividends, create liens on assets, enter into leases, make investments or acquisitions, engage in mergers or consolidations, or engage in certain transactions with subsidiaries and affiliates and otherwise restrict corporate activities (including change of control and asset sale transactions). In addition, under the Credit Facilities, the Company is required to maintain specified financial ratios and comply with certain financial tests, including interest coverage, fixed charge coverage ratios and maximum leverage ratios, some of which become more restrictive over time. The Company was in full compliance with these covenants at May 31, 1996.

The Trust V Variable Funding Loan Agreement's covenants, among other things, restricts the ability of Trust V to dispose of assets, create liens and engage in mergers or consolidations. The Company was in full compliance with these covenants at May 31, 1996.

NOTE 9 - INCOME TAXES

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

	May 31, 1996		May 31, 1995		May 31, 1994	
	Current	Deferred	Current	Deferred	Current	Deferred
			(in thousands)			
United States	$(799)	$(54,846)	$(80,445)	$(88,815)	$ 38,712	$(11,716)
State and local	1,420	(930)	(309)	(881)	2,886	(965)
Total	$ 621	$(55,776)	$(80,754)	$(89,696)	$ 41,598	$(12,681)

In fiscal 1996 the Company received a refund of federal income tax of $22.2 million paid in 1995 as estimated payments while in fiscal 1995 and 1994 the Company paid federal income tax of approximately $30.6 million and $37.1 million. State income taxes refunded in fiscal 1996 were approximately $0.1 million while state income taxes paid in 1995 and 1994 were approximately $4.0 million and $2.1 million, respectively.

The Company complies with Statement of Financial Accounting Standards No. 109 ("FASB 109"), "Accounting for Income Taxes." FASB 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. FASB 109 generally considers all expected future events other than changes in tax law or rates.

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

	For the years ended May 31,		
	1996	1995	1994
Statutory tax rate	(35.0)%	(35.0)%	35.0%
Effect of:			
Adjustment to deferred taxes	—	—	5.3
State and local income tax	.2	(.2)	3.3
Percentage depletion	(2.6)	(.5)	(1.7)
Enacted tax rate change	—	—	9.4
Nonconventional source fuel credit	—	—	(10.8)
Amortization of excess of purchase price over net assets acquired and FASB 121 charge	16.2	2.7	47.1
Benefit of capital loss carryforward	(5.9)	(1.5)	(8.5)
Adjustment of prior years net operating loss carryforward	(5.0)	—	—
Effect of rate difference and avoidance of loss of credits on net operating loss due to carryforward election	(9.1)	2.3	—
Other, net	.2	—	1.0
Effective tax rate	(41.0)%	(32.2)%	80.1%

The tax benefit related to the extraordinary item approximates the statutory rate and is deferred federal income tax.

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. FASB 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,	
	1996	1995
	(in thousands)	
Instalment sales method for instalment notes receivable in prior years	$ 34,691	$ 43,312
Depreciation	78,462	116,625
Difference in basis of assets under purchase accounting	20,424	23,894
Capital loss carryforward	—	(7,977)
Net operating loss carryforward	(155,283)	(31,488)
Accrued expenses	(39,034)	(81,855)
Postretirement benefits other than pensions	(94,431)	(87,032)
Valuation allowance	—	7,977
Total deferred tax (asset) liability	$(155,171)	$(16,544)

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

As a result of the loss incurred in the 1995 fiscal year, the Company recorded a federal income tax receivable of approximately $99.9 million. During fiscal 1996 the Company elected to carry the 1995 loss forward rather than back to prior years. Accordingly, $77.7 million has been reclassified from federal income tax receivable to a deferred tax asset. The election to carry forward the net operating loss generated a tax benefit of approximately $19 million in the fourth quarter due to the effect of the rate difference, avoidance of loss of credits, and other miscellaneous tax adjustments. The Company's net operating loss carryforward at May 31, 1996 approximates $443.6 million of which $372.3 million will expire in fiscal 2010 and $71.3 million will expire in fiscal 2011. Also during the fourth quarter of fiscal 1996, the Company utilized its capital loss carryforward of approximately $22.8 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 carry forwards. The reorganization under the Consensual Plan created an ownership change in fiscal 1995; therefore, $296 million of the net operating loss carryforward is subject to the annual limitation which will be eliminated by fiscal 1998. However, the Company believes that the annual limitation will not affect the realization of the net operating loss 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. Although the range for such claims is zero to $186 million, the Company believes that such proofs of claim are substantially without merit and intends to defend such claims against the Company vigorously.

