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RAYTECH CORP
Form 10-Q
May 12, 2004

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

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarter Ended March 28, 2004,

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to

Commission File Number 1-9298

RAYTECH CORPORATION

(Exact Name of Registrant as Specified in its Charter)

DELAWARE 06-1182033
(State or other Jurisdiction of (I.R.S. Employer Identification No.)
Incorporation or Organization)

SUITE 295, FOUR CORPORATE DRIVE 06484
SHELTON, CONNECTICUT (Zip Code)
(Address of Principal Executive Offices)

203-925-8021

(Registrant's Telephone Number)

Indicate by check mark whether the Registrant (1) has filed all reports to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes No

Indicate by check mark whether the Registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes No

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As of April 30, 2004, 41,737,306 shares of common stock were outstanding and the aggregate market value of these shares (based upon the closing price of Raytech common stock on the New York Stock Exchange) on such date held by non-affiliates was approximately \$21.0 million.

RAYTECH CORPORATION

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CONDENSED CONSOLIDATED BALANCE SHEETS (in thousands, except share data) (unaudited)

| | March 28, 2004 | December 28, 2003 |
|---|-------------------|----------------------|
| | ----- | ----- |
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 18,897 | \$ 16,413 |
| Restricted cash | 4,900 | 4,872 |
| Trade accounts receivable, less allowance of \$1,261 and \$1,250 | 30,596 | 24,739 |
| Inventories, net | 30,135 | 30,877 |
| Income taxes receivable | 1,040 | 1,085 |
| Other current assets | 6,456 | 5,770 |
| | ----- | ----- |
| Total current assets | 92,024 | 83,756 |
| | ----- | ----- |
| Property, plant and equipment | 126,618 | 126,059 |
| Less accumulated depreciation | (40,472) | (36,824) |
| | ----- | ----- |
| Net property, plant and equipment | 86,146 | 89,235 |
| | ----- | ----- |
| Goodwill, net | 5,912 | 5,912 |
| Other intangible assets, net | 24,172 | 24,652 |
| Other assets | 2,696 | 2,469 |
| | ----- | ----- |
| Total assets | \$ 210,950 | \$ 206,024 |
| | ===== | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities | | |
| Notes payable and current portion of long-term debt | \$ 13,597 | \$ 8,092 |
| Current portion of pension obligation | 5,190 | 5,190 |
| Accounts payable | 14,402 | 14,609 |
| Accrued liabilities | 26,209 | 26,636 |
| Payable to the PI Trust | 3,815 | 3,815 |
| | ----- | ----- |
| Total current liabilities | 63,213 | 58,342 |
| | ----- | ----- |
| Long-term debt | 13,497 | 14,354 |
| Pension obligation | 12,512 | 13,453 |
| Postretirement benefits other than pension | 15,408 | 15,103 |
| Deferred payable to the PI Trust | 11,887 | 11,887 |
| Deferred income taxes | 6,854 | 6,881 |
| Other long-term liabilities | 722 | 706 |
| | ----- | ----- |
| Total liabilities | 124,093 | 120,726 |
| | ----- | ----- |
| Minority interest | 9,644 | 9,388 |
| Commitments and Contingencies | | |
| Shareholders' Equity | | |

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| | | |
|--|------------|------------|
| Capital stock | | |
| Cumulative preferred stock, no par value, 5,000,000 shares authorized, none issued and outstanding | - | - |
| Common stock, par value \$1.00, 50,000,000 shares authorized, 41,737,306 issued and outstanding | 41,737 | 41,737 |
| Additional paid in capital | 117,574 | 117,574 |
| Accumulated deficit | (73,494) | (74,845) |
| Accumulated other comprehensive loss | (8,604) | (8,556) |
| | ----- | ----- |
| Total shareholders' equity | 77,213 | 75,910 |
| | ----- | ----- |
| Total liabilities and shareholders' equity | \$ 210,950 | \$ 206,024 |
| | ===== | ===== |

The accompanying notes are an integral part of these statements.

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RAYTECH CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share data)
(unaudited)

| | For the thirteen weeks ended | |
|---|------------------------------|-------------------|
| | March 28, 2004 | March 30, 2003 |
| | ----- | ----- |
| Net sales | \$ 56,598 | \$ 55,735 |
| Cost of sales | (45,539) | (46,850) |
| | ----- | ----- |
| Gross profit | 11,059 | 8,885 |
| Selling, general and administrative expenses | (8,602) | (8,279) |
| | ----- | ----- |
| Operating profit | 2,457 | 606 |
| Interest expense | (315) | (237) |
| Other income, net | 293 | 15 |
| | ----- | ----- |
| Income before provision for income taxes and minority interest | 2,435 | 384 |
| Provision for income taxes | (828) | (184) |
| | ----- | ----- |
| Income before minority interest | 1,607 | 200 |
| Minority interest | (256) | (273) |
| | ----- | ----- |

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| | | |
|-----------------------------------|----------|----------|
| Net income (loss) | \$ 1,351 | \$ (73) |
| | ===== | ===== |
| Basic earnings (loss) per share | \$.03 | \$ (.00) |
| | ===== | ===== |
| Diluted earnings (loss) per share | \$.03 | \$ (.00) |
| | ===== | ===== |

The accompanying notes are an integral part of these statements.

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RAYTECH CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

| | For the thirteen weeks ended | |
|---|------------------------------|-------------------|
| | March 28, 2004 | March 30, 2003 |
| | ----- | ----- |
| Cash flows from operating activities: | | |
| Net income (loss) | \$ 1,351 | \$ (73) |
| Depreciation and amortization | 4,157 | 4,607 |
| Other operating activities | (6,908) | (5,669) |
| | ----- | ----- |
| Net cash used in operating activities | (1,400) | (1,135) |
| Cash flow from investing activities: | | |
| Capital expenditures | (842) | (1,800) |
| | ----- | ----- |
| Net cash used in investing activities | (842) | (1,800) |
| Cash flow from financing activities: | | |
| Net borrowings (payments) on short-term notes | 5,513 | (3,393) |
| Principal payments on long-term debt | (747) | (17) |
| Proceeds from long-term borrowings | - | 131 |
| | ----- | ----- |
| Net cash (used in) provided by financing activities | 4,766 | (3,279) |
| Effect of exchange rate changes on cash | (40) | 44 |
| Net change in cash and cash equivalents | 2,484 | (6,170) |
| Cash and cash equivalents at beginning of period | 16,413 | 19,983 |
| | ----- | ----- |
| Cash and cash equivalents at end of period | \$ 18,897 | \$ 13,813 |
| | ===== | ===== |

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The accompanying notes are an integral part of these statements.

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RAYTECH CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
 (in thousands)
 (unaudited)

| | COMMON STOCK | ADDITIONAL PAID IN CAPITAL | ACCUMULATED DEFICIT | ACCUMULATED OTHER COMPREHENSIVE LOSS |
|------------------------------------|--------------------|----------------------------------|------------------------|---|
| | ----- | ----- | ----- | ----- |
| Balance, December 29, 2002 | \$ 41,701 | \$ 117,458 | \$ (8,402) | \$ |
| Comprehensive income: | | | | |
| Net loss | - | - | (73) | |
| Currency translation adjustment | - | - | - | |
| Total comprehensive income | - | - | (73) | |
| Balance, March 30, 2003 | \$ 41,701 ===== | \$ 117,458 ===== | \$ (8,475) ===== | \$ ===== |
| Balance, December 28, 2003 | \$ 41,737 | \$ 117,574 | \$ (74,845) | \$ |
| Comprehensive income: | | | | |
| Net income | - | - | 1,351 | |
| Currency translation adjustment | - | - | - | |
| Total comprehensive income | - | - | 1,351 | |
| Balance, March 28, 2004 | \$ 41,737 ===== | \$ 117,574 ===== | \$ (73,494) ===== | \$ ===== |

The accompanying notes are an integral part of these statements.

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RAYTECH CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (dollars in thousands, unless otherwise noted, except per share data)
 (unaudited)

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRESENTATION OF CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

These condensed unaudited consolidated financial statements have been prepared pursuant to the requirements of Article 10 of Regulation S-X, and in the opinion of management, contain all adjustments necessary to fairly present the consolidated financial position of Raytech Corporation (the "Company") as of March 28, 2004 and the consolidated results of operations and cash flows for all interim periods presented. All adjustments are of a normal recurring nature. The year-end condensed consolidated balance sheet data was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. The financial statements contained herein should be read in conjunction with the Company's financial statements and related notes filed on Form 10-K for the year ended December 28, 2003. Interim results are not necessarily indicative of the results for the full year.

