AMERICAN STANDARD COMPANIES INC
Form 10-Q
April 30, 2004

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**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

**For the quarterly period ended March 31, 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 1-11415

**AMERICAN STANDARD COMPANIES INC.**
(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **13-3465896** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **One Centennial Avenue, P.O. Box 6820, Piscataway, NJ** | **08855-6820** |
| (Address of principal executive offices) | (Zip Code) |

Registrant s telephone number, including area code (732) 980-6000

Indicate by check mark whether the Registrant (1) has filed all reports required 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.

[X] Yes [ ]No

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

[X] Yes [ ]No

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common stock, $.01 par value, outstanding at

| | |
|---|---|
| April 22, 2004 | 71,686,454 shares |

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## PART 1. FINANCIAL INFORMATION

### Item 1. Financial Statements

American Standard Companies Inc. (the Company ) is a Delaware corporation that owns all the outstanding common stock of American Standard Inc. and American Standard International Inc. ( ASII ), both Delaware corporations. American Standard or the Company as well as we , us and our will refer to the Company, or to the Company and American Standard Inc. and ASII including their subsidiaries, as the context requires.

**AMERICAN STANDARD COMPANIES INC.**
**UNAUDITED SUMMARY CONSOLIDATED STATEMENT OF INCOME**
(Dollars in millions except per share amounts)

| | Three months ended March 31, | |
|---|---|---|
| | **2004** | **2003** |
| Sales | $ 2,185.0 | $ 1,950.6 |
| Costs and expenses: | | |
| Cost of sales | 1,604.8 | 1,485.8 |
| Selling and administrative expenses | 420.8 | 324.1 |
| Other expense | 7.5 | 18.0 |
| Interest expense | 29.3 | 30.2 |
| | 2,062.4 | 1,858.1 |
| Income before income taxes | 122.6 | 92.5 |
| Income taxes | 38.0 | 28.7 |
| Net income applicable to common shares | $ 84.6 | $ 63.8 |
| Net income per share: | | |
| Basic | $ 1.17 | $ .88 |
| Diluted | $ 1.14 | $ .87 |

| | | |
|---|---|---|
| Average common shares outstanding | | |
| Basic | 72,158,123 | 72,141,634 |
| Diluted | 74,075,182 | 73,379,432 |

See accompanying notes

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**AMERICAN STANDARD COMPANIES INC.**
**UNAUDITED SUMMARY CONSOLIDATED BALANCE SHEET**
(Dollars in millions, except share data)

| | March 31, 2004 | December 31, 2003 |
|---|---|---|
| Current assets: | | |
| Cash and cash equivalents | $ 192.3 | $ 111.7 |
| Accounts receivable, less allowance for doubtful accounts: Mar. 2004 - $42.7; Dec.2003 - $45.3 | 1,138.5 | 1,022.8 |
| Inventories: | | |
| Finished products | 638.3 | 571.8 |
| Products in process | 199.4 | 181.4 |
| Raw materials | 164.6 | 156.7 |
| Other current assets | 441.5 | 446.3 |
| Total current assets | 2,774.6 | 2,490.7 |
| Facilities, less accumulated depreciation: Mar. 2004 - $977.2 ; Dec. 2003 - $963.5 | 1,488.7 | 1,515.4 |
| Goodwill, less accumulated amortization: Mar. 2004 - $412.4; Dec. 2003 - $413.1 | 1,124.2 | 1,140.4 |
| Capitalized software costs, less accumulated amortization: Mar. 2004 - $214.9; Dec. 2003 - $202.6 | 232.6 | 239.3 |
| Debt issuance costs, net of accumulated amortization: Mar. 2004 - $24.4; Dec. 2003 - $22.4 | 19.2 | 21.2 |
| Other assets | 507.9 | 471.7 |
| Total assets | $6,147.2 | $5,878.7 |
| Current liabilities: | | |
| Loans payable to banks | $ 162.1 | $ 49.8 |
| Current portion of long-term debt | 2.5 | 2.5 |
| Accounts payable | 815.9 | 684.3 |
| Accrued payrolls | 279.4 | 294.3 |
| Current portion of warranties | 160.2 | 153.1 |
| Taxes on income | 139.3 | 136.0 |
| Other accrued liabilities | 661.8 | 713.5 |
| Total current liabilities | 2,221.2 | 2,033.5 |
| Long-term debt | 1,731.6 | 1,626.8 |
| Reserve for post-retirement benefits | 663.5 | 657.4 |
| Warranties | 204.4 | 202.9 |
| Other liabilities | 628.6 | 644.3 |

| | | |
|---|---|---|
| Total liabilities | 5,449.3 | 5,164.9 |
| Shareholders equity: | | |
| Preferred stock, 2,000,000 shares authorized, none issued and outstanding | | |
| Common stock $.01 par value, 200,000,000 shares authorized; shares issued and outstanding: | | |
| 71,661,013 in 2004; 72,638,326 in 2003 | .7 | .7 |
| Capital surplus | 766.1 | 755.5 |
| Unearned compensation | (0.5) | (0.7) |
| Treasury stock | (711.0) | (584.3) |
| Retained earnings | 917.8 | 833.2 |
| Accumulated other comprehensive income: | | |
| Foreign currency translation effects | (197.7) | (204.5) |
| Deferred gain on hedge contracts, net of tax | 15.9 | 7.1 |
| Minimum pension liability adjustment, net of tax | (93.4) | (93.2) |
| Total shareholders equity | 697.9 | 713.8 |
| | $6,147.2 | $5,878.7 |

