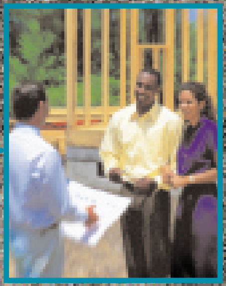
WALTER INDUSTRIES, INC.



# 1997 ANNUAL REPORT

SOLID FOUNDATIONS

# COMPANY PROFILE

Walter Industries, Inc. is a diversified, multi-subsidiary company with four operating segments: Homebuilding and Financing, Water Transmission Products, Industrial Products and Natural Resources. The Company's strategy is to focus on businesses that have strong competitive positions based on highly specialized operations and provide a balanced, 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."

## HOMEBUILDING & FINANCING

- **Jim Walter Homes, Inc.**

  Detached, single-family houses; home financing

- **Mid-State Homes, Inc.**

  Mortgage servicing for Jim Walter Homes customers

- **Best Insurors, Inc.**

  Home and general insurance services

- **Cardem Insurance Co., Ltd.**

  Reinsurance for customer property and credit life insurance

## WATER TRANSMISSION PRODUCTS

- **United States Pipe and Foundry Company, Inc.**

  Ductile iron pressure pipe, valves, hydrants and fittings; gray and ductile iron castings

## INDUSTRIAL PRODUCTS

- **JW Aluminum Company**

  Aluminum foil and sheet

- **Sloss Industries Corporation**

  Furnace coke, foundry coke, slag wool, specialty chemicals

- **Southern Precision Corporation**

  Foundry patterns, tooling molds, resin-coated sand, numerically controlled machining

- **JW Window Components, Inc.**

  Screens and components, thermal window spacers, cladding, balances

- **Vestal Manufacturing Company**

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

## NATURAL RESOURCES

- **Jim Walter Resources, Inc.**

  Metallurgical and steam coal; methane gas production

- **United Land Corporation**

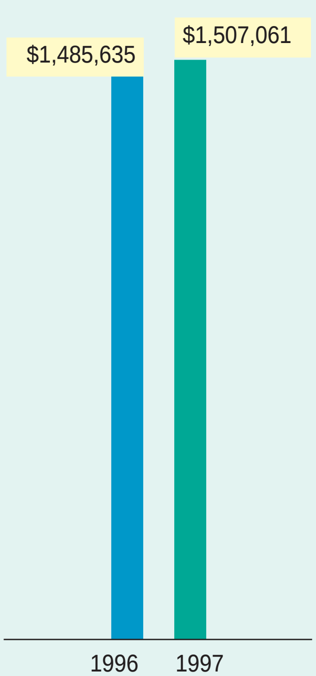
  Coal, timber, oil and gas royalties; land sales

# TABLE OF CONTENTS

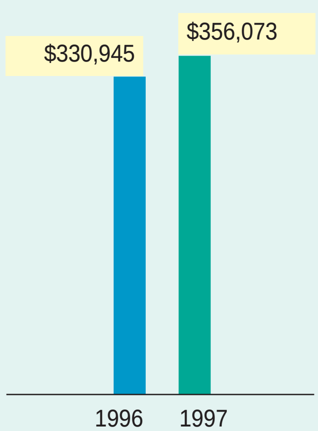
# FINANCIAL HIGHLIGHTS

| | FOR THE YEARS ENDED MAY 31, | |
|---|---|---|
| **CONSOLIDATED RESULTS** ($ in thousands, except share amounts) | **1997** | **1996** |
| Total Sales & Revenues | $ 1,507,061 | $ 1,485,635 |
| Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) | 356,073 | 330,945 |
| Earnings Before Interest and Taxes (EBIT) | 249,389 | 74,243 * |
| Net Income (Loss) | 37,117 | ( 84,696 )* |
| Net Income (Loss) Per Share | .67 | ( 1.66 )* |
| Weighted Average Shares Outstanding | 55,039,347 | 50,988,195 |
| **BALANCE SHEET** ($ in thousands) | | |
| Total Assets | $ 3,027,385 | $ 3,091,377 |
| Total Recourse Debt | 313,450 | 419,350 |
| Stockholders' Equity | 319,412 | 276,694 |
| **OTHER** ($ in thousands, except per share amounts) | | |
| Cash Flow from Operations, less Investing Activities | $ 145,705 | $ 58,367 |
| Capital Expenditures | 101,755 | 83,523 |
| Book Value Per Share | 5.80 | 5.04 |
| Employees | 7,584 | 7,755 |

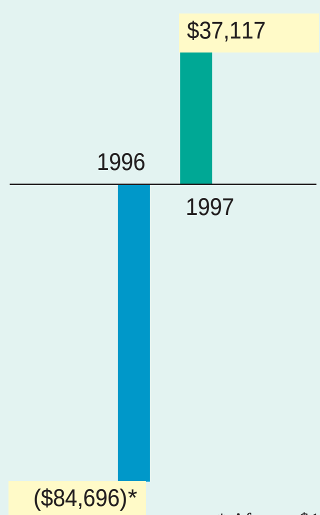
TOTAL SALES & REVENUES
($ in thousands)



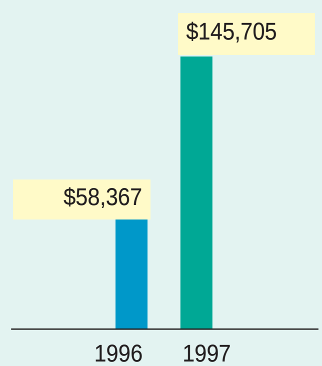

EBITDA
($ in thousands)




NET INCOME (LOSS)
($ in thousands)




FREE CASH FLOW
($ in thousands)




* After a $143.3 million charge ($101.1 million after-tax) from adoption of FASB 121.

# 1997 provided us with **solid foundations** for building shareholder value

The 50th year since our Company's founding was one of our most active and gratifying. As our first full year under a new management team and only our second since reorganization, fiscal 1997 was dedicated to renewing the earnings vitality and entrepreneurial spirit upon which Walter Industries was built.

We chose "Solid Foundations" as the theme for this year's annual report because it so aptly describes our significant actions during the past 12 months and the underlying strength we are building in each of our businesses.

It is my pleasure to highlight these accomplishments and share our outlook and vision for the future.

## STRONG OPERATING RESULTS

Walter Industries' EBITDA reached $356.1 million for fiscal 1997, an 8% increase over our $330.9 million EBITDA performance in 1996. EBIT totaled $249.4 million, compared with prior year EBIT of $217.5 million (before a required accounting charge), a 15% improvement.

Net income reached $37.1 million, or $0.67 per share, versus a net loss of $84.7 million, or $1.66 per share, in 1996. Adjusted for various non-recurring items, last year's net loss was $5.2 million, or $0.10 per share. Our higher profitability was achieved on net sales and revenues of $1.507 billion, compared with $1.486 billion in 1996.

These consolidated results reflect improved earnings from each of our four operating segments.

Jim Walter Homes, the cornerstone of our Company, posted its first comparative increase in home sales in five years while also achieving a 12% year-to-year increase in average selling prices. This turnaround was a direct result of strategic initiatives designed to enhance product offerings, strengthen our marketing, and move us toward our goal of restoring Jim Walter Homes to its historic position as the preeminent builder of affordable, single-family homes in the United States. Correspondingly, our Mid-State Homes mortgage portfolio grew $49 million to $4.3 billion during 1997. Together, our Homebuilding and Financing activities generated $232.5 million (before mortgage-related interest expense), or 65%, of Walter Industries' total EBITDA for the year.

Our Natural Resources segment, consisting of the Company's coal mining and methane gas operations, posted a 24% EBITDA increase in fiscal 1997. By year-end normal production had resumed at Jim Walter Resources' No. 5 coal mine following its 14-month development. With this “new” mine onstream, we entered fiscal 1998 with our full complement of four operating mines capable of producing nine million tons of high-quality, low sulphur Blue Creek coal annually.

United States Pipe and Foundry Company, the foundation of our Water Transmission Products segment, made significant progress in its ongoing efforts to enhance operating efficiencies and increase margins despite continued sluggishness in the release of federal funds for scheduled infrastructure improvements to our nation’s water pipelines. Segment EBITDA was 4% higher for the year, but more notably, rose 20% and 22% in the third and fourth fiscal quarters of 1997 as initial cost-improvement measures began to take effect.

In our growing Industrial Products segment, all five subsidiary companies reported improved earnings for the year, contributing to a 27% increase in EBITDA on 4% higher revenues.

## SIGNIFICANT FINANCIAL STRENGTH

Cash flow from operations, less investing activities, totaled $146 million in 1997, up from $58 million in fiscal 1996. At the same time, we reduced long-term recourse debt by nearly $106 million, to $313 million at year end, while stockholders’ equity rose $43 million, to $319 million. Shortly after the close of the fiscal year, we completed Mid-State Trust VI, the latest of our non-recourse, asset-backed financing vehicles through which we periodically monetize the instalment notes generated by our homebuilding activities. Some $439 million of asset-backed notes were offered, bearing an average coupon of 7.4%. Net proceeds from the offering, after payment of short-term mortgage borrowings, totaled $66 million and were used to fund the repurchase of approximately 1.4 million shares of the Company’s common stock in a privately negotiated transaction as well as further pay down debt. Our ratio of recourse debt-to-equity is now less than one-to-one.

## INVESTING FOR GROWTH

In addition to repaying debt and repurchasing stock, we are using proceeds from our refinancing activities and substantial cash from operations to support the

*Continued on following page*

## CORE VALUES

DURING 1997 THE COMPANY ESTABLISHED THE FOLLOWING CORE VALUES TO SERVE AS GUIDING PRINCIPLES FOR THE BUSINESS CONDUCT OF WALTER INDUSTRIES AND EACH OF ITS SUBSIDIARIES, AND AS THE FOUNDATION FOR OUR ONGOING STRATEGIC PLANNING INITIATIVES:

### EXCELLENCE

. . . in product quality, productivity and customer service. In all that we do. We strive to be the supplier of choice in each market we serve.

### COMMITMENT

. . . to do what we say we will do, and to do it right. We will be “follow through leaders.”

### INTEGRITY

. . . recognizing that our long-term success will be built upon trusting relationships with our employees, customers, suppliers, business partners and investors. We must treat these constituents honestly and with respect.

### CORPORATE RESPONSIBILITY

. . . to be a positive, contributing presence in each of our operating communities.

### VISION

. . . encouraging our people to be agents of change — curious, imaginative and unafraid to challenge current thinking in pursuit of future opportunity.

### TEAMWORK

. . . through which we will create sustainable earnings growth, increase shareholder value, and be rewarded for uncommon achievement.

growth of our core businesses. We invested $101.8 million in capital projects in 1997, up from $83.5 million in 1996. Capital expenditures in 1998 are again budgeted to exceed $100 million. These funds are being used to reduce manufacturing costs as well as add capacity in select product areas where above-average growth and enhanced shareholder value can be attained.

The recently announced expansion of our JW Aluminum subsidiary is an excellent example. For a total project cost of $31 million, we expect to increase manufacturing capacity 60% in two years to meet existing demand for our value-added niche aluminum products. Supported by prior capital investment and a sharpened product focus, JW Aluminum's sales growth has outpaced the aluminum industry by three-to-one, its return on assets has increased at a 23% compound annual rate and operating income at a 32% rate since 1991. The return on this latest JW Aluminum project is expected to comfortably exceed our 17% internal hurdle rate for capital expansion.

## ACQUISITION OPPORTUNITIES

We are pursuing acquisitions to accelerate our growth. In June 1997 Jim Walter Homes acquired Texas-based Neatherlin Homes, an on-your-lot builder with an established regional presence and distinguishing product characteristics that will broaden our homebuilding market penetration. Similar, well-managed on-your-lot builders operate throughout Jim Walter Homes' 24-state market area, providing additional opportunities to establish strategic alliances that will augment the Company's historic practice of growing by internally driven geographic expansion.

Future acquisition candidates will be carefully selected to complement our present core businesses or basic materials orientation, will generally be non-dilutive, and will serve niche markets with high barriers to entry. Size is not a determinant. Given our substantial cash flow and strong banking relationships, we have the flexibility to pursue acquisitions large or small, as long as they offer the potential to become significant contributors to our top and bottom-line performance either as stand-alone profit centers or as extensions of our existing product lines.

## PARTNERS IN PROGRESS

Underlying our substantial operating and financial progress is a workforce committed to creating a foundation for sustainable, long-term earnings growth. During the past year, we have implemented stock-based benefit programs that enable employees at all levels to share in the Company's improved results, thereby tangibly reinforcing the link between individual performance and increased shareholder value. Similarly, our key managers have been provided with stock incentives as a form of long-term compensation, and our annual incentives are now tied to year-over-year operating income growth and higher rates of return on capital invested at each of our subsidiaries. These incentives are designed to reward innovation and to reinforce the concept of Walter Industries as a blend of resourceful, self-confident entrepreneurial companies.

In an investment world that often disfavors multi-industry corporations, we embrace our diversity because of the balance and earnings consistency it provides us during economic down-cycles that can profoundly impact single-product companies. We believe that size and diversity will not inhibit our competitiveness, but instead will work to our advantage.

## OUTLOOK

This is an exciting time for Walter Industries. We are on the cusp of a new era of opportunity. A climate of challenge and change is palpable throughout our organization. The diverse base of our industrial businesses, coupled with our unique homebuilding franchise, offers us stability and the potential for substantial growth.

Moving forward, we believe that the financial, manufacturing and people strengths that powered our progress in 1997 will enable Walter Industries to achieve superior results and provide you with a heightened return on your investment in the years ahead.

We value your continued support and confidence.

Kenneth E. Hyatt
Chairman, President
and Chief Executive Officer

# CORPORATE OVERVIEW

## BUSINESSES OF THE COMPANY

The Company, through its direct and indirect subsidiaries, operates in four business segments: homebuilding and financing, water transmission products, natural resources, and industrial products. The Homebuilding and Financing Group sells, constructs on the customer's site, and finances detached, single-family homes. The Water Transmission Products Group is a leading domestic manufacturer of ductile iron pressure pipe and related products. The Natural Resources Group engages in coal mining and coalbed methane degasification. Five companies comprising the Industrial 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.

## CAPITAL INVESTMENTS

Gross capital expenditures in fiscal 1997 amounted to $102 million, compared with $84 million in 1996. The year-over-year increase largely resulted from development of a new mining area at Jim Walter Resources' No. 5 coal mine, which returned to production status in April 1997. A $105 million capital program is budgeted for fiscal 1998, including $19 million as part of a two-year, $31 million expansion program at JW Aluminum Company.

## EMPLOYEE RELATIONS

Walter Industries and its subsidiaries employ approximately 7,600 at 20 manufacturing facilities and a network of sales and administrative offices nationwide. In fiscal 1997 the Company was involved in negotiations covering three labor agreements and approximately 300 hourly employees. There were no contract renewal work stoppages during the year. Two contracts covering approximately 220 employees are scheduled for negotiation during fiscal 1998.

## INSTALMENT NOTES RECEIVABLE

Instalment notes receivable totaled $4.257 billion at year-end, representing the mortgage accounts of approximately 73,000 Jim Walter Homes customers. Time charge income earned from the Company's mortgage portfolio amounted to $231.4 million in 1997 compared with $231.1 million in fiscal 1996.

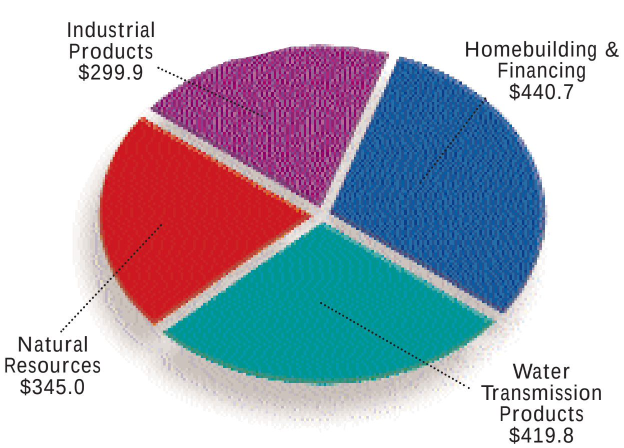
## DEBT STRUCTURE

The Company's long-term indebtedness as of May 31, 1997 consisted of recourse debt totaling $313.5 million and $1.8 billion of asset-backed notes which are secured by portions of the Mid-State Homes mortgage portfolio and are non-recourse to the Company. Recourse debt was reduced by approximately $106 million during fiscal 1997, principally from cash flows generated by the Company's operating subsidiaries and borrowings under the Mid-State Trust V Variable Funding Loan Agreement.