STOCK-BASED COMPENSATION

The Company accounts for stock-based compensation using the intrinsic value-based method of accounting in accordance with Accounting Principles Board Opinion No. 25, under which no compensation cost is recognized for stock options granted at fair market value. Had compensation costs of stock options been determined under a fair value alternative method as stated in Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an Amendment of FASB Statement No. 123," the Company would have been required to record the fair value for such options and employees' purchase rights, and record such amount in the consolidated financial statements as compensation expense. Pro forma stock-based employee compensation costs, net income (loss) and earnings (loss) per share, as they would have been recognized if the fair value method had been applied to all awards, are presented in the table below.

| | FOR THE THIRTEEN WEEKS ENDED | |
|---|------------------------------|-------------------|
| | MARCH 28, 2004 | MARCH 30, 2003 |
| Net income (loss): | | |
| As reported | \$ 1,351 | \$ (73) |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects ... | (671) | (413) |
| Pro forma | \$ 680 | \$ (486) |
| Basic earnings (loss) per share: | | |
| As reported | \$.03 | \$ (.00) |
| Pro forma | \$.02 | \$ (.01) |

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Diluted earnings (loss) per share:

| | | |
|-------------------|--------|----------|
| As reported | \$.03 | \$ (.00) |
| | ===== | ===== |
| Pro forma | \$.02 | \$ (.01) |
| | ===== | ===== |

During the first quarter of fiscal 2003, the Company granted options for 1,601,000 shares of common stock with an exercise price of \$5.70 per share. The fair value of these options was estimated at \$3.22 per common share on the date of grant, using the Black-Scholes option pricing model with the following assumptions:

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RAYTECH CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (dollars in thousands, unless otherwise noted, except per share data)
 (unaudited)

NOTE A, CONTINUED

expected volatility of 56.7%, dividend yield of 0.00%, risk free interest rate of 3.60% and an expected life of the options of six years. During the second quarter of fiscal 2003, the Company granted options for 1,172,000 shares of common stock with an exercise price of \$5.70 per share. The fair value of these options was estimated at \$2.05 per common share on the date of grant, using the Black-Scholes option pricing model with the following assumptions: expected volatility of 62.30%, dividend yield of 0.00%, risk free interest rate of 2.84% and an expected life of the options of six years.

There were no options granted during the first quarter of 2004.

For a summary of all other significant accounting policies, refer to Note A to the consolidated financial statements included with the 2003 Form 10-K.

NOTE B - RESTRICTED CASH

Restricted cash relates to the following:

| | March 28, 2004 | December 28, 2003 |
|-------------------------|-------------------|----------------------|
| | ----- | ----- |
| Payable to the PI Trust | \$ 3,209 | \$ 3,182 |
| Letters of credit | 1,631 | 1,630 |
| Other | 60 | 60 |
| | ----- | ----- |
| | \$ 4,900 | \$ 4,872 |
| | ===== | ===== |

The payable to the Personal Injury Trust ("PI Trust") consists of tax refunds and other funds received by the Company that will be paid to the PI Trust at a future date.

The letters of credit collateralize certain obligations relating primarily to workers' compensation.

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NOTE C - INVENTORIES

Inventories, net, consist of the following:

| | March 28, 2004 | December 28, 2003 |
|-----------------|----------------|-------------------|
| | ----- | ----- |
| Raw material | \$ 10,934 | \$ 11,056 |
| Work in process | 9,172 | 8,871 |
| Finished goods | 10,029 | 10,950 |
| | ----- | ----- |
| | \$ 30,135 | \$ 30,877 |
| | ===== | ===== |

Inventory reserves were \$3,808 and \$4,588 at March 28, 2004 and December 28, 2003, respectively.

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RAYTECH CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (dollars in thousands, unless otherwise noted, except per share data)
 (unaudited)

NOTE D - GOODWILL AND OTHER INTANGIBLE ASSETS

| | March 28, 2004 | | December 28, 2003 | |
|---------------------------------------|-----------------------------|-----------------------------|-----------------------------|----------------|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accu- Amor- |
| | ----- | ----- | ----- | ----- |
| Finite life intangible assets: | | | | |
| Unpatented technology | \$ 14,360 | \$ 5,646 | \$ 14,360 | \$ |
| Distribution base | 5,716 | 958 | 5,716 | |
| | ----- | ----- | ----- | ----- |
| Total | \$ 20,076 | \$ 6,604 | \$ 20,076 | \$ |
| | ===== | ===== | ===== | ===== |
| Indefinite life intangible assets: | | | | |
| Trademarks | \$ 10,700 | | \$ 10,700 | |
| | ===== | | ===== | |
| Goodwill | \$ 5,912 | | \$ 5,912 | |
| | ===== | | ===== | |
| Intangible assets, net | \$ 30,084 | | \$ 30,564 | |
| | ===== | | ===== | |

The weighted-average amortization periods for the unpatented technology

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and the distribution base are between 6 and 20 years. Amortization expense for the 13 weeks ended March 28, 2004 and March 30, 2003 amounted to \$480 and \$556, respectively.

Estimated annual amortization expense is as follows:

For the year ending:

| | |
|------|----------|
| 2004 | \$ 1,922 |
| 2005 | 1,922 |
| 2006 | 1,922 |
| 2007 | 1,622 |
| 2008 | 1,522 |

Trademarks and goodwill are not being amortized but are reviewed for impairment annually or more frequently when events or circumstances indicate that the carrying amount may be impaired. The Company's three operating segments have been defined as reporting units for purposes of testing goodwill for impairment. Goodwill has been assigned to each of the Company's segments. There were no changes in the carrying amount of trademarks or goodwill during the thirteen weeks ended March 28, 2004.

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RAYTECH CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (dollars in thousands, unless otherwise noted, except per share data)
 (unaudited)

NOTE E - DEBT

Debt at March 28, 2004 and December 28, 2003 consists of the following:

| | March 28, 2004 | | | Dece | |
|--------------------------|----------------|-------------|----------|----------|----|
| | Current | Non-Current | Total | Current | No |
| Domestic bank debt | | | | | |
| Line of credit | \$ 9,123 | \$ - | \$ 9,123 | \$ 3,604 | \$ |
| Term loans | | | | | |
| Domestic Wet Friction | 1,055 | 3,869 | 4,924 | 1,055 | |
| Aftermarket | 996 | 5,671 | 6,667 | 996 | |
| Total domestic bank debt | 11,174 | 9,540 | 20,714 | 5,655 | |
| Foreign bank debt | | | | | |
| Line of credit | - | - | - | - | |
| Term loans | | | | | |
| Europe | 957 | 3,817 | 4,774 | 979 | |
| Asia | 1,300 | - | 1,300 | 1,300 | |
| Total foreign bank debt | 2,257 | 3,817 | 6,074 | 2,279 | |

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| | | | | |
|------------------|-----------|-----------|-----------|----------|
| Total bank debt | 13,431 | 13,357 | 26,788 | 7,934 |
| Leases | 166 | 140 | 306 | 158 |
| Total borrowings | \$ 13,597 | \$ 13,497 | \$ 27,094 | \$ 8,092 |

The carrying value of the Company's debt approximates fair value.