See accompanying notes

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**AMERICAN STANDARD COMPANIES INC.**
**UNAUDITED SUMMARY CONSOLIDATED STATEMENT OF CASH FLOWS**
(Dollars in millions)

| | Three months ended March 31, | |
|---|---|---|
| | **2004** | **2003** |
| Cash provided by: | | |
| Operating Activities: | | |
| Net income | $ 84.6 | $ 63.8 |
| Adjustments to reconcile net income to net cash provided (used) by operating activities: | | |
| Depreciation | 41.4 | 38.3 |
| Amortization of capitalized software and other intangibles | 21.9 | 19.1 |
| Equity in earnings of unconsolidated joint ventures, net of dividends received | (5.4) | (1.1) |
| Non-cash stock compensation | 14.9 | 16.8 |
| Other | (.3) | (1.1) |
| Changes in assets and liabilities: | | |
| Accounts receivable | (120.5) | (155.0) |
| Inventories | (96.4) | (87.9) |
| Accounts payable | 126.1 | 112.0 |
| Other accrued liabilities and taxes | (39.4) | 37.2 |
| Post-retirement benefits | 13.3 | 11.1 |
| Other current and long-term assets | (5.0) | (20.4) |
| Other long-term liabilities | 3.6 | 6.6 |
| Net cash provided by operating activities | 38.8 | 39.4 |
| Investing activities: | | |
| Purchases of property, plant and equipment | (26.4) | (29.3) |
| Investments in affiliated companies and other businesses | | (10.3) |
| Investment in computer software | (11.7) | (11.2) |
| Loan to unconsolidated joint venture | (23.4) | |
| Other | | .3 |
| Net cash used by investing activities | (61.5) | (50.5) |
| Financing activities: | | |
| Proceeds from issuance of long-term debt | .1 | 32.1 |
| Repayments of long-term debt | (.2) | (126.2) |
| Net change in revolving credit facilities | 113.8 | 174.0 |
| Net change in other short-term debt | 113.8 | 28.2 |
| Purchases of treasury stock | (143.4) | (76.0) |

| | | |
|---|---|---|
| Proceeds from exercise of stock options | 12.0 | 4.5 |
| Proceeds from settlement of foreign exchange forward contracts | 4.7 | 17.1 |
| Other | 2.2 | 2.3 |
| Net cash provided by financing activities | 103.0 | 56.0 |
| Effect of exchange rate changes on cash and cash equivalents | .3 | (3.2) |
| Net increase in cash and cash equivalents | 80.6 | 41.7 |
| Cash and cash equivalents at beginning of period | 111.7 | 96.6 |
| Cash and cash equivalents at end of period | $ 192.3 | $ 138.3 |
| Cash interest paid | $ 24.2 | $ 28.8 |
| Cash taxes paid (received) | $ 30.0 | $ (11.4) |

See accompanying notes

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# AMERICAN STANDARD COMPANIES INC.
# NOTES TO FINANCIAL STATEMENTS

## Note 1. Basis of Financial Statement Presentation

The accompanying condensed consolidated financial statements have been prepared in conformity with generally accepted accounting principles for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring items, considered necessary for a fair presentation of financial data have been included. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the entire year. The condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2003.

Preparation of the 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 2 to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the calendar year 2003, describe the significant accounting estimates and policies used in preparation of the Consolidated Financial Statements. Actual results in these areas could differ materially from management s estimates. There have been no significant changes in the Company s critical accounting estimates during the first quarter of 2004.

## Note 2. Comprehensive Income

Total comprehensive income consisted of the following (dollars in millions):

| | Three months ended March 31, | |
|---|---|---|
| | **2004** | **2003** |
| Net income | $ 84.6 | $ 63.8 |
| Foreign currency translation effects | 6.8 | (11.5) |
| Deferred gain on hedge contracts, net of tax | 8.8 | 1.2 |
| Minimum pension liability adjustment | (.2) | .3 |
| Total comprehensive income | $100.0 | $ 53.8 |

## Note 3. Earnings Per Share

The average number of outstanding shares of common stock used in computing diluted earnings per share for the three months ended March 31, 2004 and 2003 included 1,917,059 and 1,237,798 average incremental shares, respectively, for the assumed exercise of stock options.

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**Note 4. Capital Stock**

On February 5, 2004, the Board of Directors approved a three-for-one stock split, subject to shareholder approval of an amendment to the Company s charter to increase the authorized shares of common stock from 200,000,000 shares to 560,000,000 shares at the Annual Meeting on May 4, 2004. If the amendment is approved by shareholders, the split will occur effective May 27, 2004, and therefore the split is not reflected in these financial statements.