NOTE 10 - STOCKHOLDERS' EQUITY

The Company is authorized to issue 200,000,000 shares of common stock, $.01 par value. As of May 31, 1996, 54,868,335 shares of common stock are outstanding.

Pursuant to the Consensual Plan, 494,313 shares were issued on September 13, 1995 to all former stockholders as of the Effective Date of the Consensual Plan. Also on September 13, 1995, pursuant to the Consensual Plan, 3,880,140 shares of common stock were issued to an escrow account. To the extent that certain federal income tax matters of the Company are resolved satisfactorily, up to a maximum 3,880,140 of the escrowed shares will be distributed to 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 canceled.

Net loss per share has been computed by dividing net loss by the weighted average number of common shares issued of 50,988,195, which includes 494,313 additional shares issued on September 13, 1995 pursuant to the Consensual Plan, but does not include 3,880,140 additional shares issued to an escrow account on September 13, 1995 because such issuance is contingent on future events and would be anti-dilutive in the current year. In management's opinion, per share information for fiscal year 1994 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 11 - STOCK OPTIONS

Under the Walter Industries, Inc. Long-Term Incentive Stock Plan approved by stockholders in October 1995, an aggregate of 3,000,000 shares of the Company's common stock has been reserved for the grant and issuance of incentive and non-qualified stock options, stock appreciation rights ("SAR's") and stock awards. The maximum number of such shares with respect to which stock options or SAR's may be granted to any employee during which the plan is in effect is 500,000 shares and the aggregate number of such shares that may be used in settlement of stock awards is 1,000,000 shares. An option becomes exercisable at such times and in such installments as set by the Compensation Committee of the Board, but no option will be exercisable after the tenth anniversary of the date on which it is granted. The option price per share may not be less than the fair market value of a share on the date the option is granted. Information on stock options is summarized as follows:

	1996	
	Shares	Average Price per Share
Outstanding at beginning of year	—	$ —
Granted	1,500,000	14.120
Exercised	—	—
Canceled	(13,000)	14.125
Outstanding at end of year	1,487,000	14.120
Exercisable at end of year	—	—

NOTE 12 - 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 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 (the "LBO"). Asserting a variety of theories of derivative lia-

bility, 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 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 (the "Bankruptcy Court"), which stayed all Veil-Piercing Suits pursuant to the automatic stay. In January 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.

In April 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 United States District Court for the Middle District of Florida (the "District Court") 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 Amended Joint Plan of Reorganization Dated as of December 9, 1994 as modified on March 1, 1995 (as so modified 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.

On March 8, 1996, the Company, together with various other parties, filed an adversary proceeding with the Bankruptcy Court, naming Celotex and JWC as defendants. In this proceeding the Company and the other named plaintiffs allege that Celotex and JWC breached the Veil-Piercing Settlement by failing to propose and use their best efforts to obtain confirmation of a Chapter 11 plan for Celotex (which is presently in bankruptcy) that included an injunction issued pursuant to Section 524(g) of the Bankruptcy Code or other similar injunctive relief acceptable to each of the parties to the Veil-Piercing Settlement. Although all Veil-Piercing claims by asbestos claimants were resolved as part of the Consensual Plan, the Company believes that Section 524(g) would afford additional statutory protection to the Company against the possibility of such claims in the future. The Company believed that the plan of reorganization proposed by Celotex in its Chapter 11 proceeding failed to conform with the terms of the Veil-Piercing Settlement; that the plan proposed by Celotex did not meet the requirements of Section 524(g); and that Celotex and JWC failed to propose and use their best efforts to obtain confirmation of a plan of reorganization in the Celotex bankruptcy that included a provision for an injunction as required by the Veil-Piercing Settlement. The defendants contend that the proposed Celotex plan met the requirements of the Veil-Piercing Settlement. This proceeding requested the Bankruptcy Court to (i) declare the rights and obligations of the various parties to the Veil-Piercing Settlement and (ii) issue an order requiring specific performance by each of the named defendants of their obligations under the Veil-Piercing Settlement. The Company, Celotex and JWC each filed motions in the Bankruptcy Court seeking an order granting summary judgment in favor of the respective party.