# OPERATING GROUP RESULTS — FISCAL 1997

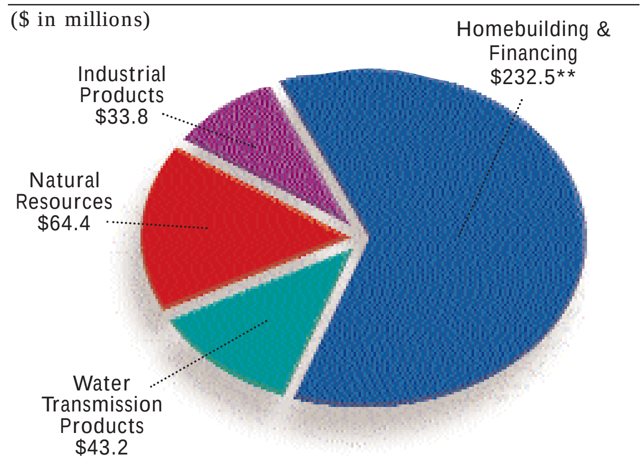
### SALES AND REVENUES

($ in millions)




### EBITDA*

($ in millions)




* Excludes corporate overhead expense. ** Before deducting $119.0 million of mortgage portfolio interest expense.

## JIM WALTER HOMES

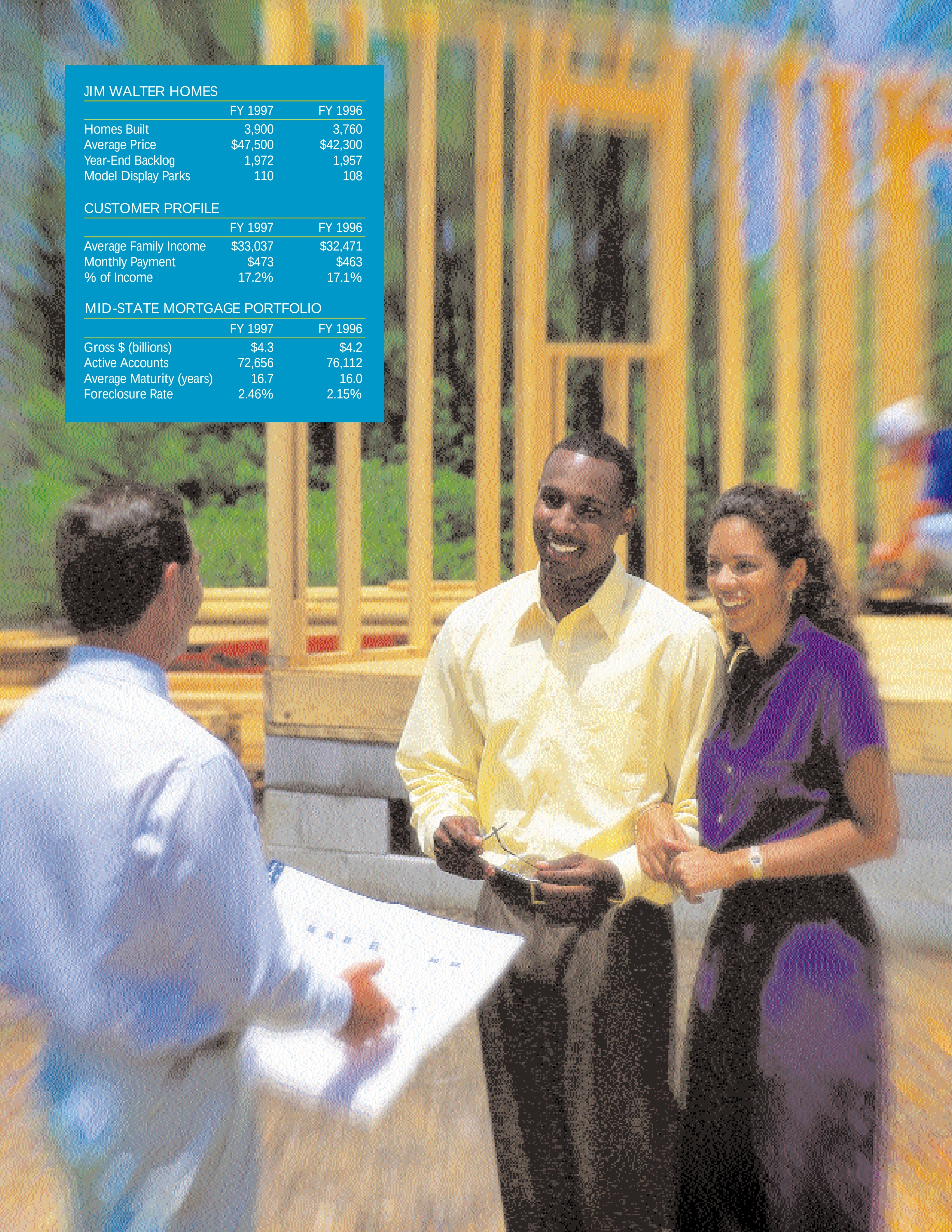
| | FY 1997 | FY 1996 |
|---|---|---|
| Homes Built | 3,900 | 3,760 |
| Average Price | $47,500 | $42,300 |
| Year-End Backlog | 1,972 | 1,957 |
| Model Display Parks | 110 | 108 |

## CUSTOMER PROFILE

| | FY 1997 | FY 1996 |
|---|---|---|
| Average Family Income | $33,037 | $32,471 |
| Monthly Payment | $473 | $463 |
| % of Income | 17.2% | 17.1% |

## MID-STATE MORTGAGE PORTFOLIO

| | FY 1997 | FY 1996 |
|---|---|---|
| Gross $ (billions) | $4.3 | $4.2 |
| Active Accounts | 72,656 | 76,112 |
| Average Maturity (years) | 16.7 | 16.0 |
| Foreclosure Rate | 2.46% | 2.15% |



# The nation's leading "on-your-lot" homebuilder, providing family foundations for generations of Americans

Jim Walter Homes is not only the foundation of Walter Industries, but also the foundation upon which families have built their home-ownership dreams for more than 50 years. The Company has built and sold more site-built single-family homes than any other builder in the country — more than 325,000 in all — since James W. Walter launched his "on-your-lot" homebuilding business in 1946. Today, Jim Walter Homes maintains a firm commitment to quality, affordability and integrity as the largest builder of on-your-lot homes and the eleventh largest builder of detached, single-family homes in the nation.

## QUALITY AND AFFORDABILITY

Jim Walter Homes' appeal lies in a simple, enduring concept: offer customers a quality home, built on their lot, at a price they can afford. Customers choose from over 30 models ranging in size from 640 square feet to 2,200 square feet, at prices ranging from $30,000 to just over $100,000. Each of these models can be built to various stages of completion — from a "shell home" that can be substantially finished by the buyer to the increasingly popular "90% complete" model, for which the customer must provide landscaping and utility connections.

Jim Walter Homes assures the quality and consistency of its products by building conventionally, from the ground up, using the same high-grade lumber and building materials found in more expensive homes. A Jim Walter home contains no modular assembly or prefabricated parts and is built to specifications that meet or exceed prevailing building codes. These factors contribute to an inherent durability and resale appreciation value superior to that of manufactured-housing alternatives.

## A FULL-SERVICE ADVANTAGE

In addition to a quality product, Jim Walter Homes offers qualified customers attractive fixed-rate, no downpayment mortgages without such add-ons as closing costs, points, credit service fees or private mortgage insurance. Currently, 96% of Jim Walter customers choose to finance their homes in this convenient, cost-effective manner. This unique combination of affordable product and competitive financing contributes to a counter-cyclical market effect — historically, the Jim Walter Homes product has grown even more attractive as interest rates rise or credit availability tightens.

Once a home sale is closed, Jim Walter Homes sells the note to Mid-State Homes, the group's mortgage servicing arm, providing customers a stable, single-source relationship for the life of their mortgage. More than 60% of Jim Walter homebuyers also take advantage of competitively priced fire and extended insurance coverage through the Company's Best Insurors subsidiary. Together, these full-service features distinguish Jim Walter Homes in the marketplace, offering customers both consistency and a long-term commitment to their investment.

## BROAD REGIONAL SCOPE

Jim Walter Homes currently operates 114 model display parks in 19 states — up from 110 at fiscal 1997 year end — and is licensed to conduct business in 24 Sunbelt and surrounding states stretching from the southwest to the

Sales and Revenues
($ in millions)


EBITDA*
($ in millions)


* Before deducting mortgage portfolio interest expense.


mid-Atlantic coast. Jim Walter Homes also operates 32 regional warehouses to deliver materials to its job sites. No single on-your-lot homebuilder operates across Jim Walter Homes' extended market area; competitors are primarily smaller-scale local and regional builders, and few offer comparable mortgage financing and insurance services.

## A SHARP MARKET FOCUS

Jim Walter Homes does not engage in speculative building or land development. The Company requires a firm contract before construction begins. The advantage of this approach is that Jim Walter Homes carries no land or product inventories or binding development interests, thus reducing risk and freeing capital to grow the business.

The Company also benefits from a unique level of customer commitment: a Jim Walter homebuyer's land value must equal at least 10% of the home's purchase price. In addition, customers must install their own utilities and property enhancements such as sidewalks and landscaping, adding substantial "sweat equity" to their investment.

## A $4.3 BILLION EDGE

Jim Walter Homes' financing activities and associated $4.3 billion Mid-State Homes mortgage portfolio are key contributors to the Company's success. With some 73,000 mortgages under contract, the Mid-State portfolio produces significant time charge income and has superior maturity, yield and credit quality characteristics.

The typical Jim Walter Homes customer earned a combined family income of just over $33,000 in 1997, with only 17% of this income — or $473 per month — allotted to housing costs, well below the national average. More than half have owned a home before, and 30% are trading-up from manufactured housing. Because customer-owned property serves as financing collateral, the Company enjoys a high recovery rate on any mortgage default. Foreclosures average just 2% of the outstanding portfolio. Stringent credit quality standards are also maintained, further stabilizing the integrity, income predictability and long-term value of the group's mortgage portfolio.

## STRATEGIC GROWTH

Jim Walter Homes will focus on growing its business through internally driven geographic expansion and selective acquisitions of regional homebuilders that offer opportunities for product differentiation in new or existing markets. An example of this strategy is the Company's June 1997 acquisition of Neatherlin Homes, Inc. — like Jim Walter Homes, a no-money-down, on-your-lot homebuilder with an established record of product quality and customer service. As part of the Jim Walter family, Neatherlin will broaden the Company's presence in Texas, Arizona and New Mexico, generating an expected 100 or more home completions during fiscal 1998.

Continued growth in the form of new model parks and display centers also plays a vital role in Jim Walter Homes' expansion plans. Within the past five years, the Company has extended its reach to 10 new markets, six within the past two years. In fiscal 1998 the Company plans to build new display parks in Jackson, Tennessee and Roanoke, Virginia, and secure new park sites in Sherman, Lubbock and Wichita Falls, Texas. Ample opportunities also exist to expand operations in a number of states where the Company maintains relatively few display parks, or where the homebuying market is served from a neighboring state. Western Pennsylvania, Kansas, southern Colorado and Nevada are among those areas targeted for expansion consideration in the coming year.

## CONTINUOUS IMPROVEMENT

Jim Walter Homes continues to upgrade the consumer appeal of its products. For fiscal 1997 the Company introduced four new home designs while updating floor plans and exterior elevations on several popular models in response to customer input. Vinyl windows and siding are now being offered in select markets, while the Company's most complete homes now feature optional cabinet and vanity upgrades and, for the first time, floor covering and interior painting options.

The Company is also pursuing broad-based system improvements. A multi-year program to strengthen operations, technology, sales methodologies, customer service and satisfaction ratings was initiated in early 1997, including the implementation of reengineered sales recruitment and training efforts and customer satisfaction-based bonus programs across the group's 19-state network of model home centers. A central sales support hotline was also established to provide immediate attention to customer service or pricing issues from the field. Five of Jim Walter Homes' 14 regions were linked to an automated sales documentation system during 1997, improving paperwork processing and turnaround, with the remaining regions to be linked by fiscal 1998 year-end. Across all offices and regions, Jim Walter Homes is pursuing a strengthened quality focus in every stage of the operation in support of anticipated growth.


## RECENT PERFORMANCE AND OUTLOOK

The combined Homebuilding and Financing group posted a fiscal 1997 net sales and revenues increase of 7% to $440.7 million, versus $413.1 million a year earlier. EBITDA (before deducting mortgage-related interest expense) totaled $232.5 million, a 3% increase compared to the $226.1 million generated in fiscal 1996. These gains are largely attributable to a 12% increase in average selling price across Jim Walter Homes' three product groups, reflecting a sustained shift in product mix to the Company's "90% complete" homes since the introduction of an 8.5% financing program in fiscal 1996. In 1997 roughly 89% of all homes sold were built to this most complete level, up 18% over the prior year and 30% over fiscal 1995. During the fiscal 1997 fourth quarter, 8.5% financing terms were extended to all models.

Jim Walter Homes completed 3,900 units in fiscal 1997, a 4% increase over the 3,760 units completed a year earlier. Entering fiscal 1998, several positive signs point to a sustained increase in home sales. The Company ended 1997 with a backlog of 1,972 confirmed orders, up slightly from the previous year. It is anticipated that homebuilding volumes will continue their upward trend in 1998 as the growth initiatives of 1997 — including new and innovative marketing plans, strategic expansion and acquisition efforts, product and design enhancements, and sales-based training and incentive programs — continue to raise operational efficiency and performance.

APPROXIMATELY 30% OF JIM WALTER HOMES' CUSTOMERS TRADE UP FROM MANUFACTURED HOUSING, AND 96% CHOOSE COMPANY PROVIDED MORTGAGE FINANCING.

WATER TRANSMISSION PRODUCTS

| | FY 1997 | FY 1996 |
|---|---|---|
| Pipe Shipments (tons) | 521.600 | 539.800 |
| Order Backlog (tons) | 108,341 | 121,734 |
| Scrap Cost (per ton) | $132.83 | $141.54 |

# Water systems worldwide must maintain **exacting standards** for solid infrastructures, making U.S. Pipe a supplier of choice

Across the country, older cities and new communities rely on the United States Pipe and Foundry Company to supply the ductile iron pressure pipe and related products that are the foundation of their water and waste water transmission and distribution systems. Founded nearly a century ago, U.S. Pipe remains a powerful industry force, maintaining a leading domestic market position and a growing international presence.

## A TRADITION OF STRENGTH

U.S. Pipe is the nation's primary supplier of ductile iron pressure pipe, a ranking the Company has maintained since its founding in 1899. Today, U.S. Pipe manufactures ductile iron pipe in diameters of 4" - 64", at lengths up to 20 feet and certified to pressure ratings often exceeding industry standards. U.S. Pipe supplements its pipe products with a broad range of valves, fittings, hydrants and boltless restrained joint technologies, offering solid, stable infrastructure solutions to waterworks customers worldwide.

U.S. Pipe's core business consists of converting scrap metal into ductile iron products used in water supply and sewage systems. While ductile iron is initially priced at a premium over PVC and other materials, its superior longevity, ease of installation and rugged durability offer the industry's most economical solution from a total-cost perspective. When compared to competing materials — such as concrete, steel and thermoplastics — ductile iron remains the most effective long-term option available, a fact underscored in recent years by highly publicized failures of alternate piping materials in several major urban water systems.