Following is a summary of shares issued or reacquired during the first quarter of 2004.

| | Number of Shares of Common Stock | | |
|---|---|---|---|
| | **Total Shares** | **Treasury Shares** | **Net Shares Outstanding** |
| Balance, December 31, 2003 | 83,919,194 | (11,280,868) | 72,638,326 |
| Shares issued upon exercise of stock options | 333 | 256,076 | 256,409 |
| Stock purchased for treasury | | (1,341,000) | (1,341,000) |
| Shares issued to ESOP | | 136,190 | 136,190 |
| Shares issued to ESPP | 105 | 17,388 | 17,493 |
| Other shares issued or (reacquired), net | | (46,405) | (46,405) |
| Balance, March 31, 2004 | 83,919,632 | (12,258,619) | 71,661,013 |

**Note 5. Stock-Based Compensation**

The Company has three stock-based compensation plans the 2002 Omnibus Incentive Plan, the Stock Incentive Plan and the Employee Stock Purchase Plan ( ESPP ) which are described in Note 11 of Notes to Financial Statements in the Company s 2003 Annual Report on Form 10-K. Under the first two plans, the Company has granted options to employees and directors to acquire a fixed number of shares of the Company s common stock at a specified price, and also has made grants of restricted shares. Under the ESPP, employees are entitled to purchase shares of the Company s common stock at a discount of 15% from the market price on the date of purchase. The Company accounts for these plans under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees ( APB 25 ),* and related Interpretations. Compensation cost is not recorded for substantially all options granted because the option exercise price was equal to the market value of the underlying common stock on the date of grant. Nor is compensation cost recorded for the 15% discount on shares purchased under the ESPP, which is not considered compensation under APB 25. Compensation cost is recorded for the value of restricted share awards, amortized over the vesting period of the award.

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The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation,* to stock-based employee compensation.

| | Three Months Ended March 31, | |
|---|---|---|
| **(Dollars in millions except per share data)** | **2004** | **2003** |
| Net income, as reported | $ 84.6 | $ 63.8 |
| Deduct: Total stock-based compensation expense determined under fair value based method for all stock option awards, net of tax, and discounts under the ESPP | (5.1) | (5.0) |
| Pro forma net income | $ 79.5 | $ 58.8 |
| Earnings per share: | | |
| Basic  as reported | $ 1.17 | $ 0.88 |
| Basic  pro forma | $ 1.10 | $ 0.82 |
| Diluted  as reported | $ 1.14 | $ 0.87 |
| Diluted  pro forma | $ 1.07 | $ 0.80 |

The weighted average fair values of grants made during the three months ended March 31, 2004 and 2003 were $31.55 and $20.94, respectively. The fair value of the stock options was estimated at the date of grant using the Black-Scholes option-pricing model with the following assumptions: risk-free interest rate of 3.05% in 2004 and 2.92% in 2003; volatility of 27.4% in 2004 and 28.7% in 2003; an expected average life of 5 years in 2004 and 2003; and a dividend yield of zero.

**Note 6. Warranties, Guarantees, Commitments and Contingencies**

Products sold by the Company are covered by a basic limited warranty with terms and conditions that vary depending upon the product and country in which it was sold. The limited warranty covers the equipment, parts and labor (in certain cases) necessary to satisfy the warranty obligation for a period ranging from one to ten years generally, and for the lifetime of certain bath and kitchen faucets. The Company estimates the costs that may be incurred under its warranty obligations and records a liability in the amount of such costs at the time product revenue is recognized. Factors that affect the Company  s warranty liability include the number of units sold, historical and anticipated rates of warranty claims, and cost per claim. At least once a quarter the Company assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary. Costs to satisfy warranty claims are charged as incurred to the accrued warranty liability.

The Company also sells a variety of extended warranty contracts for up to ten years on certain air conditioning products. Revenues from the sales of extended warranties are deferred and amortized on a straight-line basis over the terms of the contracts or based upon historical experience. Actual costs to satisfy claims on extended warranty contracts are charged to cost of sales as incurred and were $8.5 million and $8.1 million for the three months ended March 31, 2004 and 2003, respectively. Including those direct charges to expense and the warranty costs accrued for basic limited warranties (as shown in the following table, including changes to prior period accruals), total warranty expense was $40.0 million and $35.1 million for those respective periods.