The Company, through its Domestic Wet Friction segment subsidiaries, Raybestos Products Company ("RPC"), and Raybestos Automotive Components Company ("RACC"), maintains a Loan and Security Agreement, which provides for RPC and RACC to borrow up to \$25.3 million in the aggregate. The agreement, as amended in November 2003, consists of a \$20 million revolving line of credit and a term loan of \$5.3 million. The revolving line of credit is limited through a formula which provides availability based on qualified accounts receivable and inventory. The revolving line of credit matures September 28, 2006. The term loan is payable in 34 monthly payments of \$88 thousand, commencing December 1, 2003 and maturing on September 28, 2006, with the final payment being the remainder of the balance. The revolving line of credit and the term loan are collateralized by accounts receivable, inventory and property, plant and equipment. Amounts outstanding under the revolving line of credit bear interest at a rate equal to, at the Company's option, the prime rate or the adjusted Eurodollar rate, plus a margin of 0.5% and 2.75%, respectively. Amounts outstanding under the term loan bear interest at a rate equal to, at the Company's option, the prime rate or the adjusted Eurodollar rate, plus a margin of 0.75% and 3.0%, respectively. The agreement contains financial and other covenants, including a fixed charge coverage ratio and a material adverse change clause. At March 28, 2004 and December 28, 2003, the aggregate pledged assets of RPC and RACC amounted to \$62.1 million and \$59.6 million, respectively, consisting of cash, accounts receivable, inventory, machinery and equipment and all other tangible and intangible assets, except real property. The agreement permits RPC and RACC to pay dividends to the Company for costs and expenses incurred by the Company in the ordinary course of business so long as no event of default has occurred and is continuing. Subsequent to the end of the first quarter, but prior to the filing of this report, the Company entered into a fifth amendment to this agreement. The fifth amendment alters the determination of availability under the revolving

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RAYTECH CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (dollars in thousands, unless otherwise noted, except per share data)
 (unaudited)

NOTE E, CONTINUED

line of credit to exclude certain receivables due to a potential right of setoff and grants the lender a mortgage on the real property owned by the Company in Sterling Heights, Michigan. The carrying value of the real property in Sterling Heights, Michigan was \$5.1 million at March 28, 2004. Further, in accordance with the fifth amendment, the lender may make loans, subject to certain limits, under the revolving line of credit up to the lesser of the amount of the excluded receivables or \$1.9 million.

The Company, through its subsidiaries Raytech Powertrain, Inc. ("RPI"), Allomatic Products Company ("APC"), Raytech Systems, Inc. ("RSI") and Raybestos Powertrain, LLC is party to a loan agreement for \$7.0 million with an

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interest rate at 1.65 basis points over the adjusted Eurodollar rate with a five-year term. The loan is payable in 59 monthly payments of \$83, commencing on December 1, 2003, with a balloon payment of \$2.1 million payable on November 3, 2008. The proceeds from this facility will be used to pay environmental costs and pension costs. The loan is collateralized by the assets of the borrowing entities. The agreement contains financial and other covenants, including the maintenance of certain financial ratios and a material adverse change clause. At March 28, 2004 and December 28, 2003, the aggregate pledged assets of APC, RSI RPI and Raybestos Powertrain LLC were \$54.9 million and \$54.0 million respectively.

The Company's wholly-owned German subsidiary, Raybestos Industrie-Produkte GmbH ("RIP"), has available lines of credit with several German banks. Interest is charged at rates between 5.07% and 8.0%. The lines are repayable on demand. At March 28, 2004 and December 28, 2003, there were no borrowings outstanding under these lines of credit.

The Company's wholly-owned German subsidiaries, Raytech Composites Europe GmbH ("RCE") and RIP have various loan agreements where the maturities range from September 2006 through December 2012. The loans are payable in equal periodic installments (usually quarterly or semi-annually) over the term of the loan. The loans bear interest at rates ranging from 2.5% through 6.2%. At March 28, 2004 and December 28, 2003, respectively, the aggregate pledged assets, consisting of machinery and equipment, amounted to EUR13.0 million (\$16.0 million) and EUR12.7 million (\$16.0 million).

During the periods presented, the Company's wholly-owned Chinese subsidiary Raybestos Friction Products (Suzhou) Co. Ltd. ("RFP") has had various loan agreements. The loans are short-term with maturities between six and twelve months.

The weighted average rates on all domestic and foreign bank notes payable at March 28, 2004 and December 28, 2003 were 3.88% and 3.71%, respectively.

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RAYTECH CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, unless otherwise noted, except per share data)
(unaudited)

NOTE F - LITIGATION

ENVIRONMENTAL REMEDIATION

Crawfordsville, Indiana - Shelly's Ditch Contamination Removal

In October 1987, RPC, a wholly-owned subsidiary of the Company, purchased a major manufacturing facility (the "RPC Facility") in Crawfordsville, Indiana. Sometime thereafter, the Company learned that the previous owner of the RPC Facility had disposed of polychlorinated biphenyls ("PCBs") in the ground at the RPC Facility in the mid-1960s and that such PCBs were leaching from the RPC Facility into an adjacent ditch ("Shelly's Ditch").

In 1996, the Indiana Department of Environmental Management (the "IDEM") advised RPC that the RPC Facility may have contributed to, and was potentially responsible for, the release of lead and PCBs found in Shelly's Ditch. In the late 1990s, RPC and the IDEM entered into an agreed order (the "Agreed Order") for a risk-based remediation of PCBs and lead in Shelly's Ditch. When the IDEM later sought to unilaterally withdraw from the Agreed Order, RPC appealed and the court ordered the IDEM to reinstate the Agreed Order. Meanwhile, at the

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IDEM's request, the United States Environmental Protection Agency (the "EPA") became involved in Shelly's Ditch.

In December 2000, before the Agreed Order was reinstated, the EPA issued a Unilateral Administrative Order to RPC under CERCLA (the "EPA Removal Order") demanding removal of contaminated soils from those Shelly's Ditch areas identified as Reaches 1 through 3 (the "Site"). The EPA Removal Order required more work at greater expense than the IDEM Agreed Order. Thereafter, RPC proceeded with the work required under the EPA Removal Order. By March 28, 2004, RPC had spent approximately \$18.7 million on removal of lead and PCB contaminated soils from the Site and had accrued \$400 for potential EPA oversight costs relating to that work.

On January 9, 2004, the EPA confirmed that RPC had completed the action required under the EPA Removal Order, including the removal and proper disposal of Site soils and sediments contaminated with PCBs and lead. In its confirmation, the EPA noted that RPC would continue to be subject to certain obligations under that order, including record retention and the payment of oversight costs. Whether RPC will be required to pay oversight costs relating to the work under the EPA Removal Order will depend on the outcome of future negotiations with the EPA and the IDEM regarding potential environmental remediation downstream of the Site.

Crawfordsville, IN - Environmental Remediation Downstream of Reaches 1 through 3 of Shelly's Ditch

On May 6, 2003, the EPA indicated that RPC is potentially liable for PCB and lead contamination downstream of the Site. The EPA has not issued an order to RPC regarding this downstream area. However, during the third quarter of 2003, the Company began negotiations with the EPA concerning such possible additional remediation. As a result, during the third quarter of 2003, the Company recorded a \$2.4 million provision relating to this potential liability for future cleanup costs.

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RAYTECH CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, unless otherwise noted, except per share data)
(unaudited)

NOTE F, CONTINUED

Crawfordsville, IN - Environmental Remediation and Expenses relating to the RPC Facility

On May 15, 2001, the EPA issued a Pre-filing Notice and Opportunity to Confer to RPC (the "Pre-filing Notice"). This notice stated that the EPA might file a civil action lawsuit against RPC for violations of various environmental statutes and would offer RPC the opportunity to participate in pre-filing negotiations to resolve this matter. The EPA stated that it has reason to believe that RPC committed violations of the Clean Air Act, Clean Water Act, Resource Conservation and Recovery Act, and Toxic Substances Control Act and that RPC could be subject to substantial penalties. At that time, the Company recorded a provision of \$.3 million on the advice of legal counsel. On September 3, 2003, the EPA proposed that the parties settle the Pre-filing Notice. The EPA stated that penalties for violations alleged in the Pre-filing Notice could total approximately \$180 million and suggested the following resolution: RPC should pay approximately \$2.4 million in fines and undertake compliance activities, on-site investigative work that the EPA estimated would cost about \$1.0 million, and corrective action to resolve the Pre-filing Notice. The

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parties have begun preliminary negotiations regarding the potential on-site investigative work but have not obtained an overall EPA settlement proposal. The Company recorded a provision of \$3.1 million in the year-ended December 28, 2003 based on the EPA position.

Ferndale, MI - Potential Responsibility for Environmental Remediation

In a January 8, 2002 letter, the Michigan Department of Environmental Quality asserted Company responsibility for trichloroethylene contamination at a Ferndale, Michigan industrial site that Advanced Friction Materials Company ("AFM") leased from approximately 1974 to 1985. The Company acquired 47% of the stock of AFM in 1996 and the balance of the shares in 1998. The Company's liability at this site is indeterminable at this time.