## A HISTORY OF INNOVATION

U.S. Pipe is not only a leading industrial manufacturer, it is also an innovator, holding numerous patents for its proprietary pipe, fittings, valve and hydrant products. In the 1920s, U.S. Pipe purchased the rights to Dimitri Sensaud deLavaud's revolutionary centrifugal casting process — pouring molten iron into a rapidly rotating steel casting mold to form a high-grade pipe of uniform properties and unmatched durability. U.S. Pipe later became the first in the industry to utilize ductile iron exclusively for its pressure pipe and fittings, carving out a reputation for the strength and consistency of its expanding product lines. In the 1960s, the Company introduced the TYTON JOINT® pipe, the world's most widely used ductile iron pipe joint. The more recent introduction of boltless TR FLEX® pipe and FIELD LOK® gaskets further solidified U.S. Pipe's leadership in restrained joint technology. This tradition of product leadership continued in 1997 with the development of patented technology to detect flaws or cracks in the wall of pipe during manufacture by measuring magnetic flux leakage. The Company also continues to develop improvements to manufacturing processes, including a number of automation initiatives to support more precise controls on product yields, wall thickness, uniformity and similar measures designed to enhance quality and reduce production costs.

These and other innovations maintain U.S. Pipe's high profile in the marketplace — the Company is well-known and respected in the engineering and industrial contracting communities. U.S. Pipe has also moved, in recent years, to expand its services to offer in-house coatings and linings to meet specialized customer specifications both domestically and abroad.

Sales and Revenues
($ in millions)


EBITDA
($ in millions)

COMMUNITIES NATIONWIDE MUST INVEST AN ESTIMATED $138 BILLION OVER THE NEXT 20 YEARS TO COMPLY WITH FEDERAL SAFE DRINKING WATER MANDATES.

U.S. Pipe operates six manufacturing plants, including pipe production operations strategically located in Bessemer and North Birmingham, Alabama; Union City, California; and Burlington, New Jersey; a fittings, valve and hydrant manufacturing plant in Chattanooga, Tennessee; and a general castings foundry in Anniston, Alabama. The Company is organized in two operating divisions: Pressure Pipe, which accounts for approximately 95% of total segment revenues, and Castings, which produces complementary gray and ductile iron castings for fittings, valves, pumps, electric motors and construction equipment. Approximately 55% of Castings production output in 1997 was sold to the Pressure Pipe Division, with the balance reaching a diverse mix of industrial customers. To assure a high level of responsiveness, the Company maintains 36 regional sales offices across the United States, offering the broadest market coverage of any company in the industry.

Aggressive international sales and marketing efforts are directed from U.S. Pipe's Birmingham, Alabama headquarters.

## EXPANDING MARKETS

U.S. Pipe's market base consists of three segments: contractor sales (representing approximately 50% of revenues); distributor sales (35%); and direct sales to municipalities, private water companies or other governing agencies (15%). U.S. Pipe is able to meet each of these groups' stringent durability, flow capacity, transmission purity and stress resistance requirements with a complete line of ductile iron products.

The Company also provides a full range of metric offerings to meet international specifications. U.S. Pipe has supplied water and waste water systems from South America to the Pacific Rim and throughout the Middle East. International sales efforts should benefit from the April 1997 certification of the Company's North Birmingham plant to the ISO 9002 standard — a widely accepted symbol of quality requiring stringent controls during each stage of the industrial production cycle. Achieving this certification will work to further strengthen U.S. Pipe's international stature and open certain previously restricted markets to competitive bidding opportunities in fiscal 1998. Aggressive efforts are underway to extend ISO 9002 certification standards throughout the Company.

## POISED FOR GROWTH

Over the next several years, a number of market factors point to sustainable growth opportunities for U.S. Pipe. Based on infrastructure improvements mandated by the Safe Drinking Water Act (SDWA), signed into law in 1996, the Environmental Protection Agency has determined that community water systems must invest a minimum of $138 billion over the next 20 years to ensure compliance with federal SDWA requirements. The largest category of need — estimated at more than $77 billion — is the replacement of seriously deteriorating potable water transmission and distribution systems. As the nation's leading supplier of ductile iron pipe, U.S. Pipe is well positioned to benefit from this infrastructure mandate. A second favorable indicator is the continued strength of the single-family housing market, projected to maintain a steady upward trend through the turn of the century. More than half of U.S. Pipe's products serve new residential construction projects.

## RECENT PERFORMANCE AND OUTLOOK

U.S. Pipe generated revenues of $419.8 million in fiscal 1997 versus $420.0 million in the prior year. Fiscal 1997

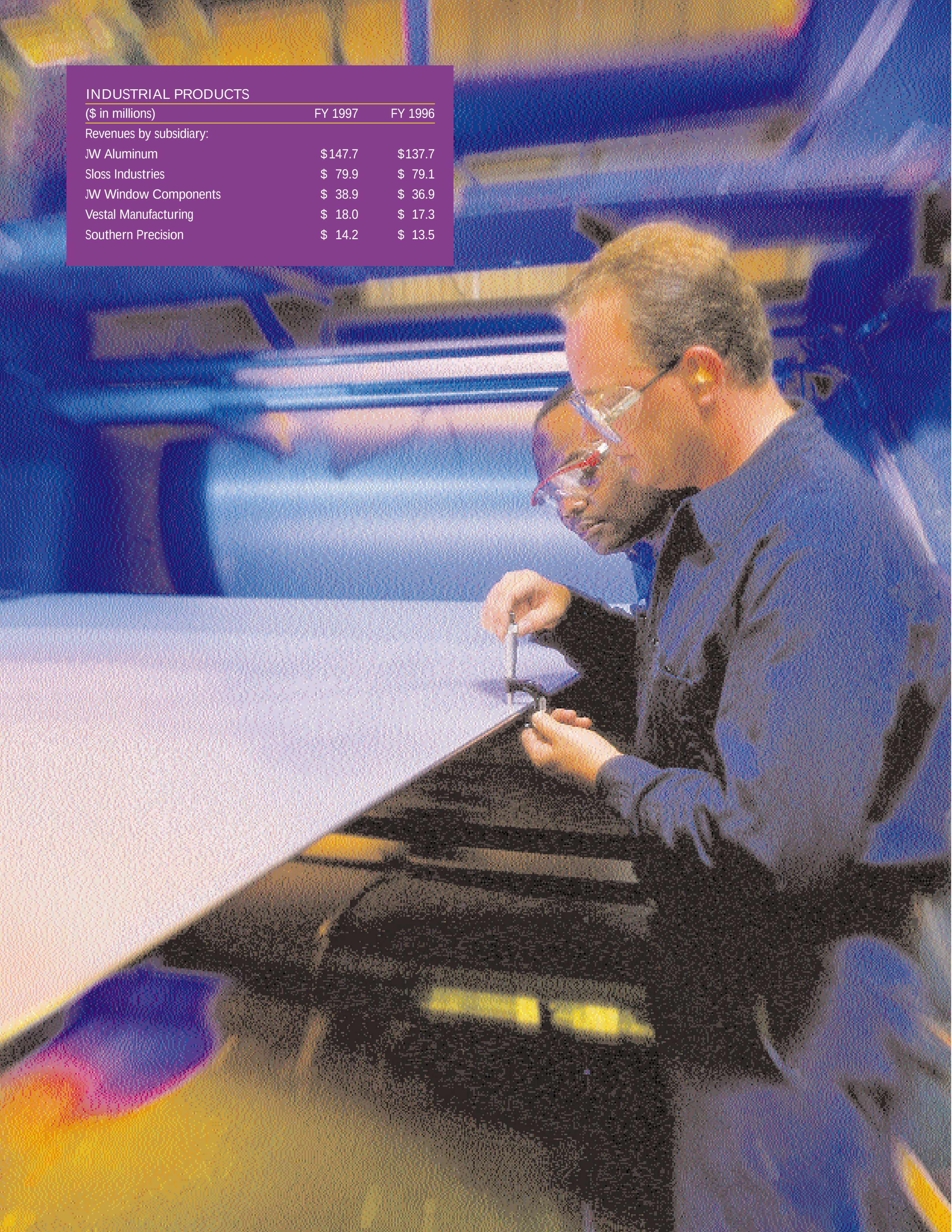


EBITDA totaled $43.2 million, a 4% increase over the $41.4 million generated in fiscal 1996. Operating income (after goodwill) was sharply higher, at $14.0 million versus $10.5 million a year earlier — a 33% increase driven by improved operating efficiencies and lower prices for scrap metal, the principal raw material in the production of ductile iron pipe. Company shipments were down 3% for the year, to 521,600 tons versus 539,800 tons a year earlier, in part due to the market trend toward lighter, thinner-walled pipe products in fiscal 1997. The Company ended 1997 with 108,341 tons in backlog compared to 121,734 tons a year earlier. A large-volume contract initiated after the close of the fiscal year, however, supplemented U.S. Pipe's shipment backlog with an additional 34,400 tons as of June 30, 1997. This $40 million contract with the nation of Qatar calls for 56 miles of potable water transmission pipe to be installed over a two-year period, further strengthening U.S. Pipe's Middle Eastern presence and international reputation.

Domestically, fiscal 1997 performance was constrained by continued delays in infrastructure spending for much-needed upgrades to the nation's piping systems. In most cases, these jobs are either on the drawing board or have been bid and are awaiting release of funds. There are indications that these anticipated projects will activate in fiscal 1998 as state revolving funds for water transmission improvement projects are released and federal SDWA mandates prompt an acceleration in government funding for necessary water system replacements. While the bulk of U.S. Pipe's sales are in the 4" - 24" market, the Company remains one of only two domestic manufacturers offering ductile iron pipe in diameters of up to 64". This larger diameter range is projected to outpace the market in coming years as many older metropolitan areas work to upgrade deteriorating water transmission systems.

Beyond these encouraging market signals, U.S. Pipe remains committed to internal process and efficiency enhancements. The Company initiated a number of aggressive operations-based improvement programs in fiscal 1997 to further reduce costs and increase market penetration.

A $40 MILLION, TWO-YEAR CONTRACT WITH THE NATION OF QATAR WILL ENHANCE U.S. PIPE'S NEAR-TERM RESULTS AND INTERNATIONAL STANDING



INDUSTRIAL PRODUCTS

| ($ in millions) | FY 1997 | FY 1996 |
|---|---|---|
| Revenues by subsidiary: | | |
| JW Aluminum | $147.7 | $137.7 |
| Sloss Industries | $ 79.9 | $ 79.1 |
| JW Window Components | $ 38.9 | $ 36.9 |
| Vestal Manufacturing | $ 18.0 | $ 17.3 |
| Southern Precision | $ 14.2 | $ 13.5 |

# A blend of **strong niche manufacturers** offering solid foundations for growth

The diverse range of products manufactured by Walter Industries' five industrial businesses include: specialty aluminum for air conditioning and lithography applications; coke and specialty chemicals; castings and molds for the foundry industry; window components and cast iron products for construction-related markets. The common link between all of these products is that they serve highly specialized industrial needs, and that Walter Industries has a competitive edge in each area through market leadership, proprietary processes, environmental compliance or low-cost operations. There is another unifying principle — they represent a broad base of business opportunities that, together, are an important part of Walter Industries' foundation for growth.

## NICHE-MARKET LEADERSHIP

JW Aluminum, founded in 1979, has built a thriving specialty aluminum manufacturing business in recent years and today ranks as a leading producer of high-quality aluminum sheet and foil products geared toward various niche-based industrial markets in the United States and internationally.

Based in Mt. Holly, South Carolina, JW Aluminum operates an independent mini-mill utilizing advanced scrap-based continuous casting technology. The Company has a sophisticated network of melting and annealing furnaces, casters, slitters and precision rolling mills, as well as a specialty coating line to apply a variety of water-based coatings to its insulation foil and fin stock products. The Company's manufacturing plant is ISO 9001 certified, assuring customers worldwide a high level of systems and quality control at each stage of the production cycle.

## A VALUE-ADDED APPROACH

Initially founded to service the building materials market, JW Aluminum redirected its efforts in the late 1980s toward developing specialized product and market niches offering greater profit margins and superior growth potential. Since that time, the Company has established a leading position in such value-added product lines as telecommunications cable wrap and custom-coated fin stock for domestic air conditioning and heat transfer applications. In fact, JW Aluminum pioneered the development of coated fin stock and remains among the world's leading suppliers of the specialty product. The Company also maintains a strong presence in the standard fin stock and lithographic print foil markets.

While specialty products represent a majority of shipments and are the Company's most profitable and fastest-growing business, JW Aluminum continues to dedicate a portion of its output to commodity-based products. These include consumer and institutional foil as well as building sheet used in the manufacture of aluminum gutters, downspouts, roofing, siding and residential window products.

## CUSTOMER-BASED SOLUTIONS

JW Aluminum's niche-market focus facilitates the custom-tailoring of new and existing products to meet specific customer requirements. The Company has gained a solid reputation for one-on-one engineering




JW ALUMINUM'S SIX-YEAR GROWTH RATE HAS OUTPACED THE INDUSTRY BY A FACTOR OF THREE-TO-ONE, GENERATING 10% YEAR-OVER-YEAR SALES INCREASES.

support and collaborative problem solving. This approach has led to the development of a number of profitable new product and process innovations, including proprietary casting technologies, coatings and alloy variants. The Company remains the only aluminum operation in the United States equipped to provide continuous cast aluminum for newspaper-grade lithography products.

## UNCOMMON GROWTH

JW Aluminum's sales growth rate has outpaced the industry by a factor of three-to-one, generating 10% year-over-year increases since 1991. During this same six-year period, return on assets increased at a 23% annual compound rate and operating income at a 33% rate. Already counted among the industry's lowest-cost producers, JW Aluminum continues to focus on aggressive process and asset optimization improvements and cost controls as a means of driving sustained operational growth.

## INVESTING IN THE FUTURE

Since the early 1990s, JW Aluminum has undertaken several sizable expansion efforts, upgrading equipment and output capabilities while doubling capacity to 150 million pounds-per-year to meet rising product demand. In fiscal 1998 the Company will initiate its most ambitious expansion to date — a $31 million project adding three continuous casters, a cold rolling mill, roll grinder and precision slitter into 65,000 square feet of new or upgraded space at the Company's Mt. Holly plant site. The equipment, acquired from a discontinued South Korean aluminum mill, will be brought online over a two-year period, boosting plant capacity 60%, to 240 million pounds-per-year, by the end of the Company's 1999 fiscal year.

This latest expansion project — the Company's fourth in five years — will also enhance JW Aluminum's cost structure and production range, enabling the manufacture of foil and sheet up to 10% wider than current plant capabilities. In addition, the new cold mill will offer 95% operational back-up in the event of a major interruption in the Company's primary production line.