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Following is a summary of changes in the Company s product warranty liability for the three months ended March 31, 2004 and 2003.

| (Dollars in millions) | Three Months Ended March 31, 2004 | Three Months Ended March 31, 2003 |
|---|---|---|
| Balance of basic warranty costs accrued and deferred income on extended warranty contracts, beginning of period | $ 356.0 | $ 315.9 |
| Warranty costs accrued | 33.1 | 30.8 |
| Deferred income on extended warranty contracts sold | 14.9 | 14.4 |
| Warranty claims settled | (25.7) | (27.9) |
| Amortization of deferred income on extended warranty contracts | (12.1) | (11.9) |
| Increases (decreases) in warranty estimates made in prior periods, including foreign exchange translation effects, net | (1.6) | .4 |
| Balance of basic warranty costs accrued and deferred income on extended warranty contracts, end of period | 364.6 | 321.7 |
| Current portion included in current liabilities | (160.2) | (122.3) |
| Long-term warranty liability | $ 204.4 | $ 199.4 |

The Company has commitments and performance guarantees, including energy savings guarantees totaling $41 million as of March 31, 2004, extending from 2004 to 2021, under long-term contracts related to its air conditioning equipment and system controls. Through March 31, 2004 the Company has experienced no net losses under such energy savings guarantees and considers the probability of losses to be unlikely. We also guarantee debt of third parties in the amount of $4 million as of March 31, 2004.

The Company fully and unconditionally guarantees the payment obligations under all the Company s Senior Notes that were issued by its wholly owned subsidiary American Standard Inc. See Note 9 of Notes to Financial Statements. The Company also guarantees other debt obligations issued by other subsidiaries, including obligations under a $49 million Euro-denominated credit facility and $37 million of Euro-denominated Senior Bonds (both at March 31, 2004 exchange rates).

Over the years, the Company has been named as a defendant in numerous lawsuits alleging various asbestos-related personal injury claims arising primarily from sales of low-risk-profile products, such as boilers and railroad brake shoes. The Company believes it has ample insurance and has never had an unfavorable court judgment.

In these asbestos-related lawsuits, the Company is usually named as one of a large group of defendants, often in excess of one hundred companies. Many of these lawsuits involve multiple claimants, do not allege a connection between any Company product and the claimed injury or disease, and/or do not contain any allegations regarding the type of claimed injury or disease incurred. As a result, numerous lawsuits have been placed and may remain on inactive or deferred dockets, which some jurisdictions have established.

Through March 31, 2004, there have been 141,393 claims filed against the Company. At March 31, 2004, there were 116,744 pending claims, compared with 114,583 at the end of 2003, and 95,031 and 50,828 at the end of 2002 and 2001, respectively, reflecting updated numbers for all prior periods. Since receipt of its first asbestos claim more than fifteen years ago, through March 31, 2004, the Company has resolved 24,649 claims, and settlements of $39.7 million have been made, for an average payment per claim of $1,609. These settlement payments have been paid or reimbursed or are expected to be reimbursed by insurance.

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The Company has recorded an obligation of $66 million as of March 31, 2004, that represents the Company s estimated payments to claimants associated with pending asbestos claims. It also has recorded a related asset of $42 million that represents the probable recoveries from insurance companies for such payments to claimants. The amount of the estimated obligations is based on the claims resolved, the assessment of claims pending, the status of ongoing litigation, defense and settlement strategies, and an assessment of other entities responsibilities for the claims. The amount of the probable recoveries is based on an analysis of insurance coverage, the insurers financial strength and insurance payments made to date.

Additional developments may occur that could affect the Company s estimate of asbestos liabilities and recoveries, such as the nature of future claims, the average payment to claimants and the amount of insurance recovery. No liability has been recorded for unknown asbestos claims. However, the Company has substantial insurance coverage for future claims. The Company believes that it is not reasonably possible that a net loss material to the liquidity and financial condition of the Company has been incurred.

**Note 7. Effect of Other Recently Issued Accounting Standards**

The Financial Accounting Standards Board ( FASB ) has recently issued several new Statements and Interpretations. For the disclosures required by Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, see Note 5 of Notes to Financial Statements. For the interim period disclosures required by Statement No. 132 (revised 2003) *Employers Disclosures about Pensions and Other Postretirement Benefits,* see Note 8 of Notes to Financial Statements. Some of the disclosure requirements of the revised Statement No. 132 related to foreign plans, interim periods and certain other matters are not effective until mid-2004. For a discussion of the impact of FASB Staff Position No. 106-1 (SFAS 106-1), Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 which addresses the accounting and disclosure implications that are expected to arise as a result of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act ) enacted on December 8, 2003, see Note 8 of Notes to Financial Statements. Other Statements and Interpretations recently issued by the FASB that are applicable to the Company have had little or no immediate effect on the Company. Those statements included No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities;* and No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity.* Interpretation No. 46, *Consolidation of Variable Interest Entities,* parts of which became effective for the Company in the first quarter of 2004, had no impact.

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**Note 8. Post-retirement Benefits**

In January 2004, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position ( FSP ) No. SFAS 106-1, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 which addresses the accounting and disclosure implications that are expected to arise as a result of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act ) enacted on December 8, 2003. The Act introduces a prescription drug benefit under Medicare as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least equivalent to Medicare. The benefit obligation and net post-retirement benefit cost of an employer that provides post-retirement prescription drug coverage will be decreased by provisions of the Act, but the accounting for those effects is uncertain. Under the FSP, companies have a one-time election to defer the effects of the new legislation in financial statements for years ending after December 7, 2003. Companies that elect to defer the effects of the Act must defer recognition of the effects until the FASB issues clarifying guidance on how the legislation should be interpreted. The Company has elected to defer the effects of the Act. All measures of the benefit obligation and net post-retirement benefit costs included in the financial statements do not reflect the effects of the Act. The Company is reviewing the provisions of the Act in conjunction with the Company s post-retirement benefit plan.