ENVIRONMENTAL LITIGATION

Cost Recovery Actions against Insurers regarding Shelly's Ditch

In 1996, RPC notified its insurers and demanded defense and indemnity regarding any environmental issues relating to alleged lead and PCB contamination of Shelly's Ditch. In January 1997, one insurer filed a complaint in the U.S. District Court, Southern District of Indiana, captioned Reliance Insurance Company vs. Raybestos Products Company (the "Insurance Case"). The complaint sought a declaratory judgment that the Reliance Insurance policies do not provide coverage to RPC for defense and indemnity relating to investigation and remediation of contamination in Shelly's Ditch. In January 2000, the District Court rejected Reliance's claims and granted summary judgment to RPC. In June 2001, Reliance Insurance Company was placed in liquidation in Pennsylvania. The Company has filed claims in the Reliance liquidation for recovery of its Shelly's Ditch expenses but has not received a decision.

In February 2002, RPC filed a third-party complaint in the Insurance Case against National Union and two other insurance carriers. The third-party complaint seeks defense and indemnity from the insurers relating to investigation and remediation of contamination in Shelly's Ditch.

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RAYTECH CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, unless otherwise noted, except per share data)
(unaudited)

NOTE F, CONTINUED

In February 2004, National Union and its affiliates commenced an adversary proceeding against the Company, RPC and others by filing a complaint in U.S. Bankruptcy Court (the "Adversary Proceeding"). In the Adversary Proceeding, National Union claims that RPC's third-party complaint against National Union is barred by a January 2002 order of the U.S. Bankruptcy Court in the Raymark Industries, Inc. and Raymark Corporation Chapter 11 cases (the "Raymark Order"). National Union claims that the Raymark Order prohibited RPC from pursuing its third-party complaint against National Union and declared that the National Union insurance policies issued to the Company and RPC have been exhausted. Also in February 2004, National Union filed a motion in the U.S. District Court, Southern District of Indiana, asking that court to stay the Insurance Case against National Union. The outcome of this Adversary Proceeding and related motion for stay and their effects, if any, on the Insurance Case against National Union cannot be predicted.

RPC Claims against IDEM

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In July 2002, RPC filed an action against the IDEM for breach of contract claiming damages based on the difference between the costs of cleanup under the EPA Removal Order and the IDEM Agreed Order. The outcome of this litigation cannot be predicted.

COMMERCIAL LITIGATION

On April 22, 2003, Automation by Design, Inc. filed a civil action against RPC in U.S. District Court for the Southern District of Indiana. The complaint alleges copyright infringement and breach of contract in connection with RPC's purchase of certain equipment. In answer to plaintiff's complaint, RPC denied liability and filed counterclaims for breach of contract and declaratory judgment. The court has granted Automation by Design's motion to amend its complaint to include Raytech Corporation and Production Design Services, Inc. as defendants. RPC has agreed to defend and provide certain indemnity protection to Production Design Services, Inc., which manufactured certain equipment that is allegedly involved in this court action. The outcome of this litigation cannot be predicted, and the Company's liability or recoveries are indeterminable at this time.

EQUITY HOLDERS LITIGATION

In February 2002, lawyers claiming to represent the Committee of Equity Holders of Raytech Corporation filed a motion in U.S. Bankruptcy Court to compel the Company to either issue up to approximately 700,000 additional shares to the pre-reorganization holders of shares in the Company or their successors, or to proportionately reduce the shareholdings of the general unsecured creditor shareholders under the Plan of Reorganization. The ultimate outcome of this matter cannot be predicted; however, it is possible that its resolution could cause the Company to issue additional shares to the original shareholder group, or to retire shares held by the general unsecured creditor shareholder group. This might directly impact the earnings per share calculations of the Company. The Bankruptcy Court denied a Company motion to dismiss this action. The Company is currently in negotiations with the equity holders' representative to settle this case.

The Company is subject to certain other legal matters that have arisen in the ordinary course of business, and management does not expect them to have a significant adverse effect on the results of consolidated operations, financial condition or cash flow.

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RAYTECH CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, unless otherwise noted, except per share data)
(unaudited)

NOTE G - SEGMENT REPORTING

The Company's operations are categorized into three operating segments and a corporate group based on management structure, product type and distribution channel, as described below. The Company, during the first quarter of 2004, restructured its operating segments to facilitate a stronger focus on the European wet friction operations. Oversight of the European wet friction operations, Raybestos Reibtechnik GmbH ("RRT") and Raybestos U.K. Ltd. ("RUK"), was transferred to the European management team. The newly defined operating segments are Domestic Wet Friction, International (including the European wet friction operations and European and Asian dry friction operations), and Aftermarket. All prior period segment information presented has been restated to

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reflect the newly defined segments.

Domestic Wet Friction

The Domestic Wet Friction segment manufactures and distributes automatic transmission and wet wheel brake system components. The Company markets its products to automobile, heavy duty truck, farm machinery, mining, and bus original equipment manufacturers ("OEMs") in North America.

International

The International segment manufactures and distributes automatic transmission, manual transmission and wet wheel brake system components. The Company markets its products to automobile, heavy duty truck, farm machinery, mining, and bus OEMs. The International segment markets its dry friction products worldwide and its wet friction products throughout Europe and Asia.

Aftermarket

The Aftermarket segment produces specialty engineered products primarily for automobile and lift truck automatic transmissions. In addition to these products, this segment markets transmission filters and other transmission related components. The focus of this segment is marketing to warehouse distributors and certain retail operations in the automotive aftermarket.

Corporate

The Corporate group consists principally of corporate expenses, including costs to maintain the corporate headquarters, certain environmental costs, and certain assets, liabilities and related income and expense stemming from the reorganization plan implemented when the Company emerged from bankruptcy in 2001. The Company has chosen not to distribute these costs to the operating segments to preserve the historical comparability at the operating segment level.

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RAYTECH CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (dollars in thousands, unless otherwise noted, except per share data)
 (unaudited)

NOTE G, CONTINUED

Information relating to operations by industry segment follows:

| | FOR THE THIRTEEN WEEKS ENDED | |
|---------------------------------|------------------------------|----------------|
| | MARCH 28, 2004 | MARCH 30, 2003 |
| Net Sales | | |
| Domestic Wet Friction | \$ 31,402 | \$ 33,053 |
| International | 16,653 | 15,063 |
| Aftermarket | 12,386 | 11,489 |
| Intersegment elimination(1) | (3,843) | (3,870) |
| | ----- | ----- |
| Net sales to external customers | \$ 56,598 | \$ 55,735 |
| | ===== | ===== |

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| | | |
|-----------------------------|-----------|------------|
| Gross Profit | | |
| Domestic Wet Friction | \$ 3,896 | \$ 2,701 |
| International | 4,789 | 3,905 |
| Aftermarket | 3,685 | 3,379 |
| Intersegment elimination(1) | (1,311) | (1,100) |
| | ----- | ----- |
| Consolidated | \$ 11,059 | \$ 8,885 |
| | ===== | ===== |
| Operating Profit (Loss) (2) | | |
| Domestic Wet Friction | \$ 670 | \$ (1,208) |
| International | 2,186 | 1,379 |
| Aftermarket | 2,234 | 2,410 |
| Corporate | (2,655) | (2,197) |
| | ----- | ----- |
| Consolidated | \$ 2,435 | \$ 384 |
| | ===== | ===== |

- (1) The Company records intersegment sales at an amount negotiated between the segments. All intersegment sales are eliminated in consolidation. Substantially all intersegment sales are sales of wet friction products to the Aftermarket segment.
- (2) The Company's management reviews the performance of its reportable segments on an operating profit basis, consisting of income before income taxes and minority interest.

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RAYTECH CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (dollars in thousands, unless otherwise noted, except per share data)
 (unaudited)

NOTE H - INCOME TAXES

The tax provision for the thirteen-week period ended March 28, 2004 is \$.8 million compared to a provision of \$.2 million for the same period in the prior year. The provision for the current period includes federal taxes resulting from profit generated by APC, foreign taxes associated with operations in Germany and China and state taxes generated by domestic operations. The Company did not recognize any tax benefits associated with the losses generated by the U.S. domestic operations, due to doubts concerning their future recoverability, in the thirteen week period ended March 28, 2004. The Company's effective tax rate for the thirteen week period ended March 28, 2004 was 34.0% compared to a rate of 47.9% for the same period in the prior year. The effective tax rate coincidentally approximates the U.S. statutory rate in the first quarter of 2004 due to the mix of income and the related income tax rates in each of the tax jurisdictions in which the Company's operations generated income. The effective tax rate for the thirteen week period ended March 30, 2003 reflects the statutory federal tax rate adjusted for state and foreign taxes and contributions made to the Raymark pension plan. In addition, the Company did not recognize any tax benefits associated with the operating losses incurred by the Company's U.K. operations due to doubts about their future recoverability.