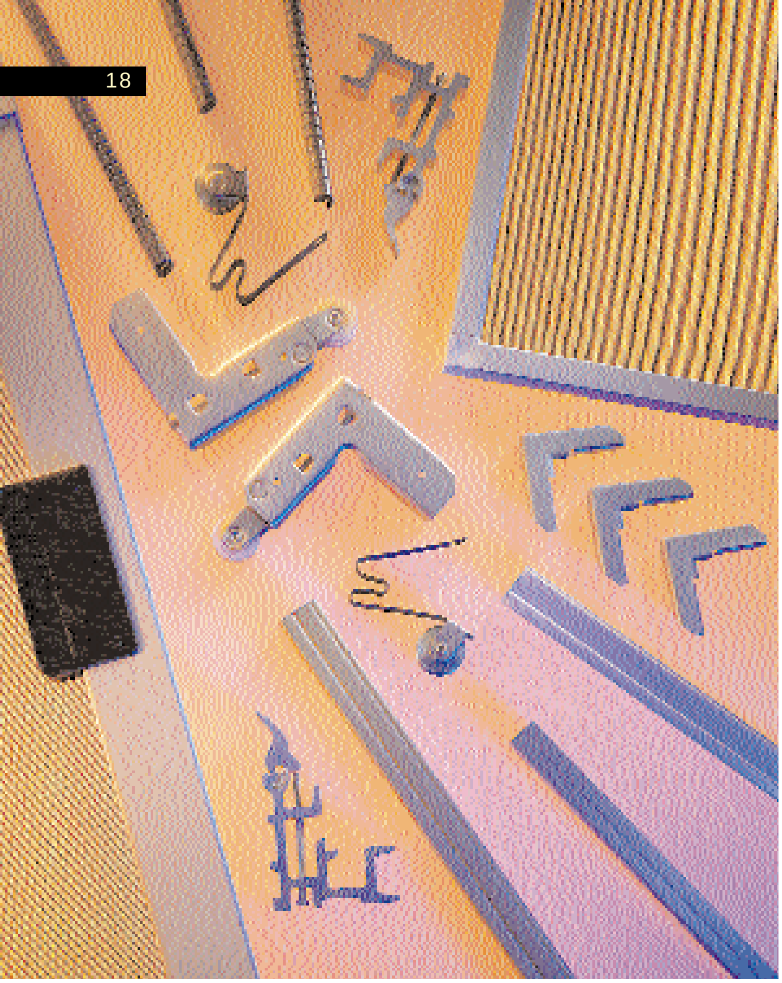
## DIVERSITY AND INGENUITY

Sloss Industries serves a broad industrial base through its high-grade furnace and foundry coke, coke by-products, chemicals and slag wool fibers. The Company

operates 120 coke ovens at capacity, supplying blast furnace coke to the steel industry and foundry coke to the automotive, agricultural and cast iron industries. Through a long-term arrangement with National Steel Corporation, Sloss' entire furnace coke output is committed through the end of the century. U.S. Pipe remains a long-term foundry coke customer, purchasing 61% of Sloss' output in fiscal 1997. In total, coke and coke by-products accounted for just over 60% of Sloss' 1997 revenues.

Sloss' slag wool product is an insulating fiber used primarily as a raw material in the manufacture of

SLOSS DIRECTS ITS SPECIALTY CHEMICALS TO MID-SIZED CUSTOMERS THAT LARGE VOLUME PRODUCERS CANNOT SERVICE AS COST-EFFECTIVELY.



ROUNDING OUT THE INDUSTRIAL SEGMENT'S STRONG 1997 PERFORMANCE WERE JW WINDOW COMPONENTS, SOUTHERN PRECISION AND VESTAL MANUFACTURING, EACH REPORTING SHARPLY IMPROVED EARNINGS FOR THE YEAR.

acoustical ceiling tile, although it has found popularity in a number of expanded applications in recent years, including manufactured-home insulation, plastics molding and asphalt paving systems, where it is used as a bonding agent. Sloss' line of Processed Mineral Fibers (PMF) serves as a reinforcement additive in friction materials, such as automotive brake shoes, as well as thermoplastic molding compounds, adhesives, paints and sealants. Combined, these products accounted for 15% of revenues in 1997.

## SPECIALTY CHEMICALS

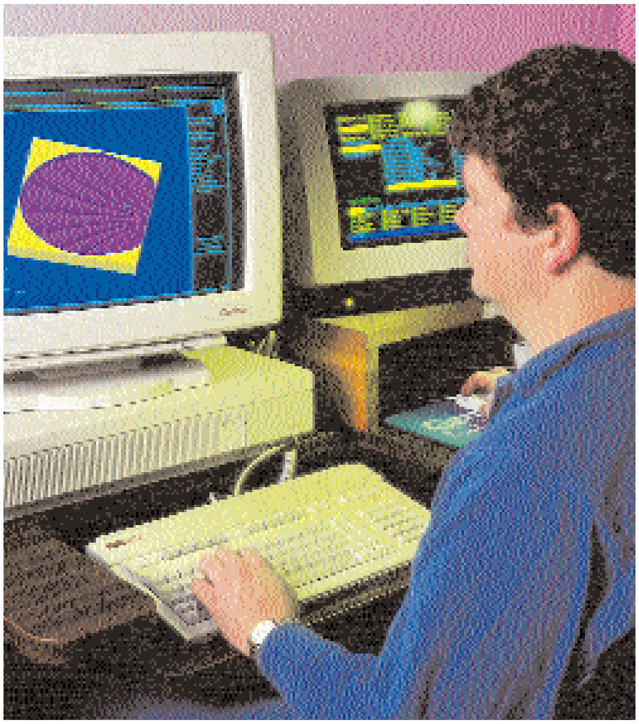
In the late 1940s, Sloss Industries expanded operations into the specialty chemical market, where it continues to focus on mid-sized custom contracts that larger volume chemical producers cannot service as cost-effectively. The Company's chemical compounds are in demand in the pharmaceutical, food supplement, plastics, rubber, foundry and coatings industries for products ranging from food dyes to sulfonic acids.

To ensure its service and quality objectives, Sloss' two chemical manufacturing plants employ internal analytical laboratories which continuously monitor product purity and production tolerances. Sloss' chemical products accounted for 23% of 1997 sales.

## MARKET-DRIVEN MANUFACTURING

The Industrial Products Group's three remaining subsidiaries offer specialty products for the foundry, residential and commercial construction industries, combining to generate 24% of the segment's fiscal 1997 revenues and 14% of EBITDA.

- **JW Window Components**, based in Elizabethton, Tennessee, offers the broadest product line of any supplier to the window and patio door industry. The Company is a recognized leader in the production of block and tackle sash balances. Other products include roll form aluminum window components; screens and screen frame products; mechanical balances; and jambliners. In addition to its Elizabethton headquarters site, JW Window



Components operates two additional production plants in Sioux Falls, South Dakota and Merrill, Wisconsin.

- From its base in Irondale, Alabama, **Southern Precision** is a leading producer of specialized industrial tooling products and resin-coated sand for the foundry industry. Its products include metal and wood pattern tooling; plastic and rubber mold tooling; and computerized, numerically controlled product machining. Founded in 1948, Southern Precision has grown to become the largest tooling and sand coating operation in the Southeast.
- **Vestal Manufacturing**, based in Sweetwater, Tennessee, produces a diversified line of metal and foundry products for residential, commercial and industrial use. The Company's product line includes energy-saving fireplaces; fireplace inserts and accessories; wood-burning stoves; and lightweight castings for the municipal and metal-building markets. Vestal's products are sold through a network of independent sales agents to hardware and building materials distributors, home centers and mass merchandisers worldwide.

## RECENT PERFORMANCE AND OUTLOOK

Walter Industries' combined industrial businesses generated revenues of $299.9 million in fiscal 1997, a 4% increase over the prior year. Fiscal 1997 EBITDA increased 27%, to $33.8 million versus $26.5 million a year earlier. This improvement reflected enhanced results at each operating subsidiary, led by strong performances from JW Aluminum and Sloss Industries.

Approximately 50% of group revenues were contributed by JW Aluminum, which shipped a record 136 million pounds of product during the year, an 11% increase over fiscal 1996. An additional 27% of sales was attributable to Sloss Industries, which continued to benefit from its diversified product mix and long-term contracts. In fiscal 1998, as the first stage of JW Aluminum's $31 million expansion begins, the focus at both operations will remain firmly fixed on optimizing capacity, maintaining a strong technological edge and developing new products and applications targeted to key niche markets.

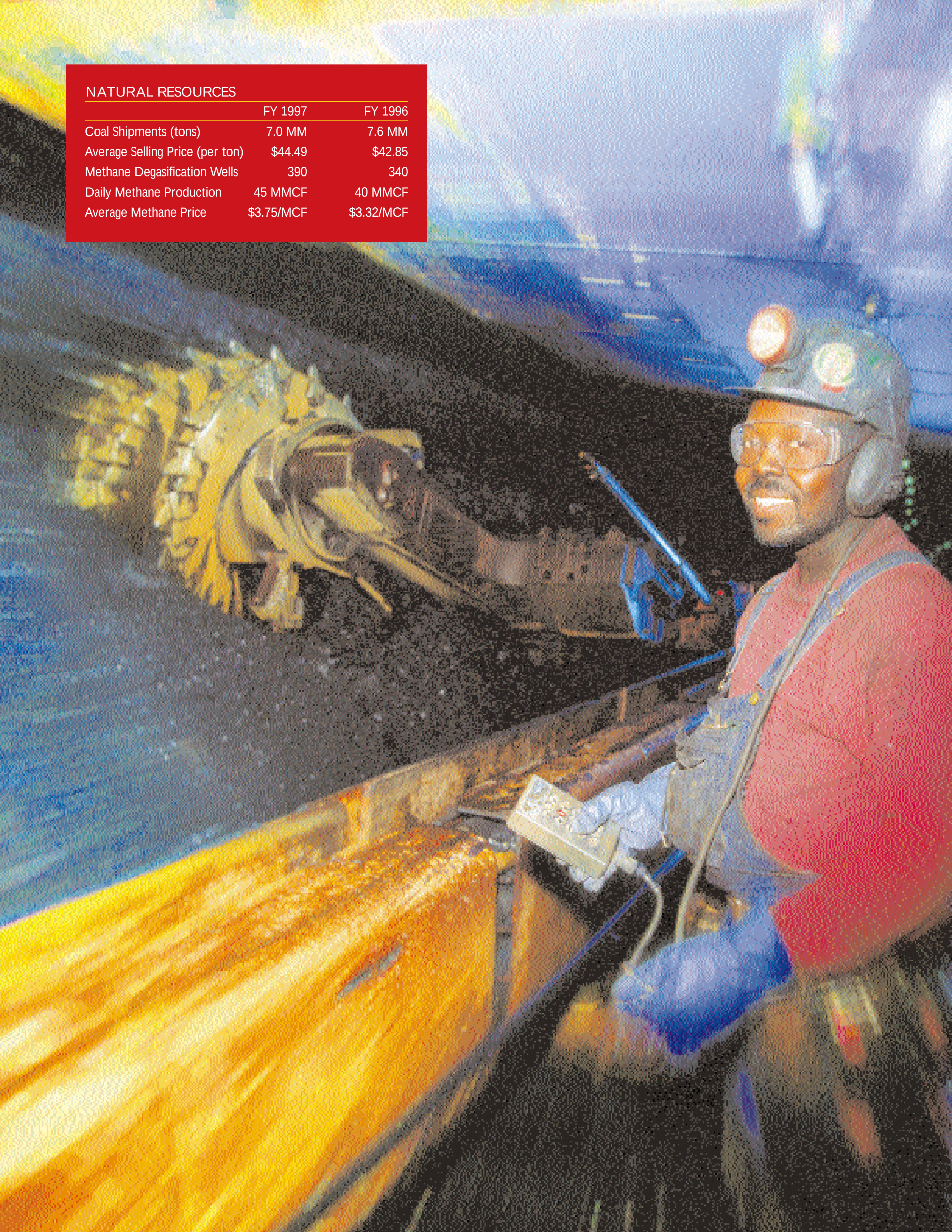
JW Window Components increased market share in fiscal 1997 through dependable delivery of a high-quality, broad product offering. Fiscal 1998 targets include the introduction of new products, the expansion of the group's customer base across all product lines, and continued efforts to become the supplier of choice in its served markets.

Vestal Manufacturing's revenues for fiscal 1997 increased 4%, resulting from improved foundry performance, lower raw material costs and a 14% increase in building products sales. Vestal is anticipating continued strong demand in the building products sector, boosted in part by targeted expansion into several new sales territories in fiscal 1998. The Company is also projecting an increase in gray iron casting sales during the year ahead.

Southern Precision's fiscal 1997 revenues grew by more than 4%, driven by the continued strength of its specialized machine pattern tooling and resin-coated sand operations. Through a combination of selective bidding, cost-cutting and efficiency improvement efforts, Southern Precision ended the year with sharply higher gross profit margins. Moving into fiscal 1998, the Company is targeting its numerically controlled machining operations, particularly in the large machine tool segment of the market, to drive continued growth. Southern Precision is expanding operations to include steel and aluminum fabrication in fiscal 1998, thereby enabling it to offer "one-source" tooling and finishing services.

## NATURAL RESOURCES

| | FY 1997 | FY 1996 |
|---|---|---|
| Coal Shipments (tons) | 7.0 MM | 7.6 MM |
| Average Selling Price (per ton) | $44.49 | $42.85 |
| Methane Degasification Wells | 390 | 340 |
| Daily Methane Production | 45 MMCF | 40 MMCF |
| Average Methane Price | $3.75/MCF | $3.32/MCF |



# High-grade coal from Alabama's **Blue Creek Seam,** internationally recognized for its enduring quality and consistency

Coal-burning utilities and steel manufacturers on five continents have come to rely on Jim Walter Resources' Blue Creek coal to fuel their operations with the cleanest, most efficient raw material available. The Company's distinguishing advantage lies in the quality and consistency of its product. Extracted from the deepest mines in North America, Blue Creek coal offers unique thermal and coking qualities in great demand throughout the industrialized world.

Domestic utilities in particular are increasingly seeking fuel sources that comply with federal acid rain and clean air mandates in the delivery of their energy services. The global steel industry continues to focus on coking properties and rigid thermal and metallurgical specifications to effectively manufacture their products. Blue Creek coal is advantageous to both markets, offering high coking strength with low coking pressure, low sulfur and low-to-medium ash content with high BTU values. Jim Walter Resources (JWR) is able to deliver these qualities, and make them available on a long-term basis to customers worldwide.

Located in Alabama's coal-rich Warrior Basin region, JWR's four underground mines reach depths of up to 2,300 feet below the Earth's surface and have the capacity to deliver more than 9 million tons of Blue Creek coal to market each year. With approximately 208 million tons of recoverable reserves, the Company is well-positioned to offer customers a reliable source of high-grade raw materials suitable for compliance steam and metallurgical applications.

The Company's Blue Creek coal supports a diversified customer base, including multi-year contract relationships with long-standing clients both domestically and abroad. JWR coal currently reaches large-volume customers in Belgium, Turkey, Brazil, Japan and numerous other international markets. Closer to home, Alabama Power Company remains one of JWR's major customers, purchasing approximately half of the Company's annual coal output under a contract extending through August 1999.

## ADVANCED LONGWALL MINING

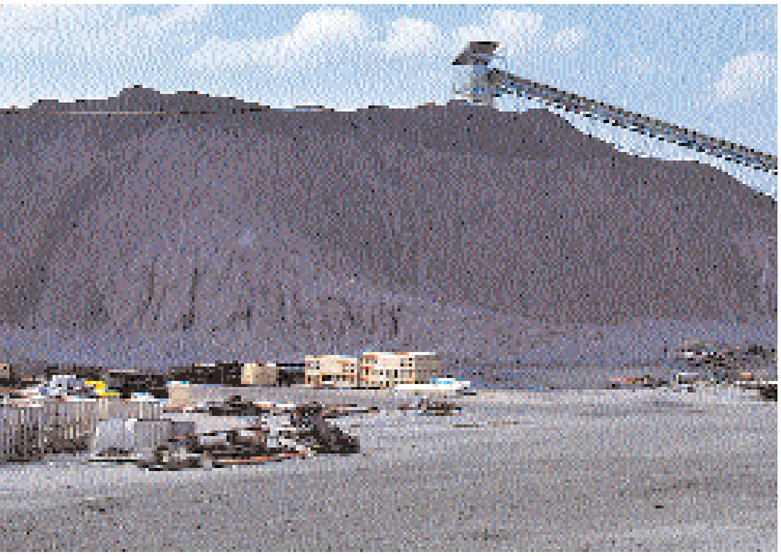
Beyond the strength of its product, JWR is renowned for its mining engineering operations. Advanced longwall extraction technologies work to mine coal panels hundreds of feet wide, depositing large quantities of Blue Creek coal on self-contained conveyor systems. The computer-guided longwall equipment assures precision shearing of the coal seams under protective hydraulic roof supports designed to advance as the seam is cut, thereby offering the fastest, cleanest and safest method of coal extraction available for deep underground mines. The enhanced throughput and efficiency associated with longwall mining systems — currently accounting for 75% of JWR production — generates volumes nearly four times that of conventional deep-mining methods. JWR was among those pioneering domestic longwall mining nearly two decades ago and remains at the forefront of high-tech mining and engineering technologies.