On May 28, 1996, the Bankruptcy Court issued an order granting in part the Company's motion for summary judgment and denying the motions for summary judgment filed by Celotex and JWC. The Bankruptcy Court found that the plan of reorganization filed by Celotex in its Chapter 11 proceeding did not comply with the terms of the Veil-Piercing Settlement. The Bankruptcy Court, however, declined to issue a mandatory injunction compelling compliance, but rather left to the parties the opportunity to fashion an alternative remedy. The parties were unable to agree on an alternative remedy and on June 7, 1996, the Company requested that the Bankruptcy Court grant injunctive

relief compelling Celotex and JWC to perform their respective obligations under the Veil-Piercing Settlement. In light of confirmation hearings scheduled to begin June 10, 1996 in the Celotex bankruptcy, the Bankruptcy Court denied the relief requested without prejudice to request such relief in the future. The Bankruptcy Court's May 28, 1996 order has been appealed by Celotex and JWC.

On June 12, 1996, the court in the Celotex bankruptcy (the "Celotex Bankruptcy Court"), in response to an announcement by certain parties, including Celotex, of an agreement to an alternative plan of reorganization, denied confirmation of the Celotex plan of reorganization. On July 12, 1996, certain parties to the Celotex reorganization, together with Celotex, filed with the Celotex Bankruptcy Court a proposed plan of reorganization. That plan contains a provision for an injunction pursuant to Section 524(g). The proposed plan is subject to approval of Celotex' creditors and confirmation by the Celotex Bankruptcy Court.

South Carolina Litigation

In February 1995, Jim Walter Homes and Mid-State filed an adversary action for declaratory judgment in the Bankruptcy Court against all South Carolina homeowners who purchased their homes between July 1, 1982 and December 27, 1989. The complaint in the adversary action sought a declaration that Jim Walter Homes and Mid-State did not violate a South Carolina statute that provided homeowners a preferential choice of attorneys to represent them in the closing of the purchase of their homes. The adversary action was settled for $3 million which, after application of settlement proceeds to pay arrearages on the homeowners' mortgages, resulted in a net cash outlay of approximately $1,050,000, and legal fees of $360,000. On November 22, 1995, the Bankruptcy Court approved the settlement and distribution pursuant to the settlement has been completed.

Texas Litigation

In May 1991, Jim Walter Homes and Mid-State, together with Trust II and certain other parties, were involved in various lawsuits, primarily in the Bankruptcy Court, with approximately 750 owners of 446 houses constructed by Jim Walter Homes in south Texas. The homeowners sought damages based upon alleged construction defects, common law fraud, and violations of various Texas and federal statutes. The litigation was settled pursuant to a settlement agreement approved by the Bankruptcy Court on July 13, 1995. The settlement figure was 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 homeowner claimants and $2,900,000 as attorney's fees (of which $900,000 was deferred and is payable over five years).

Cases involving approximately 22 non-settling homeowner accounts will be resolved on an individual basis before the Bankruptcy Court and the Company has filed motions believed by the Company to be dispositive of these remaining issues.