Pursuant to the Tax Benefits Assignment and Assumption Agreement (the "Agreement"), all tax benefits received by the Company due to the reorganization are to be passed onto the PI Trust as received. At March 28, 2004, the Company has tax loss carryforwards of \$101.2 million and tax credit carryforwards of \$3.5 million. The net operating loss carryforwards are allocated between the Company and the PI Trust in the amounts of \$21.2 million and \$80.0 million,

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respectively. The tax credit carryforwards all inure to the benefit of the PI Trust. Additionally, future payments to the PI Trust and others will create additional tax deductions, which will inure to the benefit of the PI Trust in accordance with the Agreement. These include deductions for payments to the PI Trust of tax benefits associated with the utilization of the operating losses allocated to the PI Trust, and contributions made to the Raymark pension plans. Losses generated by the Company subsequent to the emergence from bankruptcy, exclusive of losses attributed to the payments discussed above, will be retained by the Company. The method of allocation in utilizing current and future operating losses between the PI Trust and the Company has not been determined at this time. Additional tax recoveries, expected to be received in future periods, are recorded as deferred tax assets, net of valuation allowances, and a deferred payable to the PI Trust, which amounted to \$11.9 million at March 28, 2004 and December 28, 2003.

At March 28, 2004, the Company has recorded a tax receivable in the amount of \$.9 million due from state governments for returns filed in 2003. The Company received \$45 in January 2004 as a partial recovery of these state taxes. In accordance with the Agreement, this amount inures to the benefit of the PI Trust.

The Company is under an IRS audit for 1996 through 2001. Any tax assessment, up to the amount of the refunds received, arising from this audit or any other years in the carryback period, are, pursuant to the Agreement, the responsibility of the PI Trust and will therefore impact the deferred tax asset attributable to the PI Trust. Any change in the deferred tax asset attributable to the PI Trust will also impact the valuation allowance and the related deferred payable to the PI Trust. Pursuant to a settlement meeting held in April 2004, the Company and the IRS have reached a tentative settlement of the IRS audit. The settlement, if approved by the IRS District Director and the Joint Committee on Internal Revenue Taxation, would result in no payment of Federal tax given the Company's net operating losses. However, interest on the tax assessment would be payable. The Agreement does not address, and the parties have not agreed, as to whether the Company or the PI Trust would be responsible for the interest on any tax assessment. The Company expects the approval process to be completed prior to the end of the current fiscal year.

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RAYTECH CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, unless otherwise noted, except per share data)
(unaudited)

NOTE H - CONTINUED

The Company owns 57% of the stock of APC. The Company has not recorded a deferred tax liability for the undistributed earnings of APC since management expects that those earnings will be distributed to the Company in a tax-free transaction. However, the deferred tax liability on the undistributed earnings of APC would be approximately \$1.5 million at March 28, 2004, if all of APC's earnings were to be distributed through dividends.

NOTE I - EARNINGS PER SHARE

FOR THE THIRTEEN WEEKS ENDED

MARCH 28, 2004

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| | SHARES ----- | SHARE AMOUNT ----- | PER INCOME ----- | SHARES ----- |
|--|-----------------|--------------------------|------------------------|-----------------|
| Basic Earnings per Share | | | | |
| Income available to common stockholders | \$ 1,351 | 41,737 | \$.03 | \$ (73) |
| Effect of Dilutive Securities | --- | --- | | --- |
| Diluted Earnings per Share | | | | |
| Income available to common stockholders | \$ 1,351 | 41,737 | \$.03 | \$ (73) |
| | ===== | ===== | ===== | ===== |

Options to purchase 3,035,659 and 1,927,411 shares of common stock were not included in the computation of diluted earnings per share for the thirteen weeks ended March 28, 2004 and the thirteen weeks ended March 30, 2003, respectively, due to their anti-dilutive effect due either to their exercise price compared to the market price or the Company incurring a loss for the period.

In February 2002, lawyers claiming to represent the Committee of Equity Holders of Raytech Corporation filed a motion in U.S. Bankruptcy Court to compel the Company to either issue up to approximately 700,000 additional shares to the pre-reorganization holders of shares in the Company or their successors, or to proportionately reduce the shareholdings of the general unsecured creditor shareholders under the Plan of Reorganization. The ultimate outcome of this matter cannot be predicted; however, it is possible that its resolution could cause the Company to issue additional shares to the original shareholder group, or to retire shares held by the general unsecured creditor shareholder group. This might directly impact the earnings per share calculations of the Company. The Bankruptcy Court denied a Company motion to dismiss this action. The Company is currently in negotiations with the equity holders' representative to settle this case.

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RAYTECH CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, unless otherwise noted, except per share data)
(unaudited)

NOTE J - PENSION AND POST RETIREMENT BENEFIT PLANS

Components of Net Periodic Benefit Cost

| | Pension Benefits ----- | | Post Retirement Benefits ----- | |
|--------------------------------|------------------------------|-------------------|-----------------------------------|-------------------|
| | For the thirteen weeks ended | | | |
| | March 28, 2004 | March 30, 2003 | March 28, 2004 | March 30, 2003 |
| | ----- | ----- | ----- | ----- |
| Service Cost | \$ 146 | \$ 108 | \$ 197 | \$ 157 |
| Interest Cost | 698 | 719 | 290 | 270 |
| Expected return on plan assets | (636) | (414) | - | - |

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| | | | | |
|------------------------------------|--------|--------|--------|--------|
| Amortization of prior service cost | 15 | - | - | - |
| Amortization of net (gain) loss | 128 | 25 | 41 | - |
| | ----- | ----- | ----- | ----- |
| Net periodic benefit cost | \$ 351 | \$ 438 | \$ 528 | \$ 427 |
| | ===== | ===== | ===== | ===== |

The Company previously disclosed in its financial statements for the year ended December 28, 2003, that it expected to contribute \$5.3 million to its pension plans and \$.6 million to fund its post retirement plan in 2004. As of March 28, 2004, \$1.2 million of contributions have been made. The Company presently anticipates contributing an additional \$4.6 million to fund its pension and post retirement plans in 2004. The 2004 planned contributions of \$5.8 million reflect a \$.5 million reduction provided by the Pension Funding Equity Act of 2004.

In connection with the Company's Chapter 11 proceedings, the Pension Benefit Guaranty Corporation ("PBGC") filed certain motions claiming that the Company was responsible for the funding and sponsorship of two Raymark Corporation pension plans. The court ordered that the Company was liable for the maintenance and funding of the underfunded pension plan obligations of Raymark Corporation. The Company, based on the court's order, assumed the role of plan sponsor of the Raymark Plans upon emergence from bankruptcy. Subsequent to the end of the first quarter of 2004, but prior to the filing of this report, the Company executed a mortgage of its real property located in Crawfordsville, Indiana to the PBGC, guaranteeing its funding obligations of the Raymark Plans. At March 28, 2004 the carrying value of the real property mortgaged was \$4.8 million.

NOTE K - LIQUIDITY

Cash used by operating activities for quarter ended March 28, 2004 was \$1.4 million compared to \$1.1 million during the same period last year. The principal operating use of cash in both periods presented was an increase in trade accounts receivable. The increase in trade accounts receivable during the first quarter is a seasonal fluctuation. The Company effectively manages its accounts receivable as evidenced by the average days sales in trade receivables of 49 and 50 days at March 28, 2004 and March 30, 2003, respectively.

Capital expenditures during the first quarter of 2004 were \$.8 million compared to \$1.8 million during the first quarter of 2003.

The Company's cash and cash equivalents at March 28, 2004 totaled \$18.9 million compared to \$16.4 million at December 28, 2003, an increase of \$2.5 million.

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RAYTECH CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, unless otherwise noted, except per share data)
(unaudited)

NOTE K, CONTINUED

The total borrowings at March 28, 2004 of \$27.1 million compares to total borrowings of \$22.4 million at year-end 2003, an increase of \$4.7 million period-over-period. The available lines of credit at March 28, 2004 of \$9.4 million compares to \$10.6 million at year-end 2003, a decrease in availability of \$1.2 million. Full details of the Company's debt are contained in Note E to the Condensed Consolidated Financial Statements.