## COMMITTED TO QUALITY

Complementing JWR's superior product and process engineering is an aggressive quality control program. Each of the Company's mines are equipped with preparation plants designed to deliver specific product char-

Sales and Revenues
($ in millions)


EBITDA
($ in millions)



acteristics based on a wide variety of customer requirements. Coal is sampled and analyzed at critical points in the production cycle, along with systematic sampling and testing before loading and shipment. In this way, customers are assured delivery of the product grade and specific metallurgical properties their operations demand.

### A GROWING PRESENCE IN METHANE PRODUCTION

Supplementing JWR's coal mining operations is a growing methane gas recovery business established in 1981 as a joint venture with the Southern Natural Gas Company, a subsidiary of Sonat and the project's sole customer. Born out of a concern for mine safety, the methane gas extraction operation has expanded dramatically in recent years, today ranking as the most comprehensive degasification program in the industry. JWR currently operates 390 methane wells capable of recovering more than 45 million cubic feet of methane gas per day.

### RECENT PERFORMANCE AND OUTLOOK

Results in fiscal 1997 reflected the absence of longwall production from the Company's Blue Creek Mine No. 5, where development of a new mining area was underway throughout most of the year. Accordingly, the 7.0 million tons of coal shipped by JWR in fiscal 1997 compares with 7.6 million tons for the prior year, an 8% decrease. Segment sales and revenues totaled $345.0 million compared with $362.9 million in 1996. Mine No. 5 returned to production status during the fiscal 1997 fourth quarter. Longwall production resumed in the eastern part of the mine in June 1997. During fiscal 1998, JWR anticipates a gradual return to its 9 million ton-per-year production levels and a marked increase in segment cash flow and income contribution.

JWR's average selling price was $44.49 per ton in fiscal 1997 compared with $42.85 in the prior year, a 4% improvement reflecting a higher proportion of tonnage sold to Alabama Power at above-market contract prices and higher price realizations in worldwide metallurgical coal markets. Natural Resources' fiscal 1997 EBITDA was $64.4 million, a 24% increase from 1996 levels, reflecting these higher price realizations and the absence of non-recurring costs associated with geological problems in Mine No. 5's western region, which prompted this year's redeployment of operations to the mine's geologically favorable eastern side. This earnings level, while still low by historical standards, establishes a positive trend expected to increase substantially in fiscal 1998 as full mining production is resumed and as aggressive process enhancement and cost reduction programs initiated across all areas of the operation in fiscal 1997 gain momentum.

The Company's De-Gas Division was an important contributor to segment results in fiscal 1997, adding $28.8 million to net sales and revenues — a 25% increase over the prior year. De-Gas remains committed to a multi-year expansion program with plans to drill 63 new wells in fiscal 1998. This increase is expected to boost methane gas production 11%, to a targeted 50 million cubic feet-per-day level, by May 1998. United Land Corporation generated $8.6 million in fiscal 1997 revenues from coal and timber royalties, rental income and real estate sales.

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

This discussion should be read in conjunction with the consolidated financial statements and notes thereto of Walter Industries, Inc. and subsidiaries, particularly Note 1 of "Notes to Consolidated Financial Statements" on pages 34 and 35, 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 Consolidated Financial Statements" on pages 49 and 50, which presents sales and operating income by operating group.

## RESULTS OF OPERATIONS

**Years Ended May 31, 1997 and 1996**

Net sales and revenues for the year ended May 31, 1997 were $21.4 million, or 1.4%, above the prior year with a 2.8% increase in pricing and/or product mix partially offset by a 1.4% decrease in volume. The decrease in volume was principally the result of lower coal shipments, reflecting reduced production levels. In addition, continued delays in federal spending for planned water and sewer pipeline projects resulted in lower ductile iron pressure pipe shipments. The increase in pricing primarily resulted from higher average net selling prices for homes, ductile iron pressure pipe and coal.

Homebuilding and Financing Group sales and revenues were $27.7 million, or 6.7%, greater than the prior year. This performance reflects a 12.3% increase in the average net selling price per home sold, from $42,300 in 1996 to $47,500 in 1997, combined with a 3.7% increase in the number of homes sold, from 3,760 units in 1996 to 3,900 units in 1997. The higher average net selling price reflects a greater percentage of "90% complete" homes sold in the current year and price increases instituted to compensate for higher building material and labor costs. The increase in unit sales reflects the decision by Jim Walter Homes in December 1995 to reduce its financing rate from 10% to 8.5% for its "90% complete" homes on a trial basis to generate additional unit sales. In March 1996, the lower rate was formally advertised. Jim Walter Homes extended the 8.5% financing rate to the remainder of its product line ("shell" and homes sold at various "in-between" stages of interior finish) in the fourth quarter of 1997.

Jim Walter Homes' backlog at May 31, 1997 was 1,972 units (all of which are expected to be completed prior to the end of fiscal 1998) compared to 1,957 units at May 31, 1996. Time charge income (revenues received from Mid-State Homes' instalment note portfolio) increased slightly from $231.1 million in 1996 to $231.4 million in 1997. This 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 $81.7 million (net of interest expense) was $18.3 million greater than the prior year. This performance resulted from increases in the average net selling price and number of homes sold, lower interest expense in 1997 ($119.0 million) as compared to 1996 ($128.2 million), lower goodwill amortization in 1997 ($28.5 million) versus 1996 ($31.2 million), and slightly higher time charge income and homebuilding gross profit margins, partially offset by higher selling, general and administrative expenses principally resulting from changes to the base salary and commission structure at Jim Walter Homes.

Industrial Products Group sales and revenues were $12.6 million, or 4.4%, greater than the prior year. Increased sales volumes of aluminum foil and sheet products, slag wool, furnace coke, window components and metal building products, combined with improved sales prices for furnace and foundry coke, window components and metal building and foundry products, were partially offset by lower sales volumes of foundry coke and lower sales prices for aluminum foil and sheet products. The group's operating income in 1997 was $21.4 million, compared to an operating loss of $10.4 million in 1996. The improved performance was the result of the overall sales increases and higher gross profit margins realized on furnace and foundry coke, slag wool, aluminum foil and sheet products, window components and metal building and foundry products. Results for 1996 were adversely impacted by a $22.9 million write-off of goodwill, 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 Consolidated Financial Statements").

Water Transmission Products Group sales and revenues declined slightly in 1997. The group's performance reflected lower sales volumes, but higher selling prices for ductile iron pressure pipe and fittings and higher selling prices and sales volumes for valves and hydrants. The order backlog at May 31, 1997 was 108,341 tons, which represents approximately three months shipments, compared with 121,734 tons at May 31, 1996. Operating income of $14.0 million was $3.5 million above the prior year. This increase was principally due to improved operating efficiencies and lower raw material costs, especially for scrap iron, the principal raw material used in the manufacture of ductile iron pressure pipe.

Natural Resources Group sales and revenues were $17.9 million, or 4.9%, below the prior year. The decrease resulted from lower coal shipments due to reduced production levels, a $3.7 million gain (in 1996) from the sale of gas royalty interests in certain mineral properties, lower gains realized from the sale of excess real estate in 1997 ($2.5 million) versus 1996 ($6.1 million) and lower coal and timber royalty income, partially offset by higher average selling prices for coal and methane gas and greater methane gas volume. A total of 6.95 million tons of coal was sold in 1997 versus 7.61 million tons in 1996, an 8.7% decrease reflecting lower shipments to certain export customers, partially offset by increased tonnage sold to Alabama Power Company ("Alabama Power"). The average price per ton of coal sold increased $1.64 from $42.85 in 1996 to $44.49 in 1997 as a result of higher prices realized in the worldwide metallurgical market and a greater percentage of tonnage sold to Alabama Power at above-market contract prices. Methane gas sales volumes were 7.6 billion cubic feet in 1997 versus 6.8 billion cubic feet in 1996. The average selling price per thousand cubic feet, which included a monthly reservation fee of $675,000, was $3.75 in 1997 versus $3.32 in 1996. The group's operating income in 1997 was $27.6 million compared to an operating loss of $105.9 million in 1996. Coal production costs of $36.73 per ton in 1997 were slightly higher than 1996 costs of $36.12 per ton. Operating income of $27.6 million in 1997 includes settlement of a legal claim related to a theft of coal inventory from the Port of Mobile, Alabama, partially offset by a charge relating to a reduction in Jim Walter Resources' salaried workforce under a voluntary early retirement program. The operating loss of $105.9 million in 1996 included a $120.4 million FASB 121 write-down of fixed assets to estimated fair market values at two coal mines (see Note 5 of "Notes to Consolidated Financial Statements") and firefighting and idle plant costs of $16 million, principally associated with a fire at Blue Creek Mine No. 5 ("Mine No. 5") in November 1995. From December 1995 through March 1997, Mine No. 5 accelerated development of its eastern reserves. While in development, the mine's costs ($40.7 million) were capitalized.

As a result of a previous fire that began in Mine No. 5 on November 17, 1993, the Company and Jim Walter Resources claimed compensable losses in the amount of $25 million under their business interruption coverage. When the insurers refused to pay their pro rata portion of the claim, the Company and Jim Walter Resources commenced litigation seeking to enforce such insurance. The Company has entered into settlement with several insurors who, in the aggregate, have paid approximately $12.4 million to date, reducing the contract claims to approximately $12.6 million. The Company and Jim Walter Resources continue to pursue litigation against the remaining carriers, and a trial is tentatively scheduled for October 1997. (See Note 12 of "Notes to Consolidated Financial Statements").

Cost of sales, exclusive of depreciation, of $980.2 million was 78.4% of net sales in 1997 versus $987.4 million and 80.9% in 1996. Cost of sales in 1996 was adversely impacted by firefighting and idle plant costs associated with the Mine No. 5 fire. In addition, 1997 costs were favorably affected by decreases in the cost of scrap iron, the major raw material used in the manufacture of ductile iron pressure pipe.

Selling, general and administrative expenses of $144.7 million were 9.6% of net sales and revenues in 1997 versus $135.8 million and 9.1% in 1996. The increases principally reflect higher expenses at Jim Walter Homes and Jim Walter Resources as previously discussed.

Interest and amortization of debt expense was $179.3 million in 1997 versus $208.7 million in 1996, reflecting lower outstanding debt balances and reduced interest rates resulting from a debt refinancing completed on January 22, 1996. The average rate of interest in 1997 was 8.1% compared to 9.1% in 1996. The prime interest rate ranged from 8.25% to 8.5% in 1997 compared to a range of 8.25% to 9.0% in 1996.

The Company's effective tax rate in 1997 and 1996 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, and percentage depletion. Also, 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 its 1995 net operating loss forward rather than back to prior years (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 Consolidated Financial Statements" for further discussion of income taxes.)

Net income for the year ended May 31, 1997 was $37.1 million compared to a net loss of $84.7 million in 1996, reflecting all of the previously mentioned factors as well as the impact of lower postretirement health benefits in 1997. The loss in fiscal 1996 includes an extraordinary loss of $8.3 million ($5.4 million net of income tax benefit) consisting of a redemption premium and write-off of deferred financing costs resulting from the debt refinancing completed in January 1996.

**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 0.6% increase in volume. This increase was the result of improved sales and revenues in all operating groups.

Homebuilding and Financing Group sales and revenues were $5.9 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 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 from 10% to 8.5% 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 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 due to increased payoffs received in advance of maturity and an increase in the average balance per account, partially offset by a reduction in the total number of accounts. Operating income of $63.4 million (net of interest expense) was $18.4 million greater than the prior year. This performance reflected higher time charge income and improved homebuilding gross profit margins (resulting from a 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 Transmission Products Group sales and revenues were $8.5 million, or 2.1%, 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 compared with 121,548 tons at May 31, 1995. Operating income of $10.5 million was $2.4 million below the prior year. The lower performance resulted from the lower sales volumes and higher raw material costs, especially for scrap iron and alloys which are major raw material components, partially offset by higher sales prices.

Natural Resources Group sales and revenues exceeded the prior year by $30.8 million, or 9.3%. 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 resulting from greater shipments to certain export customers, partially offset by lower shipments to 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. 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, Alabama State Mine Inspectors and the United Mine Workers of America agreed that the long-wall 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 portion 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, paid approximately $11.7 million through May 31, 1996, reducing the contract claims in the lawsuit to $12.7 million. The Company and Jim Walter Resources continue to pursue litigation against the remaining carriers, and a trial is tentatively scheduled for October 1997. (See Note 12 of "Notes to Consolidated Financial Statements"). In 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 this fire were successful; however, conditions dictated that the mine be shut down for several weeks. The affected coal panels on the western side of the mine were then sealed off and development work on the eastern side of the Mine was ongoing from December 1995 through May 1996. Such development work was completed in March 1997. Jim Walter Resources' three other mines remained in full production during 1996 and 1995. The group incurred an operating loss of $105.9 million in 1996 as compared to operating income of $22.3 million in 1995. The lower performance reflects a $120.4 million FASB 121 write-down of fixed assets to estimated fair market values at two coal mines (see Note 5 of "Notes to Consolidated Financial Statements") and firefighting and idle plant costs of $16 million, principally associated with the fire at Mine No. 5. These factors were partially offset by increased sales volumes of coal and methane gas, a 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 Products Group sales and revenues were $6.0 million, or 2.1%, 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 $10.4 million compared to operating income of $6.6 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 Consolidated Financial Statements") lower window components 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 primarily the result of lower gross profit margins for pipe products, window components, patterns, tooling and metal building and foundry products, combined with 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 debt refinancing completed on January 22, 1996. The average rate of interest in 1996 was 9.1% as compared to 9.8%, 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 Consolidated Financial Statements" for further discussion of income taxes).

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 (collectively, the "Credit Facilities"). 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 the $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 of which were 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 Consolidated 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.

## FINANCIAL CONDITION

On March 17, 1995, the Company and its subsidiaries emerged from bankruptcy pursuant to the Consensual Plan. Despite the confirmation and effectiveness of the Consensual Plan, the Bankruptcy Court continues to have jurisdiction over the resolution of disputed prepetition claims against the Company and other matters that may arise in connection with or related to the Consensual Plan.

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 for taxes, interest and penalties in the amount 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. These proofs of claim represent total adjustments to taxable income of approximately $360 million for all tax periods at issue. Objections to the proofs of claim have been filed by the Company and the various issues are being litigated in the Bankruptcy Court. Included in the proofs of claim is an adjustment to taxable income disallowing a deduction of approximately $51 million for hedging losses incurred during fiscal 1988. This issue was conceded by the Internal Revenue Service pursuant to a joint stipulation of parties approved by the Bankruptcy Court by an order dated January 3, 1997. The Company believes that the balance of such proofs of claim are substantially without merit and intends to vigorously defend such claims against the Company, but there can be no assurance as to the ultimate outcome.

Since May 31, 1996, total debt has decreased $145.7 million resulting from early repayments on the Revolving Credit Facility ($89.0 million), quarterly principal payments on Term Loan A and Term Loan B ($16.0 million), scheduled payments of Mid-State Trust II Mortgage-Backed Notes ($87.0 million), scheduled payments of Mid-State Trust III Asset-Backed Notes ($30.7 million), scheduled payments of Mid-State Trust IV Asset-Backed Notes ($61.1 million) and scheduled retirements of other long-term debt ($0.9 million), partially offset by borrowings under the Mid-State Trust V Variable Funding Loan Agreement ($139.0 million).

The Credit Facilities contain a $365 million revolving credit facility which includes a sub-facility for trade and other standby letters of credit up to $75 million at any time outstanding and a sub-facility for swingline advances not to exceed/limited to $15 million at any time outstanding. At May 31, 1997, $40.0 million of letters of credit were outstanding under this facility.

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 restricts 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 ratios, fixed charge coverage ratios and maximum leverage ratios, some of which become more restrictive over time. The Company was in compliance with these covenants at May 31, 1997 and believes it will meet these financial tests over the remaining terms of these debt agreements.

The Trust V Variable Funding Loan Agreement's covenants, among other things, restrict the ability of Trust V to dispose of assets, create liens and engage in mergers or consolidations. The Company was in compliance with these covenants at May 31, 1997.