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") filed a lawsuit in the Circuit Court for Tuscaloosa County, Alabama (Civil Action No. CV-95-625) against certain insurers. The lawsuit arises out of a spontaneous combustion fire that began in JWR's underground coal mine No. 5 on November 17, 1993. Efforts to control the fire caused a blockage in the tunnels, corridors, and passageways necessary to conduct mining, so mining operations temporarily ceased. After JWR believed that the fire had been extinguished or brought under control, JWR resumed its mining operations. JWR subsequently detected that the intensity of the fire increased substantially, making it necessary to seal off portions of the mine and to lose permanently certain corridors and passageways necessary to the continued mining of the longwall panel then being mined. JWR's longwall mining was interrupted until another longwall panel could be prepared. In addition to the mining of coal, JWR produces natural gas from wells drilled into the mine, and production of the gas from the area of the lost longwall panel was also lost. As a result of the fire, the Company and JWR claimed compensable losses in the amount of $25 million under their business interruption insurance coverage. When the insurers refused to pay their pro rata part of the claim, the lawsuit described above was commenced.

The complaint filed by the Company and JWR seeks payment of the amounts claimed to be due under the insurance policies in question and a declaratory judgment that the policies in question are not void or voidable due to any alleged failure to disclose or a lack of fortuity. Certain of the insurers have counterclaimed for rescission on the basis of nondisclosure and lack of fortuity. The Company and JWR also seek a declaratory judgment stating that each of the insurers is liable for its pro rata share of the business interruption loss. In addition, the Company and JWR have asserted a claim for bad faith refusal to pay against certain insurers.

The insurers issued policies insuring various percentages of the risk. The Company has entered into settlements with several insurers, who, in the aggregate have paid approximately $11.7 million to date, reducing the contract claims in the lawsuit to approximately $12.7 million. The Company and JWR continue to pursue the litigation against the remaining carriers and a trial is tentatively scheduled for October 21, 1996.

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 of the Company. 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 confirmed by the Bankruptcy Court, which technically constituted a modification of the Creditors’ Plan, (a) kept in place the Subordinated Note Claim Election provision 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 was entered reflecting the Bankruptcy Court’s decision to permit the amendment of the Exhibit 8 Schedule and the Exchange Election Schedule to correct errors on the information contained therein and not to permit such Schedules to be amended to include any additional bondholders (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. 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. (Two of the appeals have been dismissed.) 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 filed a brief in support of the April 28 Order and also filed a motion to dismiss the remaining four appeals of the appellants as moot and to dismiss two of those appeals for failure to file timely briefs. Subsequently, one of the remaining four appeals has been voluntarily dismissed. At this time the Company is unable to predict whether or not the three pending 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 seeking payment of interest for the period from the Effective Date (March 17, 1995) until the date distribution was received by such Noteholders. The Bankruptcy Court entered an order on January 17, 1996 denying the Noteholders' claim for interest, which order was not appealed.

Income Tax Litigation

A substantial controversy exists with regard to federal income taxes allegedly owed by the Company. See Note 9 - Income Taxes for a more complete explanation.

Miscellaneous Litigation

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

NOTE 13 - 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, 1996, 1995 and 1994, was $11.8 million, $8.2 million and $9.7 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,		
	1996	**1995**	**1994**
	(in thousands)		
Service cost-benefits earned during the period	$ 6,072	$ 5,817	$ 5,334
Interest cost on projected benefit obligation	16,972	16,174	16,333
Actual loss (return) on assets	(35,347)	4,304	(19,352)
Net amortization and deferral	20,236	(21,377)	3,145
Net pension costs	$ 7,933	$ 4,918	$ 5,460

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

	May 31, 1996		May 31, 1995	
	Plans in which		Plans in which	
	Assets exceed accumulated benefits	Accumulated benefits exceed assets	Assets exceed accumulated benefits	Accumulated benefits exceed assets
	(in thousands)			
Actuarial present value of accumulated benefit obligations:				
Vested benefits	$ 149,542	$ 50,941	$ 134,589	$ 47,474
Non-vested benefits	6,815	1,585	5,849	1,207
	$ 156,357	$ 52,526	$ 140,438	$ 48,681
Plan assets at fair value, primarily stocks and bonds	$ 189,728	$ 34,609	$ 169,635	$ 31,023
Projected benefit obligations	188,422	54,008	169,984	49,681
Plan assets in excess of (less than) projected benefit obligations	1,306	(19,399)	(349)	(18,658)
Unamortized portion of transition (asset) obligation at June 1, 1986	(9,185)	4,021	(10,507)	4,785
Unrecognized net loss from actual experience different from that assumed	13,191	6,124	20,545	6,610
Prior service cost not recognized	618	3,595	696	2,269
Contribution to plans after measurement date	—	1,042	—	667
Prepaid (accrued) pension cost	5,930	(4,617)	10,385	(4,327)
Additional liability	—	(12,507)	—	(12,664)
Prepaid pension cost (pension liability) recognized in the balance sheet	$ 5,930	$(17,124)	$ 10,385	$(16,991)