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In summary of the above, the cash and available lines of credit at March 28, 2004 were \$28.3 million compared to \$27.0 million at year-end 2003, an increase in cash and available lines of credit of \$1.3 million.

Refer to Notes F - Debt and N - Commitments to the consolidated financial statements, included within the Company's 2003 Form 10-K, for information regarding the Company's obligations and commitments by year. These obligations and commitments consist of long-term debt, capital leases and rental agreements.

The Company's potential obligations regarding environmental remediation are explained fully in Note F - Litigation of the Condensed Consolidated Financial Statements.

The Company assumed the liability for the Raymark pension plans as part of the reorganization. Funding for the plans in 2004 is expected to be approximately \$4.4 million of which \$1.2 million was funded in the first quarter of 2004.

Certain tax issues are discussed in Note H - Income Taxes, which provide details concerning the status of the current Internal Revenue Service audit and the use of certain future tax benefits.

The most significant factor affecting the Company's future cash flows is its ability to earn and collect cash from customers. The automotive parts industry is extremely competitive. Many of the Company's customers and competitors are significantly larger than the Company. The Company's customers are often able to demand price reductions from the suppliers including all segments of Raytech. Some of the Company's sales are made under standard sales contracts that include price commitments for multiple years. Specifically in the Domestic Wet Friction segment, the Company is selling certain products to certain customers at a loss under the terms of its current sales contracts. The Company is currently working with its customers to re-negotiate the terms of these loss contracts. In addition, the Company is reviewing alternatives to improve its cost structure.

Items that will potentially require the use of cash during the remainder of fiscal 2004 other than normal operating expenses include the following.

- The Company has recorded an accrued liability of \$6.2 million for certain environmental matters more fully discussed in Note F - Litigation. It is not certain at this time when these funds will be expended. There exists the potential that all or a portion of the funds will be spent in 2004.
- The Company assumed the liability for the Raymark pension plans as part of the Chapter 11 reorganization. The plans, which are discussed as part of Note M - Employee Benefits to the consolidated financial statements, included within the Company's 2003 Form 10-K, are under funded and the Company, through an agreement with the Internal Revenue Service, is providing both current contributions and catch-up contributions. The expected funding for the plans in 2004 will be approximately \$4.4 million, \$1.2 million of which was funded during the first quarter.

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RAYTECH CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, unless otherwise noted, except per share data)
(unaudited)

NOTE K, CONTINUED

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- Certain tax issues are discussed in Note H - Income Taxes, which provides detail concerning the status of the current Internal Revenue Service audit and the use of certain future tax benefits.

Management believes that existing cash balances, the Company's lending facilities and cash flow from operations during 2004 will be sufficient to meet all of the Company's obligations arising in the normal course of business, including anticipated capital investments. However, the ability of the Company to utilize its lending facilities is dependent on the Company's ability to meet its financial forecasts for 2004, which is not assured, and to meet the financial covenants contained in its credit facilities. These forecasts include certain revenue assumptions generally consistent with the prior year for the Domestic Wet Friction (on a comparable basis) and Aftermarket segments and modest growth in the International segment, as well as certain cost-saving initiatives. If the Company does not comply with the financial covenants, an event of default would occur and could result in the acceleration of the Company's indebtedness under its domestic credit facilities. If that were to occur, the ability of the Company to continue would be dependent upon, among other things, its ability to amend the credit facilities, enact certain actions to generate cash and/or to seek additional alternative financing from other lenders.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In preparing the discussion and analysis required by the federal securities laws, it is assumed that users of the interim financial information have read or have access to the discussion and analysis for the preceding fiscal year.

Caution Regarding Forward Looking Statements

Statements in this "Management's Discussion and Analysis" relating to management's views of trends, the effects of changing prices, plans, objectives and other matters for future operating periods are "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to significant risks and uncertainties that could cause actual results to differ materially from the results in the statements. Forward-looking statements relating to Raytech Corporation (the "Company") businesses are based on assumptions concerning certain factors that are not predictable and are subject to change. These factors include general economic conditions, worldwide demand for automotive and heavy duty vehicles, consumer confidence, actions of our competitors, vendors and customers, factors affecting our costs such as raw material prices, labor relations and environmental compliance and remediation, interest and foreign currency exchange rates, technological issues, accounting standards, and the risks set forth in the section entitled "Risk Factors." The forward-looking statements herein are made as of the date of this report. We have no obligation to update our forward-looking statements.

Risk Factors

The Company's businesses are subject to certain risks, including but not limited to those described below, that could cause material changes in its results of operations or financial condition in the future.

- The Company's businesses are greatly affected by general economic conditions. The Company sells components to the automotive and heavy duty equipment

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industries and in large part is dependent upon consumer demand for automobiles, consumer confidence and business investment in heavy equipment. The Company's businesses sell components for transmissions and brakes to automotive and heavy duty original equipment manufacturers ("OEMs") as well as the automotive aftermarket. The economic slowdown and recession of the last three years have resulted in reduced heavy equipment and passenger vehicle production in the United States and in foreign markets and reduced demand in the aftermarket. It is possible that OEM vehicle and equipment production will not increase significantly in 2004 and future years. Continuation of the economic slowdown may adversely affect the Company's revenues in all of its business segments.

- The Company's customers are large companies under pressure to cut component costs. The Domestic Wet Friction segment's largest customers are experiencing margin erosion due to reduced volume, high labor costs and intense foreign competition. The Company is a relatively small supplier of a limited number of components. Due to their size, the Company's customers are often able to demand component price reductions from their suppliers, including all segments of the Company. These customers may also demand technological changes and quality improvements at the Company's expense. In addition, the trend in the automotive aftermarket is toward longer transmission service and replacement cycles due to improved quality. If foreign automotive manufacturers continue to take U.S. market share from the Company's domestic OEM customers and economic conditions do not improve significantly, the Company's revenues will be adversely affected by these factors.
- The Company is subject to substantial environmental remediation obligations for past contamination that are not yet fixed in scope or amount. The nature of environmental contamination and its remediation are such that the amount and nature of work necessary is often unknown until late in the process. The level of responsibility of the parties involved and the level of remediation to be required by governmental

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authorities is also uncertain. The Company also incurs substantial ongoing environmental compliance costs in operating its production facilities. Substantial unanticipated environmental costs could adversely affect profitability.

- Raytech's Common Stock is currently included in the Russell 3000 equity index. The Russell 3000 is a market capitalization-weighted index of the 3,000 largest U.S. companies. Russell reconstitutes the index annually in order to accurately rank the 3,000 largest companies in the U.S. stock market by market capitalization to provide a truer reflection of stock market activity and performance. There is a risk that Raytech may no longer be part of that index after the next recalculation of the index in June 2004. If Raytech ceases to be a member of the Russell 3000, its common stock price may be adversely affected because mutual funds and other investors who must own or wish to own the Russell 3000 index will sell or no longer purchase Raytech common stock. The Personal Injury ("PI Trust") holds 82.9% and the Environmental Protection Agency ("EPA") holds 5.5% of the outstanding common stock of the Company at March 28, 2004.
- Worldwide increases in steel demand have led to increased prices and concerns of a steel shortage. Potential impacts on the Company from the current steel market conditions could include reduced delivery levels of finished products to Raybestos customers and lower profitability due to higher raw material costs.

Significant Accounting Policies

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Preparation of the Company's financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Management believes the most complex and sensitive judgments, because of their significance to the consolidated financial statements, result primarily from the need to make estimates about the effects of matters that are inherently uncertain. Management's Discussion and Analysis and Note A to the Consolidated Financial Statements in the Company's Form 10-K for fiscal 2003 describe the significant accounting estimates and policies used by management in the preparation of the consolidated financial statements. Actual results in these areas could differ from management's estimates. There have been no changes in the Company's critical accounting estimate processes and policies during the first quarter 2004.