# LIQUIDITY AND CAPITAL RESOURCES

At May 31, 1997, cash and cash equivalents, net of bank overdrafts, were approximately $10.3 million. Operating cash flows for the year ended May 31, 1997, together with issuance of long-term debt under the Revolving Credit Facility and the Mid-State Trust V Variable Funding Loan Agreement, were primarily used for working capital requirements, 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, 1997 are not material; however, it is estimated that gross capital expenditures for the Company and its subsidiaries for the year ending May 31, 1998 will approximate $105 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. On June 11, 1997, Mid-State purchased from Mid-State Trust V mortgage instalment notes having a gross amount of $1,196.5 million and an economic balance of $462.3 million and subsequently sold such mortgage instalment notes to Mid-State Trust VI ("Trust VI"), a business trust organized by Mid-State which owns all of the beneficial interest in Trust VI. These sales were in exchange for the net proceeds from the public issuance by Trust VI of $439.2 million of Trust VI Asset-Backed Notes. The notes were issued in four classes, bear interest at rates ranging from 7.34% to 7.79% and have a final maturity of July 1, 2035. Payments will be made quarterly on January 1, April 1, July 1, and October 1 based on collections on the underlying collateral less amounts paid for interest on the notes and Trust VI expenses. Net proceeds from the public offering were used primarily to pay down the Mid-State Trust V Variable Funding Loan Agreement indebtedness of $384.0 million. It is anticipated that one or more permanent financings similar to Mid-State Trust VI 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, planned capital expenditures and meet substantially all operating needs. It is further expected that amounts available under the Credit Facilities will be sufficient to meet peak operating needs of the Company.

# 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 of cash flows present fairly, in all material respects, the financial position of Walter Industries, Inc. and its subsidiaries at May 31, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended May 31, 1997 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 10, 1997

# CONSOLIDATED BALANCE SHEET

| | May 31, 1997 | May 31, 1996 |
|---|---|---|
| | (in thousands) | |
| **ASSETS** | | |
| Cash and cash equivalents (Notes 3 and 14) | $ 35,782 | $ 32,543 |
| Short-term investments, restricted (Notes 3 and 14) | 195,371 | 175,432 |
| Marketable securities (Notes 3 and 14) | 41,222 | 49,338 |
| Instalment notes receivable (Notes 4, 8 and 14) | 4,256,845 | 4,208,252 |
| Less - Provision for possible losses | ( 26,394) | ( 26,138) |
| Unearned time charges | ( 2,896,517) | ( 2,851,961) |
| Net | 1,333,934 | 1,330,153 |
| Trade receivables | 170,236 | 178,847 |
| Less - Provision for possible losses | ( 8,225) | ( 8,180) |
| Net | 162,011 | 170,667 |
| Other notes and accounts receivable | 20,880 | 21,055 |
| Inventories, at lower of cost (first in, first out or average) or market | | |
| Finished goods | 117,949 | 124,456 |
| Goods in process | 32,291 | 32,798 |
| Raw materials and supplies | 52,066 | 51,674 |
| Houses held for resale | 3,068 | 2,517 |
| Total inventories | 205,374 | 211,445 |
| Prepaid expenses | 11,862 | 11,937 |
| Property, plant and equipment, at cost (Notes 5 and 6) | 978,006 | 888,991 |
| Less - Accumulated depreciation, depletion and amortization | ( 409,830) | ( 347,455) |
| Net | 568,176 | 541,536 |
| Investments | 5,112 | 6,646 |
| Deferred income taxes (Note 9) | 109,023 | 155,171 |
| Unamortized debt expense (Note 8) | 22,793 | 29,548 |
| Other assets (Note 13) | 41,671 | 44,971 |
| Excess of purchase price over net assets acquired (Notes 1, 5 and 7) | 274,174 | 310,935 |
| | $ 3,027,385 | $ 3,091,377 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Bank overdrafts (Note 3) | $ 25,523 | $ 28,194 |
| Accounts payable | 86,418 | 74,330 |
| Accrued expenses | 131,768 | 120,477 |
| Income taxes payable (Note 9) | 58,884 | 56,238 |
| Long-term senior debt (Notes 4, 8 and 14): | | |
| Mortgage-backed/asset-backed notes | 1,752,125 | 1,791,946 |
| Other senior debt | 313,450 | 419,350 |
| Accrued interest | 23,220 | 28,819 |
| Accumulated postretirement health benefits obligation (Note 13) | 268,959 | 247,827 |
| Other long-term liabilities (Note 13) | 47,626 | 47,502 |
| Stockholders' equity (Notes 1, 10 and 11): | | |
| Common stock, $.01 par value per share: | | |
| Authorized - 200,000,000 shares | | |
| Issued - 55,063,412 shares and 54,868,335 shares | 551 | 549 |
| Capital in excess of par value | 1,164,261 | 1,159,332 |
| Retained earnings (deficit) | ( 840,744) | ( 877,861) |
| Excess of additional pension liability over unrecognized prior years service cost | ( 4,656) | ( 5,326) |
| Total stockholders' equity | 319,412 | 276,694 |
| | $ 3,027,385 | $ 3,091,377 |

# CONSOLIDATED STATEMENT OF OPERATIONS

| | For the years ended May 31, | | |
|---|---|---|---|
| | 1997 | 1996 | 1995 |
| | (in thousands except per share amounts) | | |
| Sales and revenues: | | | |
| Net sales | $ 1,251,022 | $ 1,220,397 | $ 1,181,635 |
| Time charges (Note 4) | 231,388 | 231,104 | 222,221 |
| Miscellaneous | 24,651 | 34,134 | 30,838 |
| Interest income from Chapter 11 proceedings (Note 1) | — | — | 7,628 |
| | 1,507,061 | 1,485,635 | 1,442,322 |
| Cost and expenses: | | | |
| Cost of sales | 980,235 | 987,354 | 951,381 |
| Depreciation, depletion and amortization (Note 6) | 71,814 | 74,341 | 72,037 |
| Selling, general and administrative | 144,703 | 135,840 | 130,616 |
| Postretirement health benefits (Note 13) | 22,710 | 27,129 | 25,961 |
| Provision for possible losses | 3,340 | 4,367 | 4,485 |
| Chapter 11 costs (Note 1) | — | — | 442,362 |
| Interest and amortization of debt discount and expense (Notes 1 and 8) | 179,291 | 208,690 | 304,548 |
| Amortization of excess of purchase price over net assets acquired (Note 7) | 34,870 | 39,096 | 40,027 |
| Long-lived asset impairment (Note 5) | — | 143,265 | — |
| | 1,436,963 | 1,620,082 | 1,971,417 |
| | 70,098 | ( 134,447 ) | ( 529,095 ) |
| Income tax benefit (expense) (Note 9): | | | |
| Current | ( 8,244 ) | ( 621 ) | 80,754 |
| Deferred | ( 24,737 ) | 55,776 | 89,696 |
| Income (loss) before extraordinary item | 37,117 | ( 79,292 ) | ( 358,645 ) |
| Extraordinary item - loss on debt repayment (net of income tax benefit of $2,910) (Note 8) | — | ( 5,404 ) | — |
| Net income (loss) | $ 37,117 | $( 84,696 ) | $( 358,645 ) |
| Net income (loss) per share (Note 10): | | | |
| Income (loss) before extraordinary item | $ .67 | $( 1.56 ) | $( 7.10 ) |
| Extraordinary item | — | ( .10 ) | — |
| Net income (loss) | $ .67 | $( 1.66 ) | $( 7.10 ) |

# CONSOLIDATED STATEMENT OF CASH FLOWS

| | For the years ended May 31, | | |
|---|---|---|---|
| | 1997 | 1996 | 1995 |
| | | (in thousands) | |
| **OPERATIONS** | | | |
| Income (loss) before extraordinary item | $ 37,117 | $( 79,292 ) | $( 358,645 ) |
| Charges to income not affecting cash: | | | |
| Settlement of Chapter 11 claims with debt and new common stock | — | — | 444,752 |
| Depreciation, depletion and amortization | 71,814 | 74,341 | 72,037 |
| Provision for deferred income taxes | 24,737 | ( 55,776 ) | ( 89,696 ) |
| Accumulated postretirement health benefits obligation (Note 13) | 21,132 | 19,416 | 18,449 |
| Provision for other long-term liabilities | 1,336 | ( 4,034 ) | 294 |
| Amortization of excess of purchase price over net assets acquired (Note 7) | 34,870 | 39,096 | 40,027 |
| Amortization of debt discount and expense | 6,914 | 7,250 | 11,783 |
| Long-lived asset impairment (Note 5) | — | 143,265 | — |
| | 197,920 | 144,266 | 139,001 |
| Decrease (increase) in: | | | |
| Short-term investments, restricted (Notes 3 and 14) | ( 19,939 ) | ( 47,430 ) | ( 20,450 ) |
| Marketable securities (Notes 3 and 14) | 8,116 | 20,534 | 92,168 |
| Instalment notes receivable, net (a) | ( 3,781 ) | 30,875 | ( 1,849 ) |
| Trade and other receivables, net | 8,831 | ( 8,900 ) | ( 44,009 ) |
| Federal income tax receivable | — | 99,875 | ( 99,875 ) |
| Inventories | 6,071 | ( 15,008 ) | ( 23,858 ) |
| Prepaid expenses | 75 | 757 | ( 1,359 ) |
| Deferred income taxes (Note 9) | 21,411 | ( 79,941 ) | — |
| Increase (decrease) in: | | | |
| Bank overdrafts (Note 3) | ( 2,671 ) | ( 5,552 ) | 3,867 |
| Accounts payable | 14,850 | ( 7,361 ) | 28,925 |
| Accrued expenses | 11,937 | 7,054 | 28,242 |
| Income taxes payable (Note 9) | 2,646 | 2,977 | ( 15,348 ) |
| Accrued interest | ( 5,599 ) | ( 9,033 ) | 24,156 |
| Cash flows from operations | 239,867 | 133,113 | 109,611 |
| **FINANCING ACTIVITIES** | | | |
| Issuance of long-term senior debt (Notes 4, 8 and 14) | 159,000 | 680,000 | 974,450 |
| Additions to unamortized debt expense | ( 159 ) | ( 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 (Notes 4, 8 and 14) | ( 304,721 ) | ( 689,074 ) | ( 120,250 ) |
| Disposition of liabilities subject to Chapter 11 proceedings | 3,427 | ( 63,932 ) | ( 604,044 )(b) |
| Payment of accrued postpetition interest on Chapter 11 secured debt obligations | — | — | ( 244,334 ) |
| Fractional share payments | ( 13 ) | ( 8 ) | — |
| Cash flows used in financing activities | ( 142,466 ) | ( 83,959 ) | ( 11,331 ) |
| **INVESTING ACTIVITIES** | | | |
| Additions to property, plant and equipment, net of normal retirements | ( 98,454 ) | ( 73,485 ) | ( 76,966 ) |
| Decrease (increase) in investments and other assets | 4,292 | ( 1,261 ) | ( 4,442 ) |
| Cash flows used in investing activities | ( 94,162 ) | ( 74,746 ) | ( 81,408 ) |
| Net increase (decrease) in cash and cash equivalents | 3,239 | ( 25,592 ) | 16,872 |
| Cash and cash equivalents at beginning of year (Notes 3 and 14) | 32,543 | 58,135 | 41,263 |
| Cash and cash equivalents at end of year (Notes 3 and 14) | $ 35,782 | $ 32,543 | $ 58,135 |

(a) Consists of sales and resales, net of repossessions and provision for possible losses, of $173,418,000, $148,749,000 and $155,236,000 and cash collections on account and payouts in advance of maturity of $169,637,000, $179,624,000 and $153,387,000, for the years ended May 31, 1997, 1996 and 1995, 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, 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 CONSOLIDATED 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:

(1) Interest income from Chapter 11 proceedings of $7,628,000, which would not have been realized assuming the Consensual Plan became effective June 1, 1994, has been eliminated.

(2) Chapter 11 costs of $442,362,000, 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 $81,364,000 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 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. In addition, certain reclassifications have been made in the accompanying consolidated financial statements in order to conform with the fiscal 1997 presentation.

## NOTE 3 – CASH AND CASH EQUIVALENTS, RESTRICTED SHORT-TERM INVESTMENTS AND MARKETABLE SECURITIES

Cash and cash equivalents include short-term deposits and highly liquid investments which have original maturities of three months or less and are stated at cost which approximates market. The Company's cash management system provides for the reimbursement of all major bank disbursement accounts on a daily basis. Checks issued but not yet presented to the banks for payment are classified as 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 ($101,467,000) 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 ($79,706,000) and (iii) miscellaneous other segregated accounts restricted to specific uses ($14,198,000).

Investments with original maturities greater than three months are classified as marketable securities. In accordance with Statement of Financial Accounting Standards No. 115 - "Accounting for Certain Investments in Debt and Equity Securities," the Company's marketable securities are classified as available for sale and are carried at estimated fair values.

## 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. The credit terms offered by Jim Walter Homes, Inc. ("Jim Walter Homes") are usually for 100% of the purchase price of the home and the instalment notes receivable currently carry either an 8.5% or 10% annual percentage rate, without points or closing costs. 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 to which the Company has access should the buyer default on payment of the instalment note obligation. Of the gross amount of $4,256,845,000 an amount of $3,967,340,000 is due after one year. Instalment payments estimated to be receivable within each of the five years from May 31, 1997 are $289,505,000, $284,802,000, $277,990,000, $270,327,000 and $262,932,000, respectively, and $2,871,289,000 after five years. Of the gross amount of instalment notes receivable of $4,256,845,000, 19%, 12% and 11% are secured by homes located in the states of Texas, Mississippi and Florida, 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 90 or more days delinquent was 2.78% and 3.14% of total instalment notes receivable at May 31, 1997 and 1996, respectively.

Mid-State Homes, Inc. ("Mid-State") purchases instalment notes from 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. The gross amount of instalment notes receivable at May 31, 1997 was $4,256,845,000 and had an economic balance of $2,019,581,000. The economic balance of an account is the present value of the future scheduled monthly payments due on the account. Such present value is calculated by discounting the remaining future scheduled monthly payments on an account by the effective financing rate. The effective financing rate is determined by calculating the discount rate which, when applied in a present value calculation, results in the present value of all originally scheduled monthly payments on such account being equal to the original amount financed. In effect, the economic balance of an account is the amount of principal that can be amortized by the instalment payments due over the remaining term of the account at the effective financing rate. Instalment notes receivable owned by Trust II had a gross book value of $966,072,000 and an economic balance of $609,227,000; receivables owned by Trust III had a gross book value of $364,872,000 and an economic balance of $195,535,000; and receivables owned by Trust IV had a gross book value of $1,612,880,000 and an economic balance of $704,532,000. 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, 1997, receivables owned by Trust V had a gross book value of $1,310,206,000 and an economic balance of $509,059,000 (see Note 8). Instalment notes receivable not pledged to the trusts had a gross book value of $2,815,000 and an economic balance of $1,228,000.

## NOTE 5 – LONG-LIVED ASSET IMPAIRMENT

In March 1995, the Financial Accounting Standards Board issued 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 became 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. A fire which resulted from the unexpected recurrence of spontaneous combustion heatings at Jim Walter Resources' Mine No. 5 at the end of the fiscal second quarter, as well as various geological problems at the three other coal mines during portions of the year, led to the conclusion that there was an impairment of fixed assets within the Natural Resources segment.

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 in 1996 of $143,265,000 before tax ($101,125,000 after tax). The charge included 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 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 Note 5):

| | May 31, 1997 | May 31, 1996 |
|---|---|---|
| | (in thousands) | |
| Land and minerals | $150,667 | $150,708 |
| Land improvements | 20,476 | 18,143 |
| Buildings and leasehold improvements | 106,004 | 98,452 |
| Mine development costs | 80,363 | 47,930 |
| Machinery and equipment | 597,357 | 548,562 |
| Construction in progress | 23,139 | 25,196 |
| Total | $978,006 | $888,991 |

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

| | |
|---|---|
| Land improvements | 3.5% to 10% |
| Buildings | 2% to 20% |
| Leasehold improvements | Over term of leases |
| Mine development costs | Over life of mines |
| Machinery and equipment | 3.5% to 33.3% |

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, 1997, 1996 and 1995 was immaterial.