Post-retirement pension, health and life insurance costs had the following components:

| | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | **2004** | **2004** | **2003** | **2003** |
| **(Dollars in millions)** | **Pension Benefits** | **Health & Life Ins. Benefits** | **Pension Benefits** | **Health & Life Ins. Benefits** |
| Service cost-benefits earned during the period | $ 12.5 | $ 2.5 | $ 10.8 | $ 2.0 |
| Interest cost on the projected benefit obligation | 21.2 | 4.8 | 17.7 | 4.3 |
| Less assumed return on plan assets | (15.4) | | (12.3) | |
| Amortization of prior service cost | 1.6 | (1.1) | 1.5 | (1.2) |
| Amortization of net loss | 3.3 | 2.1 | 1.5 | 1.2 |
| Defined benefit plan cost | $ 23.2 | $ 8.3 | $ 19.2 | $ 6.3 |
| Accretion expense reflected in Other expense | $ 5.8 | $ 4.8 | $ 5.4 | $ 4.3 |

Amortization of prior service cost is computed on the straight-line method over the average remaining service period of active participants.

The Company expects to contribute $50 million to the domestic pension plans in the third quarter of 2004.

**Note 9. Supplemental Consolidating Condensed Financial Information**

All of the Company s Senior Notes were issued by its 100%-owned subsidiary, American Standard Inc. ( ASI ). American Standard Companies Inc. (the Parent Company ) fully and unconditionally guarantees the payment obligations under these securities (the Company s Public Debt ). In lieu of providing separate financial statements for ASI, the Company has included the accompanying consolidating condensed financial information. Management believes that separate financial statements of ASI are not material to investors. The following supplemental financial information sets forth, on an unconsolidated basis, statements of income and statements of cash flows for the three months ended March 31, 2004 and 2003, and balance sheets as of March 31, 2004 and December 31, 2003 for the Parent Company, ASI, and the subsidiaries of the Parent Company which are not subsidiaries of ASI (the Other Subsidiaries ). None of the Other Subsidiaries guarantees the ASI Public Debt. The equity method of accounting is used to reflect investments of the Parent Company in ASI and Other Subsidiaries.

CONSOLIDATING CONDENSED STATEMENTS OF INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2004
(Unaudited)

| (Dollars in millions) | Parent Company | ASI | Other Subsidiaries | Eliminations | Consolidated Total |
|---|---|---|---|---|---|
| Sales | | $1,094.4 | $1,203.2 | $(112.6) | $2,185.0 |
| Costs and expenses: | | | | | |
| Cost of sales | | 814.5 | 902.9 | (112.6) | 1,604.8 |
| Selling and administrative expenses | | 222.6 | 198.2 | | 420.8 |
| Other (income) expense | | 8.2 | (0.7) | | 7.5 |
| Interest expense | | 25.8 | 3.5 | | 29.3 |
| Intercompany interest expense (income) | | 1.6 | (1.6) | | |
| Total expenses | | 1,072.7 | 1,102.3 | (112.6) | 2,062.4 |
| Income before income taxes and equity in net income of consolidated subsidiaries | | 21.7 | 100.9 | | 122.6 |
| Income taxes | | 8.6 | 29.4 | | 38.0 |
| Income before equity in net income of consolidated subsidiaries | | 13.1 | 71.5 | | 84.6 |
| Equity in net income of consolidated subsidiaries | $ 84.6 | | | (84.6) | |
| Net income | $ 84.6 | $ 13.1 | $ 71.5 | $ (84.6) | $ 84.6 |

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**Note 9. Supplemental Consolidating Condensed Financial Information (continued)**

CONSOLIDATING CONDENSED BALANCE SHEETS
AS OF MARCH 31, 2004
(Unaudited)