Results of Operations and Liquidity and Capital Resources

The following table sets forth selected income statement data for the thirteen weeks ended March 28, 2004 and March 30, 2003.

| | For the thirteen weeks ended (amounts in millions) | | | |
|--|---|--------|----------------|--------|
| | March 28, 2004 | | March 30, 2003 | |
| | ----- | ----- | ----- | ----- |
| Net sales | \$ 56.6 | 100.0% | \$ 55.7 | 100.0% |
| Gross profit | 11.1 | 19.5 | 8.9 | 15.9 |
| Selling, general and administrative expense | 8.6 | 15.2 | 8.3 | 14.9 |
| Interest expense | .3 | .6 | .2 | .4 |
| Other income, net | (.3) | -.5 | - | - |
| Income before taxes and minority interest | 2.4 | 4.3 | .4 | .7 |
| Income taxes | (.8) | 1.5 | (.2) | .3 |
| Minority interest | (.3) | .5 | (.3) | .5 |
| | ----- | ----- | ----- | ----- |
| Net income (loss) | \$ 1.4 | 2.4% | \$ (.1) | -.2% |
| | ===== | ===== | ===== | ===== |

The Company reported increased sales in the first quarter of 2004 compared to the first quarter of 2003. The increase in sales was due principally to favorable currency translation adjustments in the Company's European operations and modest growth in the Aftermarket segment. The Company continues to

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experience pressure to reduce prices from certain of its major customers, most notably in the Domestic Wet Friction segment.

Gross profit increased to 19.5% of sales in the first quarter of 2004 compared to 15.9% during the same period last year. The Company realized improved gross profit across all three of its operating segments, principally due to improved productivity and cost reduction programs, partially offset by the impact of price reductions. The Company's cost reduction programs generated \$2.3 million in savings during the first quarter of 2004. During the first quarter of 2004 the Company experienced increases in the price of steel, a key raw material. Continued increases in the price of steel could negatively impact the Company's future profitability.

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SG&A expenses increased \$.3 million or 3.6% during the first quarter of 2004 compared to the first quarter of 2003. The increase is principally due to currency translation, increased incentive compensation expense and medical expense, partially offset by cost reductions.

Interest expense is incurred on the Company's debt facilities. See Note E of the Condensed Consolidated Financial Statements.

The Company's income taxes are discussed in detail in Note H of the Condensed Consolidated Financial Statements. As a condition of the reorganization plan, all tax benefits received by the Company as a result of the reorganization inure to the benefit of the PI Trust.

Minority interest relates to the Company's majority-owned subsidiary, Allomatic Products Company ("APC"). APC, a member of the Company's Aftermarket segment, is 57% owned by the Company, 40% owned by a related party and 3% owned by certain employees of the Company. APC is consolidated in the financial statements and a minority interest is recorded to reflect the minority shareholders' interest in APC.

The Company recorded net income of \$1.4 million, or \$.03 per basic share, for the thirteen week period ended March 28, 2004 compared to a net loss of \$0.1 million, or nil per basic share for the same period in the prior year. The increase in earnings of \$1.5 million is due to improved operating results in the Domestic Wet Friction and International segments.

The Company, during the first quarter of 2004, restructured its operating segments to facilitate a stronger focus on the European wet friction operations. Management of the European wet friction operations, Raybestos Reibtechnik GmbH ("RRT") and Raybestos U.K. Ltd. ("RUK") was transferred to the European management team. The newly defined operating segments are Domestic Wet Friction, International (including the European wet friction operations and European and Asian dry friction operations), and Aftermarket. Details of performance by operating segment are presented below. All prior period segment information presented has been restated to reflect the newly defined segments.

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DOMESTIC WET FRICTION

The following table sets forth selected income statement data for the Domestic Wet Friction segment for the thirteen weeks ended March 28, 2004 and March 30, 2003.

| | For the thirteen weeks ended (amounts in millions) | | | |
|--|---|--------|----------------|--------|
| | March 28, 2004 | | March 30, 2003 | |
| | ----- | ----- | ----- | ----- |
| Net sales | \$ 31.4 | 100.0% | \$ 33.1 | 100.0% |
| Gross profit | 3.9 | 12.4 | 2.7 | 8.2 |
| Selling, general and administrative expense | 2.7 | 8.7 | 3.4 | 10.3 |
| Income (loss) before taxes | .7 | 2.1 | (1.2) | -3.7 |

The Domestic Wet Friction segment's sales decreased \$1.7 million or 5.1% in the first quarter of 2004 from the same period in 2003. The decrease in sales is due to price reductions in both the automotive and heavy duty components of

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the segment of \$1.1 million, decreased automotive volume of \$1.7 million, partially offset by increased heavy duty volume of \$.7 million. The remaining change is due to intercompany sales.

Gross profit as a percentage of sales increased to 12.4% in the first quarter of 2004 compared to 8.2% in the same quarter last year. Overall, the increase in gross profit is the combined result of cost reductions, improved productivity and improved overhead absorption, partially offset by the impact of sales price reductions. Additionally, as a result of the impairment charge recorded during the fourth quarter of 2003, depreciation expense was reduced by \$.3 million in the first quarter of 2004. The increase in the price of steel resulted in an increase of raw material costs of \$.2 million during the first quarter of 2004. Correspondingly, the segment also realized an increase in the proceeds from the sale of scrap of \$.5 million in the first quarter of 2004 compared to the same period in the prior year. The Company believes that the net favorable result of steel price increases realized in the first quarter of 2004 is a timing issue and that, in future periods, it is likely that the increase in the cost of raw material will be equal to or exceed the increase in the proceeds received from the sale of scrap.

The Domestic Wet Friction segment produces goods for its customers based on a purchase order system, and in certain instances using longer-term contracts that stipulate a fixed selling price with no commitment as to quantity. In instances where the product's cost exceeds the selling price, a reserve is established for the expected loss on products in inventory and customer purchase orders received by the balance sheet date. The Company has not recorded an estimate of the loss over the term of these contracts since the quantity and mix of parts is not known and the future production costs will be impacted by, among other things, changes in economic conditions and management's actions, including expected cost reductions. Cost reductions realized during the first quarter 2004 allowed the Company to reduce its reserve for expected loss on goods in inventory and customer purchase orders in the amount of \$.4 million at March 28, 2004 compared to December 28, 2003.

SG&A expense for the first quarter of 2004 decreased \$.7 million or 20.6% compared to the first quarter of 2003. The decrease in SG&A is principally the result of an increased emphasis on managing expenses. Additionally, the first quarter of 2003 included \$.2 million of non-recurring severance and relocation expenses.

As a result of the above, income before taxes improved to \$.7 million in the first quarter of 2004 compared to a loss before taxes and minority interest of \$1.2 million in the same period in 2003.

The Company continues to review alternatives to improve the operating results for this segment. Actions taken or being contemplated are as follows:

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- During the first quarter of 2004, the Company reorganized its operating segments to facilitate a stronger focus on the European wet friction operations. Oversight of the European wet friction operations, RRT and RUK, was transferred to the European management team.
- During March of 2004 the Sterling Heights technical center was closed. The automotive sales and applications engineering groups previously located in this building have been relocated to a nearby office building in the Detroit area.
- Cost reduction programs generated \$2.3 million in cost savings during the first quarter of 2004. The Company has identified additional cost savings

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projects that it expects to implement during 2004.

- The Company is conducting a facilities utilization review to determine if improved performance can be obtained through consolidating certain facilities with a focus on improved overhead absorption.

INTERNATIONAL

The following table sets forth selected income statement data for the International segment for the thirteen weeks ended March 28, 2004 and March 30, 2003.

| | For the thirteen weeks ended (amounts in millions) | | | |
|--|---|--------|----------------|--------|
| | March 28, 2004 | | March 30, 2003 | |
| | ----- | | ----- | |
| Net sales | \$ 16.7 | 100.0% | \$ 15.1 | 100.0% |
| Gross profit | 4.8 | 28.8 | 3.9 | 25.9 |
| Selling, general and administrative expense | 2.7 | 16.2 | 2.4 | 16.1 |
| Income before taxes | 2.2 | 13.1 | 1.4 | 9.2 |

The International segment's sales increased \$1.6 million or 10.6% in the first quarter of 2004 compared to the same period in 2003. The increase is due to favorable currency translation gains of \$2.3 million partially offset by volume, mix and price decreases of \$.7 million. The currency translation gains reflect the increase period-over-period in the exchange rate of the Euro and the British pound to the U.S. dollar. During the first quarter of 2004 the Company consolidated its dry friction distribution facility into its wet friction production facility in the U.K.. The relocation of the dry friction facility resulted in lower production and lower sales to certain customers. The German wet friction operation is experiencing increased competition resulting in the loss of some sales and in price reductions. The German and Chinese dry friction operations have increased sales modestly despite some pressure from customers for price reductions.