Rental expense for all operating leases was $12.0 million, $11.0 million and $10.0 million for the fiscal years ended May 31, 1997, 1996 and 1995, respectively. Future minimum payments under noncancelable operating leases at May 31, 1997 are: 1998, $11.3 million; 1999, $7.8 million; 2000, $6.7 million; 2001, $6.6 million; and 2002, $5.4 million.

## 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, 1997, the accumulated amortization of goodwill was approximately $478.1 million. At May 31, 1997, 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, 1997 | May 31, 1996 |
|---|---|---|
| | (in thousands) | |
| Senior debt: | | |
| Walter Industries, Inc. | | |
| Revolving Credit Facility | $ 146,000 | $ 235,000 |
| Term Loan A | 106,250 | 121,250 |
| Term Loan B | 58,750 | 59,750 |
| Other | 2,450 | 3,350 |
| | 313,450 | 419,350 |
| Mid-State Trusts | | |
| Trust II Mortgage-Backed Notes | 410,000 | 497,000 |
| Trust III Asset-Backed Notes | 116,934 | 147,669 |
| Trust IV Asset-Backed Notes | 841,191 | 902,277 |
| Trust V Variable Funding Loan | 384,000 | 245,000 |
| | 1,752,125 | 1,791,946 |
| Total | $2,065,575 | $2,211,296 |

Interest paid in cash for the years ended May 31, 1997, 1996 and 1995 was $179,749,000, $220,959,000 and $437,357,000, respectively.

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 $75 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 .50%, or (ii) a LIBOR rate plus an Applicable Margin of .75% to 1.75% (based upon a leverage ratio pricing grid). At May 31, 1997, the weighted average interest rate was 7.73%. A commitment fee ranging from .25% to .50% 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 .375%. At May 31, 1997, there were no swingline borrowings outstanding under this facility; however, letters of credit in the aggregate face amount of $39,967,000 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 .50%, or (ii) a LIBOR rate plus .75% to 1.75% (based upon a leverage ratio pricing grid). Scheduled principal payments to be made in each of the five years from May 31, 1997 are $16,250,000, $21,250,000, $25,000,000, $25,000,000 and $18,750,000, respectively. At May 31, 1997, the weighted average interest rate was 6.87%.

Term Loan B interest is at LIBOR plus 2% to 2.25% (based upon a leverage ratio pricing grid). At May 31, 1997, the interest rate was 7.88%. Scheduled principal payments in each of the five years from May 31, 1997 are $1,000,000, $1,000,000, $1,000,000, $1,000,000 and $11,750,000, respectively.

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, 1997 is $87,000,000, $64,600,000, $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, 2000. Accordingly, the $384 million of borrowings outstanding at May 31, 1997 has been classified as long-term debt. Interest is based on the cost of A-1 and P-1 rated commercial paper plus .50%. The commitment fee on the unused portion of the facility is .20%

On June 11, 1997, Mid-State purchased from Mid-State Trust V mortgage instalment notes having a gross amount of $1,196,479,000 and an economic balance of $462,287,000 and subsequently sold such mortgage instalment notes to Mid-State Trust VI ("Trust VI"), a business trust organized by Mid-State which owns all of the beneficial interest in Trust VI. These sales were in exchange for the net proceeds from the public issuance by Trust VI of $439,150,000 of Trust VI Asset-Backed Notes. The notes were issued in four classes, bear interest at rates ranging from 7.34% to 7.79% and have a final maturity of July 1, 2035. Payments will be made quarterly on January 1, April 1, July 1 and October 1 based on collections on the underlying collateral, less amounts paid for interest on the notes and Trust VI expenses. Net proceeds from the public offering were used primarily to pay down the Trust V indebtedness of $384,000,000.

The Company has traditionally used interest rate swaps as hedge instruments to manage interest rate risks. The Company has two types of interest rate risks: (i) current risk on interest rates related to debt which has floating rates and (ii) risk of interest 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, 1997, Trust V had in place a swap agreement with a notional amount of $360 million under which it pays a fixed interest rate of 5.25% and receives interest based on commercial paper rates. This swap was in effect until June 30, 1997, it accreted monthly and was designed to offset the interest rate risk of the Trust V Variable Funding Loan Agreement. Also at May 31, 1997, Trust V had in place forward swaps totaling $150 million notional amount which were to start June 30, 1997 and run for 10 years at a blended monthly fixed rate of 7.25%. At that time, Trust V was to receive interest based on prevailing commercial paper rate levels. On May 15, 1997, in order to offset refinancing risk, Trust V entered into a rate swap agreement with a notional amount of $250 million under which Trust V was to pay a fixed rate of 6.62%. This transaction had a termination date of June 13, 1997. With the creation of Trust VI on June 11, 1997, all swap agreements were terminated. Since interest rates have declined over the past year, Trust VI coupon levels were below those originally expected. This lower level of interest cost served to mitigate the losses incurred ($8.6 million) on the swap agreements at termination. These losses will be deferred and amortized over the life of Trust VI.

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 compliance with these covenants at May 31, 1997.

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 compliance with these covenants at May 31, 1997.

## NOTE 9 – INCOME TAXES

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

| | May 31, 1997 | | May 31, 1996 | | May 31, 1995 | |
|---|---|---|---|---|---|---|
| | Current | Deferred | Current | Deferred | Current | Deferred |
| | (in thousands) | | | | | |
| United States | $ 4,745 | $ 25,697 | $( 799) | $( 54,846) | $( 80,445 ) | $( 88,815) |
| State and local | 3,499 | ( 960 ) | 1,420 | ( 930) | ( 309 ) | ( 881) |
| Total | $ 8,244 | $ 24,737 | $ 621 | $( 55,776) | $( 80,754 ) | $( 89,696) |

In fiscal 1997 and 1995, the Company paid federal income tax of approximately $3.0 million and $30.6 million, respectively. In fiscal 1997, the Company received a refund of federal income tax of $21.4 million due to a net operating loss carryback. In fiscal 1996, the Company received a refund of federal income tax of $22.2 million paid in a previous year as estimated payments. State income taxes paid in 1997 and 1995 were approximately $2.6 million and $4.0 million respectively, while state income taxes refunded in fiscal 1996 were approximately $100,000.

The Company complies with Statement of Financial Accounting Standards No. 109 - "Accounting for Income Taxes" ("FASB 109"). 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, | | |
|---|---|---|---|
| | 1997 | 1996 | 1995 |
| Statutory tax rate | 35.0% | (35.0)% | ( 35.0)% |
| Effect of: | | | |
| State and local income tax | 2.3 | .2 | ( .2) |
| Percentage depletion | ( 8.8) | ( 2.6) | ( .5) |
| Amortization of excess of purchase price over net assets acquired and FASB 121 charge | 17.5 | 16.2 | 2.7 |
| Benefit of capital loss carryforward | — | ( 5.9) | ( 1.5) |
| 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 | .5 | ( 9.1) | 2.3 |
| Other, net | .5 | .2 | — |
| Effective tax rate | 47.0% | (41.0)% | ( 32.2)% |

In fiscal 1996, the tax benefit related to the extraordinary item approximated the statutory rate and is deferred federal income tax.

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

| | May 31, 1997 | May 31, 1996 |
|---|---|---|
| | (in thousands) | |
| Instalment sales method for instalment notes receivable in prior years | $ 27,504 | $ 34,691 |
| Depreciation | 84,721 | 78,462 |
| Difference in basis of assets under purchase accounting | 18,536 | 20,424 |
| Net operating loss carryforward | ( 91,230) | (155,283) |
| Accrued expenses | ( 46,101) | ( 39,034) |
| Postretirement benefits other than pensions | (102,453) | ( 94,431) |
| Total deferred tax (asset) liability | $( 109,023) | $(155,171) |

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 1996 fiscal year, the Company recorded a deferred tax asset of $25.0 million. During fiscal 1997, the Company elected to carry the 1996 loss back to prior years rather than forward, resulting in a refund of federal income taxes of $21.4 million, which was accordingly charged against the deferred tax asset. The election to carry back the net operating loss generated a tax charge of approximately $400,000 in the fourth quarter of fiscal 1997 due to the effect of the rate difference and other miscellaneous tax adjustments.

During fiscal 1996, the Company elected to carry a 1995 loss forward rather than back to prior years, which generated a tax benefit of approximately $19 million in the fourth quarter of fiscal 1996 due to the effect of the rate difference, avoidance of loss of credits and other miscellaneous tax adjustments. Also during the fourth quarter of fiscal 1996, the Company utilized its capital loss carryforward of approximately $22.8 million. The Company's net operating loss carryforward at May 31, 1997 approximates $242.1 million, which will expire in fiscal 2010. The Company's minimum tax credit carryforward at May 31, 1997 approximates $6.5 million.

Under the Internal Revenue Code, if certain substantial changes in the Company's ownership occur, there are annual limitations on the amount of loss and credit carryforwards. The reorganization under the Consensual Plan created an ownership change in fiscal 1995; therefore, $164.6 million of the remaining net operating loss carryforward is subject to the annual limitation. However, the Company believes that the annual limitation will not affect the realization of the net operating loss carryforward, which is expected to be fully utilized by fiscal 1999.

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 for taxes, interest and penalties 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. These proofs of claim represent total adjustments to taxable income of approximately $360 million for all tax periods at issue. Objections to the proofs of claim have been filed by the Company, and the various issues are being litigated in the Bankruptcy Court. Included in the proofs of claim is an adjustment to taxable income disallowing a deduction of approximately $51 million for hedging losses incurred during fiscal year 1988. This issue was conceded by the Internal Revenue Service pursuant to a joint stipulation of parties approved by the Bankruptcy Court by an order dated January 3, 1997. The Company believes that the balance of such proofs of claim are substantially without merit and intends to defend vigorously such claims; however, there can be no assurance as to the ultimate outcome.

## NOTE 10 – STOCKHOLDERS' EQUITY

The Company is authorized to issue 200,000,000 shares of common stock, $.01 par value. As of May 31, 1997, 55,063,412 shares of common stock were outstanding. On June 24, 1997, the Company repurchased 1,387,092 shares of outstanding common stock and such shares are being held as treasury stock.

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 former stockholders of the Company as of the Effective Date. To the extent such matters are not resolved satisfactorily, the escrowed shares will be returned to the Company and canceled.

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

Primary net income per share in 1997 was computed by dividing net income by the monthly weighted average number of shares of common stock and common stock equivalents outstanding. Common stock equivalents include the number of shares issuable on the exercise of dilutive employee stock options less the number of shares of common stock which could have been purchased with the proceeds from the exercise of such options. These purchases were assumed to have been made at the average market price of the common stock during the year. Primary net loss per share in 1996 does not include 3,880,140 additional shares issued to an escrow account on September 13, 1995 pursuant to the Consensual Plan because such issuance would be anti-dilutive. Fully diluted net income (loss) per share is not materially different from primary net income (loss) per share.

Changes in stockholders' equity for the two years ended May 31, 1997 are summarized as follows:

| | Common Stock | | Capital in | Retained Earnings | Excess of Additional Pension |
|---|---|---|---|---|---|
| | Shares | Par Value | Excess | (Deficit) | Liability |
| (in thousands) | | | | | |
| Balance at May 31, 1995 | 50,494 | $ 505 | $ 1,159,384 | $ (793,165) | $ ( 5,950) |
| Stock issued | 4,374 | 44 | ( 44) | | |
| Fractional share payments | | | ( 8) | | |
| Net loss | | | | ( 84,696) | |
| Reverse excess of additional pension liability | | | | | 624 |
| Balance at May 31, 1996 | 54,868 | 549 | 1,159,332 | (877,861) | ( 5,326) |
| Stock issued, net | 195 | 2 | 4,942 | | |
| Fractional share payments | | | ( 13) | | |
| Net income | | | | 37,117 | |
| Reverse excess of additional pension liability | | | | | 670 |
| Balance at May 31, 1997 | 55,063 | $ 551 | $ 1,164,261 | $ (840,744) | $ ( 4,656) |

In management's opinion, information for fiscal 1995 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).

In February 1997, Statement of Financial Accounting Standards No. 128 - "Earnings per Share" ("FASB 128"), was issued. FASB 128 will be effective for both interim and annual periods ending after December 15, 1997 and will require a restatement of previously reported earnings per share. Under FASB 128, "basic" earnings per share will replace the reporting of "primary" earnings per share. Basic earnings per share is calculated by dividing the income available to common stockholders by the weighted average number of common shares outstanding for the period, without consideration for common stock equivalents. "Fully diluted" earnings per share will be replaced by "diluted" earnings per share under FASB 128. The calculation of diluted earnings per share is similar to that of fully diluted earnings per share under existing accounting pronouncements. Basic earnings per share and diluted earnings per share are not expected to be significantly different from primary net income per share and fully diluted net income per share as calculated by the Company for the years ended May 31, 1997 or 1996.

## 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 have been reserved for the grant and issuance of incentive and non-qualified stock options, stock appreciation rights ("SARs") and stock awards. The maximum number of such shares with respect to which stock options or SARs may be granted to any employee during 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:

| | 1997 | | 1996 | |
|---|---|---|---|---|
| | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| Outstanding at beginning of year | 1,487,000 | $ 14.120 | — | $ — |
| Granted | 1,219,000 | 12.313 | 1,500,000 | 14.120 |
| Exercised | — | — | — | — |
| Canceled | ( 36,001 ) | 13.571 | ( 13,000 ) | 14.125 |
| Outstanding at end of year | 2,669,999 | 13.301 | 1,487,000 | 14.120 |
| Exercisable at end of year | 487,333 | 14.118 | — | — |

| | Options Outstanding | | Options Exercisable |
|---|---|---|---|
| Exercise Prices | Number Outstanding at May 31, 1997 | Weighted Average Remaining Contractual Life (years) | Number Exercisable at May 31, 1997 |
| 12.313 | 1,208,000 | 9.2 | — |
| 14.063 | 153,000 | 8.2 | 51,000 |
| 14.125 | 1,308,999 | 8.2 | 436,333 |
| | 2,669,999 | 8.7 | 487,333 |

Had compensation cost for the Company's option plans been determined based on the fair value at the grant dates as prescribed by Statement of Financial Accounting Standards No. 123 "Accounting for Stock Based Compensation" ("FASB 123"), the Company's net income and net income per share on a pro forma basis would have been (in thousands, except per share data):

| | 1997 |
|---|---|
| Pro forma net income | $ 35,314 |
| Pro forma net income per share | $ .64 |

The preceding pro forma results were calculated with the use of the Black Scholes option-pricing model. The following assumptions were used for the year ended May 31, 1997: (1) risk free interest rate of 7.36%; (2) dividend yield of 0.0%; (3) expected life of 5.0 years; and (4) volatility of 29.3%.

The Walter Industries, Inc. Employee Stock Purchase Plan was adopted in January 1996. All full-time employees of the Company who have attained the age of majority in the state in which they reside are eligible to participate. The Company contributes a sum equal to 15% of each participant's actual payroll deduction as authorized, and remits such funds to a designated brokerage firm who purchases in the open market, as agent for the Company, as many shares of common stock as such funds will permit for the accounts of the participants. The amount of stock purchased depends upon the market prices of the common stock at the time the purchases are made. The total number of shares which may be purchased under the plan is 500,000. Total shares purchased under the plan in 1997 were approximately 200,000, and the Company's contribution was approximately $400,000.

## NOTE 12 – LITIGATION

**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 liability, including piercing the corporate veil, the suits alleged, among other things, that Original Jim Walter was liable for all asbestos-related liabilities of Celotex and that the distribution by HAC of substantially all of its assets to the Company pursuant to the LBO was 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") in October 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.

In March 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 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) affords additional statutory protection to the Company against the possibility of such claims in the future.

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, among other things, 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's May 28, 1996 Order was appealed by Celotex and JWC.