| (Dollars in millions) | Parent Company | ASI | Other Subsidiaries | Eliminations | Consolidated Total |
|---|---|---|---|---|---|
| ASSETS | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | $ .5 | $ 1.9 | $ 189.9 | | $ 192.3 |
| Accounts receivable, net | | 461.3 | 677.2 | | 1,138.5 |
| Inventories | | 472.0 | 530.3 | | 1,002.3 |
| Other current assets | | 300.2 | 141.3 | | 441.5 |
| Total current assets | .5 | 1,235.4 | 1,538.7 | | 2,774.6 |
| Facilities, net | | 567.4 | 921.3 | | 1,488.7 |
| Goodwill, net | | 107.1 | 1,017.1 | | 1,124.2 |
| Investment in subsidiaries | 1,558.2 | | | $(1,558.2) | |
| Other assets | | 517.0 | 242.7 | | 759.7 |
| Total assets | $1,558.7 | $ 2,426.9 | $3,719.8 | $(1,558.2) | $6,147.2 |
| LIABILITIES AND SHAREHOLDERS (DEFICIT) EQUITY | | | | | |
| Current liabilities: | | | | | |
| Loans payable to banks | | $ 75.0 | $ 87.1 | | $ 162.1 |
| Current maturities of long-term debt | | 1.5 | 1.0 | | 2.5 |
| Other current liabilities | | 959.7 | 1,096.9 | | 2,056.6 |
| Total current liabilities | | 1,036.2 | 1,185.0 | | 2,221.2 |
| Long-term debt | | 1,603.7 | 127.9 | | 1,731.6 |
| Reserve for postretirement benefits | | 341.6 | 321.9 | | 663.5 |
| Intercompany accounts, net | $ 860.8 | 123.9 | (984.7) | | |
| Other long-term liabilities | | 466.9 | 366.1 | | 833.0 |
| Total liabilities | 860.8 | 3,572.3 | 1,016.2 | $ | 5,449.3 |
| Total shareholders (deficit) equity | 697.9 | (1,145.4) | 2,703.6 | (1,558.2) | 697.9 |

| | | | | | |
|---|---|---|---|---|---|
| Total liabilities and shareholders equity | $1,558.7 | $ 2,426.9 | $3,719.8 | $(1,558.2) | $6,147.2 |

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**Note 9. Supplemental Consolidating Condensed Financial Information (continued)**

CONSOLIDATING CONDENSED STATEMENTS OF CASH FLOW
FOR THE THREE MONTHS ENDED MARCH 31, 2004
(Unaudited)

| (Dollars in millions) | Parent Company | ASI | Other Subsidiaries | Eliminations | Consolidated Total |
|---|---|---|---|---|---|
| Cash provided by: | | | | | |
| Operating activities: | | | | | |
| Net income | $ 84.6 | $ 13.1 | $ 71.5 | $ (84.6) | $ 84.6 |
| Adjustments to reconcile net income to net cash provided by operations: | | | | | |
| Depreciation and amortization | | 23.9 | 39.4 | | 63.3 |
| Equity in earnings of unconsolidated joint ventures, net of dividends received | | (3.5) | (1.9) | | (5.4) |
| Non-cash stock compensation | | 14.9 | | | 14.9 |
| Equity in net income of subsidiaries | (84.6) | | | 84.6 | |
| Other | | (.3) | | | (.3) |
| Changes in assets and liabilities: | | | | | |
| Accounts receivable | | 19.6 | (140.1) | | (120.5) |
| Inventories | | (49.4) | (47.0) | | (96.4) |
| Accounts payable | | 82.0 | 44.1 | | 126.1 |
| Other accrued liabilities and taxes | | 19.7 | (59.1) | | (39.4) |
| Post-retirement benefits | | 11.4 | 1.9 | | 13.3 |
| Other current and long-term assets | | 5.2 | (10.2) | | (5.0) |
| Other long-term liabilities | | .1 | 3.5 | | 3.6 |
| Net cash provided by operating activities | | 136.7 | (97.9) | | 38.8 |
| Investing activities: | | | | | |
| Purchase of property, plant and equipment | | (9.2) | (17.2) | | (26.4) |
| Investments in computer software | | (6.6) | (5.1) | | (11.7) |
| Loan to unconsolidated joint venture | | (23.4) | | | (23.4) |
| Net cash used by investing activities | | (39.2) | (22.3) | | (61.5) |
| Financing activities: | | | | | |
| Proceeds from issuance of long-term debt | | | .1 | | .1 |
| Repayments of long-term debt | | | (.2) | | (.2) |
| Net change in revolving credit facilities | | 119.0 | (5.2) | | 113.8 |
| Net change in other short-term debt | | 75.0 | 38.8 | | 113.8 |
| Purchases of treasury stock | (143.4) | | | | (143.4) |

| | | | | | |
|---|---|---|---|---|---|
| Net change in intercompany accounts | 130.3 | (224.6) | 94.3 | | |
| Proceeds from exercise of stock options | 12.0 | | | | 12.0 |
| Proceeds from settlement of foreign exchange forward contracts | | 4.7 | | | 4.7 |
| Other | 1.5 | .7 | | | 2.2 |
| Net cash provided (used) by financing activities | .4 | (25.2) | 127.8 | | 103.0 |
| Effect of exchange rate changes on cash and cash equivalents | | | .3 | | .3 |
| Net increase in cash and cash equivalents | .4 | 72.3 | 7.9 | | 80.6 |
| Cash and cash equivalents a beginning of period | .1 | (70.4) | 182.0 | | 111.7 |
| Cash and cash equivalents at end of period | $ .5 | $ 1.9 | $ 189.9 | $ | $ 192.3 |

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**Note 9. Supplemental Consolidating Condensed Financial Information (continued)**