Gross profit as a percentage of sales increased to 28.8% in the first quarter of 2004 from 25.9% during the first quarter of 2003. The improved gross profit as a percentage of sales is principally the result of cost reductions at the Company's U.K. facility. The segments gross profit was favorably impacted by currency translation gains in the amount of \$.4 million.

SG&A expense for the first quarter of 2004 was \$2.7 million or 16.2% of sales compared to \$2.4 million or 16.1% of sales in the first quarter of 2003. The increase in SG&A of \$.3 million is the result of currency translation gains and increased incentive compensation expense.

As a result of the foregoing, income before taxes increased \$.8 million or 57% in the first quarter of 2004 compared to the same period in 2003.

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AFTERMARKET

The following table sets forth selected income statement data for the Aftermarket segment for the thirteen weeks ended March 28, 2004 and March 30, 2003.

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| | For the thirteen weeks ended | | | |
|--|------------------------------|--------|----------------|--------|
| | (amounts in millions) | | | |
| | March 28, 2004 | | March 30, 2003 | |
| | ----- | | ----- | |
| Net sales | \$ 12.4 | 100.0% | \$ 11.5 | 100.0% |
| Gross profit | 3.7 | 29.8 | 3.4 | 29.4 |
| Selling, general & administrative expense | 1.5 | 12.4 | 1.1 | 9.1 |
| Income before taxes & minority interest | 2.2 | 18.0 | 2.4 | 21.0 |

The Aftermarket segment's sales increased \$.9 million or 7.8% in the first quarter of 2004 from the same period in 2003. The increase in sales is due primarily to growth in sales to foreign customers and new product offerings.

Gross profit increased \$.3 million as a result of the increase in sales. As a percentage of sales, gross profit increased to 29.8% in the first quarter of 2004 compared to 29.4% in the same quarter last year.

SG&A expense for the first quarter of 2004 was \$1.5 million or 12.4% of sales compared to \$1.1 million or 9.1% of sales in the first quarter of 2003. The increase in SG&A of \$.4 million is principally the result of increased incentive compensation and medical costs.

As a result of the above, income before taxes and minority interest decreased slightly to \$2.2 million in the first quarter of 2004 compared to \$2.4 million in the same period in 2003.

Liquidity, Capital Resources and Future Liquidity

The Company's cash and cash equivalents at March 28, 2004 totaled \$18.9 million compared to \$16.4 million at December 28, 2003, an increase of \$2.5 million. Capital expenditures for the three-month period totaled \$.8 million, which is lower than planned expenditures, and a reduction of \$1.0 million compared with the capital spending for the same period in the prior year. Net cash used in operating activities was \$1.4 million for the three-month period ended March 28, 2004, compared to cash used in operating activities of \$1.1 million in the prior year period. Cash outflows for working capital were \$6.9 million during the current year period, which was primarily comprised of the following: a \$6.0 million increase in trade accounts receivable, a \$1.2 million cash payment for pension funding, and a \$.9 million increase in other assets, partially offset by a \$.7 million decrease in inventories and a \$.5 million increase in other liabilities. These were the most significant aspects of the change in other operating activities recorded on the statement of cash flows.

The total borrowings at March 28, 2004 of \$27.1 million compares to total borrowings of \$22.4 million at year-end 2003, an increase of \$4.7 million period-over-period. The available lines of credit at March 28, 2004 of \$9.4 million compares to \$10.6 million at year-end 2003, a decrease in availability of \$1.2 million. Full details of the Company's debt are contained in Note E to the Condensed Consolidated Financial Statements.

In summary of the above, the cash and available lines of credit at March 28, 2004 were \$28.3 million compared to \$27.0 million at year-end 2003, an increase in cash and available lines of credit of \$1.3 million.

Refer to the Management's Discussion and Analysis section and to Notes F -

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Debt and N - Commitments to the consolidated financial statements, included within the Company's 2003 Form 10-K, for information

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regarding the Company's obligations and commitments by year. These obligations and commitments consist of long-term debt, capital leases and rental agreements.

The Company's potential obligations regarding environmental remediation are explained fully in Note F - Litigation of the Condensed Consolidated Financial Statements.

The Company assumed the liability for the Raymark pension plans as part of the reorganization. Funding for the plans in 2004 is expected to be approximately \$4.4 million of which \$1.2 million was funded in the first quarter of 2004.

Certain tax issues are discussed in Note H - Income Taxes, which provide details concerning the status of the current Internal Revenue Service audit and the use of certain future tax benefits.

Management believes that existing cash balances, the Company's lending facilities and cash flow from operations will be sufficient to meet all of the Company's obligations arising in the normal course of business, including anticipated capital investments. However, the ability of the Company to utilize its lending facilities is dependent on the Company's ability to meet its financial forecasts, which is not assured, and to meet the financial covenants contained in its credit facilities. These forecasts include certain revenue assumptions generally consistent with the prior year for the Domestic Wet Friction (on a comparable basis) and Aftermarket segments and modest growth in the International segment, as well as certain cost-saving initiatives. If the Company does not comply with the financial covenants, an event of default would occur and could result in the acceleration of the Company's indebtedness under its domestic credit facilities. If that were to occur, the ability of the Company to continue would be dependent upon, among other things, its ability to amend the credit facilities, take certain actions to generate cash and/or to seek additional alternative financing from other lenders.

Financial Risks

The Company maintains lines of credit with United States and foreign banks, as well as other creditors detailed in Note E to the Condensed Unaudited Consolidated Financial Statements. The Company is naturally exposed to various interest rate risk and foreign currency risk in its normal course of business.

The Company effectively manages its accounts receivable as evidenced by the average days sales in trade receivables of 49 days. This allows for minimum borrowings in supporting inventory and trade receivables. Management does not anticipate a significant change in fiscal policy in any of its borrowing markets in 2004 given current economic conditions. Further, the Company can reduce the short-term impact of interest rate fluctuations through deferral of capital investment should the need arise.

The Company maintains borrowings in both fixed rate and variable rate debt instruments. The fixed rate debt at March 28, 2004 of \$6.1 million had rates of interest that ranged from 2.5% to 6.2%. The variable rate debt at March 28, 2004 of \$20.7 million had rates of interest that ranged from 2.7% to 4.8%. The variable debt reprices either at prime rate or the Eurodollar rate. The Company has not entered into any interest rate management programs such as interest rate swaps or other derivative type transactions. The amount of exposure in the short-term that could be created by increases in rates is not considered

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significant by management.

The local currencies of the Company's foreign subsidiaries have been designated as their functional currencies. Accordingly, financial statements of foreign operations are translated using the exchange rate at the balance sheet date for assets and liabilities, historical exchange rates for elements of stockholders' equity and an average exchange rate in effect during the year for revenues and expenses. Where possible, the Company attempts to mitigate foreign currency translation effects by borrowing in local currencies to fund operations. The Company does not believe that the fluctuations in foreign currency will have a material adverse effect on the Company's overall consolidated financial condition. Additionally, the Company does not enter into agreements to manage any currency transaction risks.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See Item 2.

ITEM 4. CONTROLS AND PROCEDURES

- (a) The Company conducted an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures under the supervision and with the participation of management, including the Company's principal executive officer and principal financial officer as of March 28, 2004. Based on this evaluation, the principal executive officer and principal financial officer have each concluded that such disclosure controls and procedures were effective in all material respects in ensuring that information required to be disclosed by the Company in reports that it files under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.
- (b) No significant changes were made to the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

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PART II. OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

See discussion of the Company's debt agreements in Note E of the Condensed Consolidated Financial Statements.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

- 10(a) Waiver and Fifth Amendment to Loan and Security Agreement, dated May 10, 2004, to the Loan Security Agreement dated September 28, 2000 by and between Raybestos Products Company, Raytech Automotive Components Company, and Automotive Composites Company, as amended.
- 10(b) Joinder and Assumption Agreement dated May 11, 2004, among Raytech

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Powertrain, Inc., Allomatic Products Company, Raytech Systems Inc., Raytech Corporation, and Raybestos Powertrain, LLC.

- 31-1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31-2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32-1 Certifications of the Chief Executive Officer and the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on 8-K

None

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SIGNATURE

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

RAYTECH CORPORATION

By: /s/ JOHN B. DEVLIN

John B. Devlin
Vice President, Treasurer
and Chief Financial Officer

Date: May 12, 2004

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