In October 1996, Celotex and various other parties in the Celotex bankruptcy announced to the Court in the Celotex Bankruptcy (the "Celotex Bankruptcy Court") that an agreement had been reached between Celotex and each of its creditor groups pursuant to a Modified Joint Plan of Reorganization (the "Celotex Modified Plan") which, among other things, superseded and replaced all prior plans. The Celotex Modified Plan contains a provision for a Section 524(g) injunction as to all asbestos claimants. The Celotex Modified Plan was approved by a vote of the Celotex creditors and in December 1996 the Celotex Bankruptcy Court entered an Order confirming the Celotex Modified Plan. The Celotex Modified Plan became effective as of May 30, 1997. As a result of the Celotex Modified Plan containing a provision for a Section 524(g) injunction and such Plan having become effective, the Company believes that the appeal of Celotex and JWC of the Bankruptcy Court's May 28, 1996 Order is now moot and that the only issue which remains in that adversary proceeding is whether the Company and other plaintiffs are entitled to collect attorneys' fees and expenses from Celotex and JWC with respect to the prosecution of the adversary proceeding.

**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 had 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 portion 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 $12.4 million to date, reducing the contract claims in the lawsuit to approximately $12.6 million. The Company and JWR continue to pursue the litigation against the remaining carriers, and a trial is tentatively scheduled for October 1997.

**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 certificates.

In preparing to make distributions to subordinated bondholders, it came to the attention of the Company that certain schedules associated with the certifications 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 schedules and certain of the ballots cast by subordinated bondholders.

The Company filed a motion with the Bankruptcy Court seeking to amend the schedules. In April 1995, an order was entered reflecting the Bankruptcy Court's decision to permit the amendment of the schedules in certain respects but not others (the "April Order").

Appeals from the April Order were filed with the District Court by various bondholders. In November 1996, the District Court entered an order granting the Company's motion to dismiss and dismissing as moot all appeals in this matter. No appeal of the District Court's Order was taken and that Order is now final.

**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, 1997, 1996 and 1995, was $7.6 million, $11.8 million and $8.2 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, | | |
|---|---|---|---|
| | 1997 | 1996 | 1995 |
| | (in thousands) | | |
| Service cost-benefits earned during the period | $ 6,644 | $ 6,072 | $ 5,817 |
| Interest cost on projected benefit obligation | 17,589 | 16,972 | 16,174 |
| Actual loss (return) on assets | ( 28,532 ) | ( 35,347 ) | 4,304 |
| Net amortization and deferral | 8,680 | 20,236 | (21,377) |
| Net pension costs | $ 4,381 | $ 7,933 | $ 4,918 |

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

| | May 31, 1997 Plans in which | | May 31, 1996 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 | $ 166,103 | $ 46,853 | $ 149,542 | $ 50,941 |
| Non-vested benefits | 7,444 | 1,525 | 6,815 | 1,585 |
| | $ 173,547 | $ 48,378 | $ 156,357 | $ 52,526 |
| Plan assets at fair value, primarily stocks and bonds | $ 213,726 | $ 33,341 | $ 189,728 | $ 34,609 |
| Projected benefit obligations | 207,610 | 48,430 | 188,422 | 54,008 |
| Plan assets in excess of (less than) projected benefit obligations | 6,116 | ( 15,089) | 1,306 | ( 19,399 ) |
| Unamortized portion of transition (asset) obligation at June 1, 1986 | ( 7,524 ) | 2,918 | ( 9,185) | 4,021 |
| Unrecognized net loss from actual experience different from that assumed | 6,743 | 4,758 | 13,191 | 6,124 |
| Prior service cost not recognized | 633 | 3,695 | 618 | 3,595 |
| Contribution to plans after measurement date | 103 | 1,126 | — | 1,042 |
| Prepaid (accrued) pension cost | 6,071 | ( 2,592) | 5,930 | ( 4,617 ) |
| Additional liability | — | ( 11,294) | — | ( 12,507 ) |
| Prepaid pension cost (pension liability) recognized in the balance sheet | $ 6,071 | $( 13,886) | $ 5,930 | $( 17,124 ) |

The projected benefit obligations were determined using an assumed discount rate of 7.50% in fiscal 1997 and 1996 and, where applicable, an assumed increase in future compensation levels of 4.50% in fiscal 1997 and 1996. The assumed long-term rate of return on plan assets was 9% and 8% in fiscal 1997 and 1996, respectively.

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 $34.7 million at May 31, 1997. 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 $22.7 million in 1997, $27.1 million in 1996 and $26.0 million in 1995. Amounts paid for postretirement benefits were $7.3 million in 1997, $7.7 million in 1996 and $7.5 million in 1995.

The net periodic postretirement benefit cost includes the following components:

| | For the years ended May 31, | | |
|---|---|---|---|
| | 1997 | 1996 | 1995 |
| | (in thousands) | | |
| Service cost | $ 7,642 | $ 8,668 | $ 8,491 |
| Interest cost | 14,990 | 18,701 | 17,470 |
| Net amortization and deferral | 78 | ( 240 ) | — |
| Net periodic postretirement benefit cost | $ 22,710 | $ 27,129 | $ 25,961 |

The accumulated postretirement benefits obligation at May 31, 1997 and 1996 are as follows:

| | May 31, | |
|---|---|---|
| | 1997 | 1996 |
| | (in thousands) | |
| Retirees | $ 81,731 | $ 93,380 |
| Fully eligible, active participants | 37,189 | 32,896 |
| Other active participants | 106,493 | 132,026 |
| Accumulated postretirement benefit obligation | 225,413 | 258,302 |
| Unrecognized net gain (loss) | 43,546 | (10,475) |
| Postretirement benefit liability recognized in the balance sheet | $ 268,959 | $ 247,827 |

The principal assumptions used to measure the accumulated postretirement benefit obligation include a discount rate of 7.50% in fiscal 1997 and 1996 and a health care cost trend rate of 8.50% declining to 5.25% over a eight year period and remaining level thereafter in fiscal 1997 and a health care cost trend rate of 9.50% declining to 5.25% over a nine year period in fiscal 1996. A one percent increase in trend rates would increase the accumulated postretirement benefit obligation by 18% and increase net periodic postretirement benefit cost for 1997 by 21%.

Certain subsidiaries of the Company maintain profit sharing plans. The total cost of these plans for the years ended May 31, 1997, 1996 and 1995 was $3.4 million, $2.9 million and $3.0 million, respectively

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

## 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 and cash equivalents, restricted short term investments and marketable securities — The carrying amounts reported in the balance sheet approximate fair value.

Instalment notes receivable — The estimated fair value of instalment notes receivable at May 31, 1997 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, 1997. 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, 1997 was $2.142 billion based on current yields for comparable debt issues or prices for actual transactions.

## NOTE 15 – SEGMENT INFORMATION

| | For the years ended May 31, | | |
|---|---|---|---|
| | 1997 | 1996 | 1995 |
| | | (in thousands) | |
| Sales and Revenues: | | | |
| Homebuilding and Financing | $ 440,749 | $ 413,078 | $ 407,172 |
| Water Transmission Products | 419,813 | 419,984 | 411,442 |
| Natural Resources (a) | 345,011 | 362,948 | 332,151 |
| Industrial Products | 299,851 | 287,230 | 281,280 |
| Corporate | 1,637 | 2,395 | 10,277 |
| Consolidated sales and revenues (b)(c) | $ 1,507,061 | $ 1,485,635 | $ 1,442,322 |
| Contributions to Operating Income (d)(e): | | | |
| Homebuilding and Financing (f) | $ 81,731 | $ 63,390 | $ 44,954 |
| Water Transmission Products | 13,986 | 10,517 | 12,965 |
| Natural Resources (g) | 27,595 | ( 105,929 ) | 22,314 |
| Industrial Products (g) | 21,433 | ( 10,406 ) | 6,570 |
| | 144,745 | ( 42,428 ) | 86,803 |
| Less-Unallocated corporate interest and other expense (h) | ( 74,647 ) | ( 92,019 ) | ( 615,898 ) |
| Income tax benefit (expense) | ( 32,981 ) | 55,155 | 170,450 |
| Income (loss) before extraordinary item | $ 37,117 | $( 79,292 ) | $( 358,645 ) |
| Depreciation, Depletion and Amortization: | | | |
| Homebuilding and Financing | $ 3,311 | $ 3,279 | $ 3,336 |
| Water Transmission Products | 17,010 | 18,636 | 16,520 |
| Natural Resources | 38,107 | 38,652 | 41,434 |
| Industrial Products | 11,696 | 11,890 | 9,073 |
| Corporate | 1,690 | 1,884 | 1,674 |
| Total | $ 71,814 | $ 74,341 | $ 72,037 |
| Gross Capital Expenditures: | | | |
| Homebuilding and Financing | $ 5,617 | $ 3,735 | $ 4,192 |
| Water Transmission Products | 14,479 | 12,888 | 15,538 |
| Natural Resources | 54,999 | 53,576 | 46,214 |
| Industrial Products | 25,968 | 12,792 | 24,692 |
| Corporate | 692 | 532 | 681 |
| Total | $ 101,755 | $ 83,523 | $ 91,317 |
| Identifiable Assets: | | | |
| Homebuilding and Financing | $ 1,796,949 | $ 1,802,950 | $ 1,789,582 |
| Water Transmission Products | 452,963 | 480,209 | 480,617 |
| Natural Resources | 387,167 | 381,582 | 465,680 |
| Industrial Products | 192,688 | 177,668 | 213,836 |
| Corporate (i) | 197,618 | 248,968 | 295,438 |
| Total | $ 3,027,385 | $ 3,091,377 | $ 3,245,153 |

(a) Includes sales of coal of $309,308,000, $325,495,000 and $297,650,000 in 1997, 1996 and 1995, 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. Sales to Alabama Power Company in each of the years ended May 31, 1997, 1996 and 1995 were 13% of consolidated net sales and revenues.

(b) 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 Products Group to the Water Transmission Products Group of $12,440,000, $13,292,000 and $13,373,000 and sales of the Natural Resources Group to the Industrial Products Group of $4,172,000, $4,774,000 and $5,397,000 in 1997, 1996 and 1995, respectively.

(c) Export sales, primarily coal, were $134,733,000, $171,446,000 and $129,071,000 in 1997, 1996 and 1995, 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 $34,870,000 in 1997, $39,096,000 in 1996 and $40,027,000 in 1995. A breakdown by segment is as follows:

| | For the years ended May 31, | | |
|---|---|---|---|
| | 1997 | 1996 | 1995 |
| | | (in thousands) | |
| Homebuilding and financing | $ 28,538 | $ 31,246 | $ 31,703 |
| Water transmission products | 12,212 | 12,247 | 12,214 |
| Natural resources | ( 1,327 ) | ( 1,331 ) | ( 1,328 ) |
| Industrial products | 638 | 2,135 | 2,627 |
| Corporate | ( 5,191 ) | ( 5,201 ) | ( 5,189 ) |
| | $ 34,870 | $ 39,096 | $ 40,027 |

(e) Includes postretirement health benefits of $22,710,000, $27,129,000 and $25,961,000 in 1997, 1996 and 1995. A breakdown by segment is as follows:

| | For the years ended May 31, | | |
|---|---|---|---|
| | 1997 | 1996 | 1995 |
| | | (in thousands) | |
| Homebuilding and financing | $ 1,888 | $ 1,636 | $ 2,295 |
| Water transmission products | 3,857 | 3,729 | 4,362 |
| Natural resources | 11,873 | 16,640 | 15,004 |
| Industrial products | 4,519 | 4,581 | 3,610 |
| Corporate | 573 | 543 | 690 |
| | $ 22,710 | $ 27,129 | $ 25,961 |

(f) In July 1986, Waltsons, Inc., a corporation in which James W. Walter, Chairman Emeritus and a Director of the Company, has a twenty percent (20%) interest, acquired a fifty percent (50%) interest in the operations of Booker & Company, Inc. ("Booker"), a wholesale distributor of building supplies and materials. In December 1996, Waltsons, Inc. sold all of its interest in the operations of Booker. Booker has been a supplier of various building supplies and materials to Dixie Building Supplies, Inc., a wholly owned subsidiary of the Company. Booker's sales of building supplies and materials to such subsidiary totaled $6,091,000, $5,679,000 and $5,434,000 in 1997, 1996 and 1995, respectively. The Company believes that the terms of the transactions between the Company and Booker are at least as favorable to the Company as those that could be obtained from unaffiliated third parties.

(g) 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 Products Group in 1996.

(h) Excludes interest expense incurred by the Homebuilding and Financing Group of $118,959,000, $128,215,000 and $131,560,000 in 1997, 1996 and 1995, respectively. Such amounts are net of intercompany interest income of $33,135,000 and $28,127,000 in 1997 and 1996, and include intercompany interest expense of $35,128,000 in 1995. The balance of unallocated expenses consisting primarily of unallocated interest, corporate expenses and Chapter 11 costs (in 1995) are attributable to all groups and cannot be reasonably allocated to specific groups.

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

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

**Kenneth E. Hyatt**
Chairman, President and
Chief Executive Officer

**Richard E. Almy**
Executive Vice President and
Chief Operating Officer

**Dean M. Fjelstul**
Senior Vice President and
Chief Financial Officer

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

## BOARD OF DIRECTORS

Left to right:
Perry Golkin, Member, Kohlberg Kravis Roberts & Co., LLC (1,6)
Howard L. Clark, Jr., Vice Chairman, Lehman Brothers, Inc. (2,3,5,6)
James B. Farley, Retired Chairman and Chief Executive Officer, Mutual of New York (1,2,3,4,5)
Richard E. Almy, Executive Vice President and Chief Operating Officer, Walter Industries, Inc.
Kenneth E. Hyatt, Chairman, President and Chief Executive Officer, Walter Industries, Inc.
James W. Walter, Chairman Emeritus and founder, Walter Industries, Inc. (2,6)
Michael T. Tokarz, Member, Kohlberg Kravis Roberts & Co., LLC (2,3,4)
James L. Johnson, Chairman Emeritus, GTE Corporation (1,3,4,5,6)
Eliot M. Fried, Managing Director, Lehman Brothers, Inc. (1,4)

(1) Audit Committee, (2) Finance Committee, (3) Compensation Committee
(4) Environmental, Health and Safety Committee, (5) Special 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 and
Chief Financial Officer

**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, Inc.

**David L. Townsend**
Vice President-Administration

**Cynthia B. Eisch**
Assistant Controller; Tax Director

**Stephen H. Foxworth**
Assistant Treasurer

**Kathy H. Love**
Assistant Controller; Director of
Operations Audit

**Kimberly A. Perez**
Assistant Controller; Director of
Accounting and Strategic Planning

**S. Louise Russell**
Assistant Secretary

**Mary C. Snow**
Assistant General Counsel; 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 on Tuesday, September 16, 1997, at 10 a.m. at the Tampa Convention Center, Ball Room Level, Meeting Room 6-7, 333 South Franklin Street, Tampa, Florida.

## QUARTERLY STOCK PRICE RANGE – FISCAL 1997

| | 1Q | 2Q | 3Q | 4Q |
|---|---|---|---|---|
| **High** | 14 1/4 | 14 1/4 | 15 1/4 | 15 3/8 |
| **Low** | 11 7/8 | 12 5/8 | 12 5/8 | 13 1/4 |

## INVESTOR/MEDIA INQUIRIES

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
Phone (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 1997 is available upon written request to:

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

## CORPORATE OFFICES

Walter Industries, Inc.
1500 North Dale Mabry Highway
Tampa, Florida 33607
(813) 871-4811

This Annual Report contains various forward-looking statements and includes assumptions concerning Walter Industries' operations, future results and prospects. These forward-looking statements are based on current expectations and are subject to risk and uncertainties. In connection with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, Walter Industries provides the following cautionary statement identifying important economic, political and technology factors which, among others, could cause the actual results or events to differ materially from those set forth in or implied by the forward-looking statements and related assumptions.

Such factors include the following: (i) changes in the current and future business environment, including interest rates and capital and consumer spending; (ii) competitive factors and competitor responses to Walter Industries' initiatives; (iii) successful development and market introductions of anticipated new products; (iv) changes in government law and regulations, including taxes; and (v) continuation of the favorable environment to make acquisitions, domestic and foreign, including regulatory requirements and market values of candidates.