CONSOLIDATING CONDENSED STATEMENTS OF INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2003
(Unaudited)

| (Dollars in millions) | Parent Company | ASI | Other Subsidiaries | Eliminations | Consolidated Total |
|---|---|---|---|---|---|
| Sales | | $1,034.7 | $1,017.5 | $(101.6) | $1,950.6 |
| Costs and expenses: | | | | | |
| Cost of sales | | 805.4 | 782.0 | (101.6) | 1,485.8 |
| Selling and administrative expenses | | 181.6 | 142.5 | | 324.1 |
| Other expense | | .5 | 17.5 | | 18.0 |
| Interest expense | | 27.6 | 2.6 | | 30.2 |
| Intercompany interest expense (income) | | 3.1 | (3.1) | | |
| Total expenses | | 1,018.2 | 941.5 | (101.6) | 1,858.1 |
| Income before income taxes and equity in net income of consolidated subsidiaries | | 16.5 | 76.0 | | 92.5 |
| Income taxes | | 5.5 | 23.2 | | 28.7 |
| Income before equity in net income of consolidated subsidiaries | | 11.0 | 52.8 | | 63.8 |
| Equity in net income of consolidated subsidiaries | $ 63.8 | | | (63.8) | |
| Net income | $ 63.8 | $ 11.0 | $ 52.8 | $ (63.8) | $ 63.8 |

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**Note 9. Supplemental Consolidating Condensed Financial Information (continued)**

CONSOLIDATING CONDENSED STATEMENTS OF CASH FLOW
FOR THE THREE MONTHS ENDED MARCH 31, 2003
(Unaudited)

| (Dollars in millions) | Parent Company | ASI | Other Subsidiaries | Eliminations | Consolidated Total |
|---|---|---|---|---|---|
| Cash provided (used) by: | | | | | |
| Operating activities: | | | | | |
| Net income | $ 63.8 | $ 11.0 | $ 52.8 | $ (63.8) | $ 63.8 |
| Adjustments to reconcile net income to net cash provided (used) by operations: | | | | | |
| Depreciation and amortization | | 23.8 | 33.6 | | 57.4 |
| Equity in earnings of unconsolidated joint ventures, net of dividends received | | | (1.1) | | (1.1) |
| Non-cash stock compensation | | 16.8 | | | 16.8 |
| Equity in net income of subsidiaries | (63.8) | | | 63.8 | |
| Other | | (1.5) | .4 | | (1.1) |
| Changes in assets and liabilities: | | | | | |
| Accounts receivable | | (7.0) | (148.0) | | (155.0) |
| Inventories | | (51.9) | (36.0) | | (87.9) |
| Accounts payable | | 63.7 | 48.3 | | 112.0 |
| Other accrued liabilities and taxes | | (16.0) | 53.2 | | 37.2 |
| Post-retirement benefits | | 10.4 | .7 | | 11.1 |
| Other assets | | (12.9) | (7.5) | | (20.4) |
| Other long-term liabilities | | (2.2) | 8.8 | | 6.6 |
| Net cash provided by operating activities | | 34.2 | 5.2 | | 39.4 |
| Investing activities: | | | | | |
| Purchase of property, plant and equipment | | (11.6) | (17.7) | | (29.3) |
| Investments in affiliated companies and other businesses | | | (10.3) | | (10.3) |
| Investments in computer software | | (5.9) | (5.3) | | (11.2) |
| Other | | | .3 | | .3 |
| Net cash used by investing activities | | (17.5) | (33.0) | | (50.5) |
| Financing activities: | | | | | |
| Proceeds from issuance of long-term debt | | | 32.1 | | 32.1 |
| Repayments of long-term debt | | (125.2) | (1.0) | | (126.2) |
| Net change in revolving credit facilities | | 177.5 | (3.5) | | 174.0 |

| | | | | | |
|---|---|---|---|---|---|
| Net change in other short-term debt | | 25.0 | 3.2 | | 28.2 |
| Purchases of treasury stock | (76.0) | | | | (76.0) |
| Net change in intercompany accounts | 70.3 | (78.3) | 8.0 | | |
| Proceeds from exercise of stock options | 4.5 | | | | 4.5 |
| Proceeds from settlement of foreign exchange forward contracts | | 17.1 | | | 17.1 |
| Other | 1.5 | .8 | | | 2.3 |
| Net cash provided (used) by financing activities | .3 | 16.9 | 38.8 | | 56.0 |
| Effect of exchange rate changes on cash and cash equivalents | | | (3.2) | | (3.2) |
| Net increase (decrease) in cash and cash equivalents | .3 | 33.6 | 7.8 | | 41.7 |
| Cash and cash equivalents a beginning of period | | (22.9) | 119.5 | | 96.6 |
| Cash and cash equivalents at end of period | $ .3 | $ 10.7 | $ 127.3 | $ | $ 138.3 |

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**Note 9. Supplemental Consolidating Condensed Financial Information (continued)**