The projected benefit obligations were determined using an assumed discount rate of 7-1/2% in fiscal 1996 and 8% in 1995 and, where applicable, an assumed increase in future compensation levels of 4-1/2% in fiscal 1996 and 5% in 1995. The assumed long-term rate of return on plan assets was 8% in fiscal 1996 and 1995.

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 $41.5 million at May 31, 1996. 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 provides certain postretirement benefits other than pensions, primarily healthcare, to eligible retirees. The Company's postretirement benefit plans are not funded. Postretirement benefit costs were $27.1 million in 1996, $26.0 million in 1995 and $25.6 million in 1994. Amounts paid for postretirement benefits were $7.7 million in 1996, $7.5 million in 1995 and $5.5 million in 1994.

The net periodic postretirement benefit cost includes the following components:

	For the years ended May 31,		
	1996	1995	1994
	(in thousands)		
Service cost	$ 8,668	$ 8,491	$ 9,302
Interest cost	18,701	17,470	16,283
Net amortization and deferral	(240)	—	—
Net periodic postretirement benefit cost	$ 27,129	$ 25,961	$ 25,585

The accumulated postretirement benefits obligation at May 31, 1996 and 1995 are as follows:

	May 31,	
	1996	1995
	(in thousands)	
Retirees	$ 93,380	$ 92,550
Fully eligible, active participants	32,896	30,129
Other active participants	132,026	111,084
Accumulated postretirement benefit obligation	258,302	233,763
Unrecognized net loss	(10,475)	(5,352)
Postretirement benefit liability recognized in the balance sheet	$247,827	$ 228,411

The principal assumptions used to measure the accumulated postretirement benefit obligation include a discount rate of 7-1/2% in fiscal 1996 and 8% in 1995 and a health care cost trend rate of 9-1/2% declining to 5-1/4% over a nine year period and remaining level thereafter in fiscal 1996 and a health care cost trend rate of 10% declining to 5-1/2% over a ten-year period in fiscal 1995. A 1% increase in trend rates would increase the accumulated postretirement benefit obligation by 18% and increase net periodic postretirement benefit cost for 1996 by 20%.

Certain subsidiaries of the Company maintain profit sharing plans. The total cost of these plans for the years ended May 31, 1996, 1995 and 1994 was $2.9 million, $3.0 million and $3.1 million, respectively.

NOTE 14 - FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 107, “Disclosures about Fair Value of Financial Instruments” (“FASB 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 FASB 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, FASB 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 FASB 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, 1996 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 May 31, 1996. 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, 1996 was $2.268 billion based on current yields for comparable debt issues or prices for actual transactions.

NOTE 15 - SEGMENT INFORMATION

Prior years' Contributions to Operating Income has been restated to reflect amortization of excess purchase price over net assets acquired by operating segment, which amortization was previously included in unallocated corporate interest and other expense.

	For the years ended May 31,		
	1996	1995	1994
	(in thousands)		
Sales and Revenues:			
Homebuilding and related financing	$ 413,111	$ 407,119	$ 424,530
Water and waste water transmission products	421,436	412,237	357,189
Natural resources (b)	364,113	332,251	319,410
Industrial and other products	286,783	284,230	224,673
Corporate	192	6,485	2,722
Consolidated sales and revenues (a)(c)	$ 1,485,635	$ 1,442,322	$ 1,328,524
Contributions to Operating Income (d)(e):			
Homebuilding and related financing	$ 63,317	$ 44,822	$ 61,763
Water and waste water transmission products	13,966	16,240	13,426
Natural resources (f)	(106,509)	21,400	152
Industrial and other products (f)	(9,509)	9,275	11,227
	(38,735)	91,737	86,568
Less-Unallocated corporate interest and other expense (g)	(95,712)	(620,832)	(50,476)
Income taxes	55,155	170,450	(28,917)
Income (loss) before extraordinary item	$ (79,292)	$ (358,645)	$ 7,175
Depreciation, Depletion and Amortization:			
Homebuilding and related financing	$ 3,279	$ 3,336	$ 3,093
Water and waste water transmission products	18,636	16,520	16,063
Natural resources	38,652	41,434	40,326
Industrial and other products	11,890	9,073	9,821
Corporate	1,884	1,674	1,732
Total	$ 74,341	$ 72,037	$ 71,035
Gross Capital Expenditures:			
Homebuilding and related financing	$ 3,735	$ 4,192	$ 3,210
Water and waste water transmission products	12,888	15,538	14,426
Natural resources	53,576	46,214	40,224
Industrial and other products	12,792	24,692	10,054
Corporate	532	681	1,917
Total	$ 83,523	$ 91,317	$ 69,831
Identifiable Assets:			
Homebuilding and related financing	$ 1,802,950	$ 1,789,582	$ 1,832,919
Water and waste water transmission products	480,209	480,617	490,004
Natural resources	381,582	465,680	450,468
Industrial and other products	177,668	213,836	173,618
Corporate (h)	248,968	295,438	193,883
Total	$ 3,091,377	$ 3,245,153	$ 3,140,892

(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 $13,292,000, $13,373,000 and $11,480,000 and sales of the Natural Resources Group to the Industrial and Other Products Group of $4,774,000, $5,397,000 and $5,650,000 in 1996, 1995 and 1994, respectively.

(b) Includes sales of coal of $325,495,000, $297,650,000 and $289,279,000 in 1996, 1995 and 1994, respectively. Jim Walter Resources' coal supply contract with Alabama Power Company that had been in effect since January 1, 1979, as amended, was superseded 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, 1996, 1995 and 1994 were 13%, 13% and 11% of consolidated net sales and revenues, respectively.

(c) Export sales, primarily coal, were $171,446,000, $129,071,000 and $155,966,000 in 1996, 1995 and 1994, respectively. Export sales to any single geographic area do not exceed 10% of consolidated net sales and revenues.

(d) Operating income amounts are after deducting amortization of excess of purchase price over net assets acquired (goodwill) of $39,096,000 in 1996, $40,027,000 in 1995 and $48,515,000 in 1994. A breakdown by segment is as follows:

	For the years ended May 31,		
	1996	**1995**	**1994**
		(in thousands)	
Homebuilding and related financing	$ 31,246	$ 31,703	$ 40,191
Water and waste water transmission products	12,247	12,214	12,215
Natural resources	(1,331)	(1,328)	(1,327)
Industrial and other products	2,135	2,627	2,624
Corporate	(5,201)	(5,189)	(5,188)
	$ 39,096	$ 40,027	$ 48,515

(e) Includes postretirement health benefits of $27,129,000, $25,961,000 and $25,585,000 in 1996, 1995 and 1994. A breakdown by segment is as follows:

	For the years ended May 31,		
	1996	**1995**	**1994**
		(in thousands)	
Homebuilding and related financing	$ 1,636	$ 2,295	$ 2,170
Water and waste water transmission products	3,729	4,362	4,391
Natural resources	16,640	15,004	14,681
Industrial and other products	4,581	3,610	3,662
Corporate	543	690	681
	$ 27,129	$ 25,961	$ 25,585

(f) Includes FASB 121 write-down of fixed assets of $120,400,000 at two coal mines in the Natural Resources Group and write-off of goodwill of $22,865,000 in the Industrial and Other Products Group.

(g) Excludes interest expense incurred by the Homebuilding and Related Financing Group of $128,215,000, $131,560,000 and $128,828,000 in 1996, 1995 and 1994, respectively. The balance of unallocated expenses consisting primarily of unallocated interest, corporate expenses and Chapter 11 costs (in 1995 and 1994) are attributable to all groups and cannot be reasonably allocated to specific groups.

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

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.

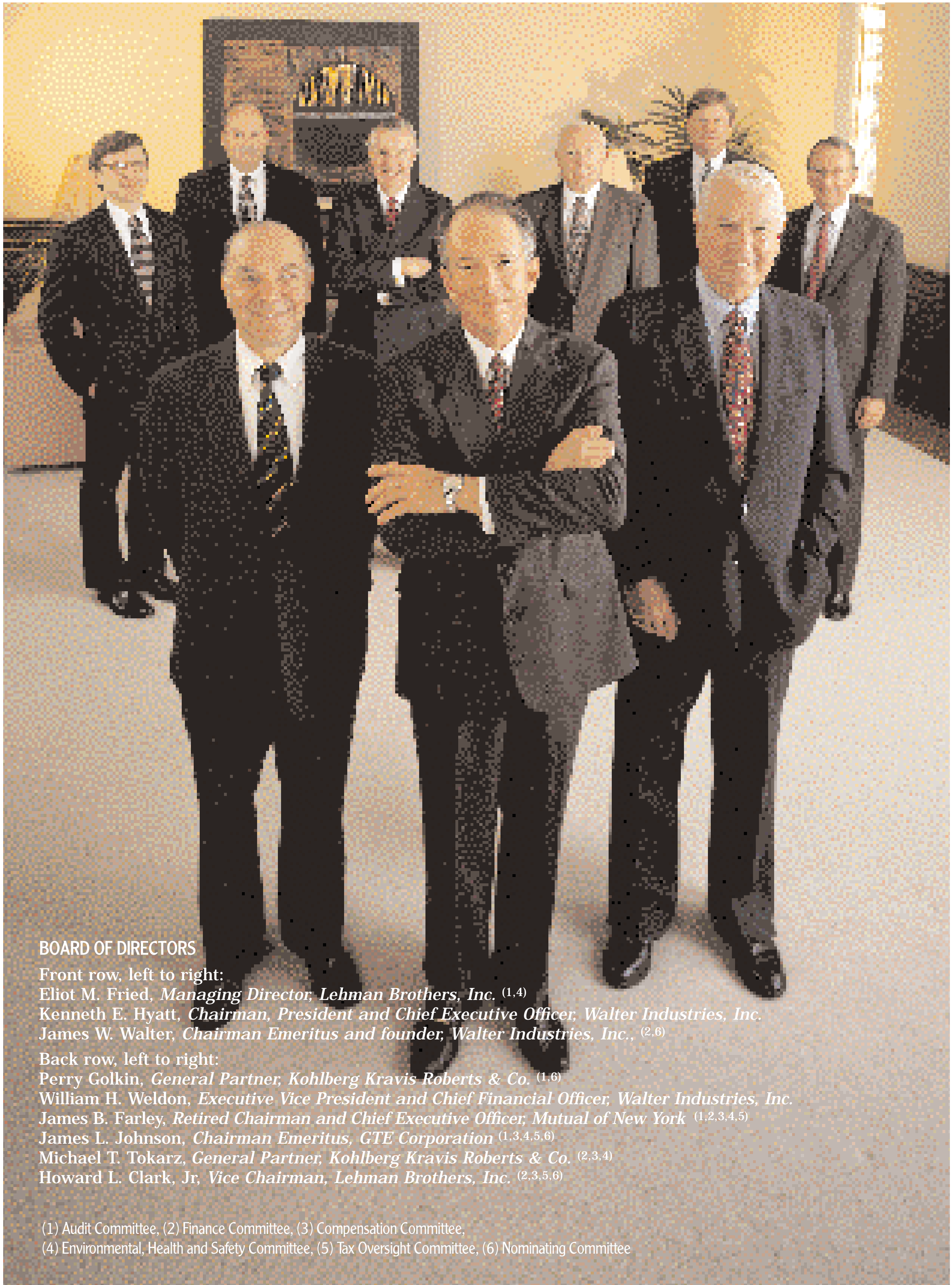
The Board of Directors, through the Audit Committee of the Board, is responsible for recommending to stockholders the independent certified public accountants to be engaged, and for assuring that management fulfills its responsibilities in the preparation of the consolidated financial statements. The 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.

Kenneth E. Hyatt
Chairman, President and
Chief Executive Officer

William H. Weldon
Executive Vice President and
Chief Financial Officer

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



BOARD OF DIRECTORS

Front row, left to right:
Eliot M. Fried, *Managing Director, Lehman Brothers, Inc.* [1,4]
Kenneth E. Hyatt, *Chairman, President and Chief Executive Officer, Walter Industries, Inc.*
James W. Walter, *Chairman Emeritus and founder, Walter Industries, Inc.*, [2,6]

Back row, left to right:
Perry Golkin, *General Partner, Kohlberg Kravis Roberts & Co.* [1,6]
William H. Weldon, *Executive Vice President and Chief Financial Officer, Walter Industries, Inc.*
James B. Farley, *Retired Chairman and Chief Executive Officer, Mutual of New York* [1,2,3,4,5]
James L. Johnson, *Chairman Emeritus, GTE Corporation* [1,3,4,5,6]
Michael T. Tokarz, *General Partner, Kohlberg Kravis Roberts & Co.* [2,3,4]
Howard L. Clark, Jr, *Vice Chairman, Lehman Brothers, Inc.* [2,3,5,6]

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

Corporate Directory and Stockholder Information

OFFICERS

Richard E. Almy
Executive Vice President and
Chief Operating Officer

Dean M. Fjelstul
Senior Vice President-Finance

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

Kenneth E. Hyatt
Chairman, President and
Chief Executive Officer

Donald M. Kurucz
Vice President and Treasurer

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

Edward A. Porter
Vice President-General Counsel
and Secretary

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

David L. Townsend
Vice President-Administration

William H. Weldon
Executive Vice President and
Chief Financial Officer

William Kendall Baker
Assistant Treasurer

Cynthia B. Eisch
Assistant Controller

Stephen H. Foxworth
Assistant Treasurer

Kathy H. Love
Assistant Controller

S. Louise Russell
Assistant Secretary

Mary C. Snow
Assistant Secretary

Joseph W. Spransy
Assistant Secretary

COMMON STOCK

Trading
Nasdaq National Market
Trading Symbol: WLTR

Transfer Agent and Registrar
Harris Trust and Savings Bank
311 West Monroe
Chicago, Illinois 60690
(312) 461-3309

INDEPENDENT ACCOUNTANTS

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

ANNUAL MEETING

The Annual Meeting of Stockholders of Walter Industries, Inc. will be held Tuesday, September 17, 1996, at 10 a.m. in rooms 11 and 12 of the Tampa Convention Center, 333 South Franklin Street, Tampa, Florida.

QUARTERLY STOCK PRICE RANGE FISCAL 1996

	1Q	2Q	3Q	4Q
High	16 3/4	14 3/4	13 3/4	14 1/2
Low	13	12 3/8	12	12 5/8

Note: The Company's common stock traded on Nasdaq's OTC Bulletin Board from March 1995 to the date of its listing on the Nasdaq National Market in October 1995.

INVESTOR CONTACT

For further information about Walter Industries, Inc. and its subsidiaries, please contact:
Public Relations Department
Walter Industries, Inc.
P.O. Box 31601
Tampa, Florida 33631-3601
(813) 871-4448
Fax (813) 871-4430

FORM 10-K

A copy of the Company's annual report to the Securities and Exchange Commission on Form 10-K for 1996 is available upon written request to:

Walter Industries, Inc.
Public Relations Department
P.O. Box 31601
Tampa, Florida 33631-3601

CORPORATE OFFICES

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