CONSOLIDATING CONDENSED BALANCE SHEETS AS OF DECEMBER 31, 2003

| (Dollars in millions) | Parent Company | ASI | Other Subsid-iaries | Elimin-ations | Consoli-dated Total |
|---|---|---|---|---|---|
| ASSETS | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | $ .1 | $ (70.4) | $ 182.0 | | $ 111.7 |
| Accounts receivable, net | | 481.7 | 541.1 | | 1,022.8 |
| Inventories | | 422.6 | 487.3 | | 909.9 |
| Other current assets | | 256.5 | 189.8 | | 446.3 |
| Total current assets | .1 | 1,090.4 | 1,400.2 | | 2,490.7 |
| Facilities, net | | 582.1 | 933.3 | | 1,515.4 |
| Goodwill, net | | 137.2 | 1,003.2 | | 1,140.4 |
| Investment in subsidiaries | 1,441.1 | | | $(1,441.1) | |
| Other assets | | 510.6 | 221.6 | | 732.2 |
| Total assets | $1,441.2 | $ 2,320.3 | $3,558.3 | $(1,441.1) | $5,878.7 |
| LIABILITIES AND SHAREHOLDERS (DEFICIT) EQUITY | | | | | |
| Current liabilities: | | | | | |
| Loans payable to banks | | $ | $ 49.8 | | $ 49.8 |
| Current maturities of long-term debt | | 1.5 | 1.0 | | 2.5 |
| Other current liabilities | | 863.4 | 1,117.8 | | 1,981.2 |
| Total current liabilities | | 864.9 | 1,168.6 | | 2,033.5 |
| Long-term debt | | 1,489.2 | 137.6 | | 1,626.8 |
| Reserve for post-retirement benefits | | 326.4 | 331.0 | | 657.4 |
| Intercompany accounts, net | $ 727.4 | 251.4 | (978.8) | | |
| Other long-term liabilities | | 481.5 | 365.7 | | 847.2 |
| Total liabilities | 727.4 | 3,413.4 | 1,024.1 | $ | 5,164.9 |
| Total shareholders equity (deficit) | 713.8 | (1,093.1) | 2,534.2 | (1,441.1) | 713.8 |

| | | | | | |
|---|---|---|---|---|---|
| Total liabilities and shareholders equity (deficit) | $1,441.2 | $ 2,320.3 | $3,558.3 | $(1,441.1) | $5,878.7 |

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**Note 10. Segment Data**

**Summary Segment and Income Statement Data**
Dollars in millions
(Unaudited)

| | Three Months Ended March 31, 2004 | Three Months Ended March 31, 2003 |
|---|---|---|
| Sales: | | |
| Air Conditioning Systems and Services | $1,163.3 | $1,083.7 |
| Bath and Kitchen | 601.4 | 542.9 |
| Vehicle Control Systems | 420.3 | 324.0 |
| Total sales | $2,185.0 | $1,950.6 |
| Segment income: | | |
| Air Conditioning Systems and Services | $ 93.0 | $ 83.0 |
| Bath and Kitchen | 50.3 | 35.1 |
| Vehicle Control Systems | 58.9 | 46.7 |
| Total segment income | 202.2 | 164.8 |
| Equity in net income of unconsolidated joint ventures | 6.5 | 4.5 |
| | 208.7 | 169.3 |
| Interest expense | 29.3 | 30.2 |
| Corporate and other expenses | 56.8 | 46.6 |
| Income before income taxes | 122.6 | 92.5 |
| Income taxes | 38.0 | 28.7 |
| | $ 84.6 | $ 63.8 |

For a comparative analysis of this Summary Segment and Income Statement Data, see Management s Discussion and Analysis of Financial Condition and Results of Operations on the following pages.

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## Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

### Overview

We achieved record first-quarter sales, segment income, net income and earnings per diluted share in the first quarter of 2004. Earnings were $1.14 per diluted share, up 31% from $0.87 per diluted share a year ago. Sales were $2.185 billion, up 12% from $1.951 billion a year ago. Net income rose to $84.6 million from $63.8 million, up 33%. All three business segments contributed to the gains, which were aided by favorable foreign translation effects. We achieved those results in an economic environment that we believe improved overall, although tentatively, but still lagged in some important markets. The North American market for commercial applied air conditioning equipment remained weak. We continued to face weak economic conditions in Europe, which restrained our air conditioning, bath and kitchen and vehicle controls aftermarket businesses there. The U.S. economy appeared to strengthen, which helped our U.S. residential air conditioning and bath and kitchen businesses. Demand for commercial unitary air conditioning in the U.S. also improved. Truck manufacturing in Europe and North America was strong. Segment income for the first quarter of 2004 was $202.2 million, an increase of 23%, from strong improvements in all segments, aided by favorable foreign exchange translation effects. Excluding favorable foreign exchange translation effects, segment income for the quarter increased 14% over the 2003 quarter. The income tax provision for 2004 reflected an estimated effective annual income tax rate of 31%, the same as the 2003 rate.

The following discussion and analysis addresses year-over-year changes in the line items shown in the Summary Segment and Income Statement Data in Note 10 of Notes to Financial Statements. Year-over-year changes in segment sales and segment income and, in certain cases, segment operating margins, for 2004 compared with 2003 are presented both with and without the effects of foreign exchange translation. Presenting results of operations excluding certain recorded amounts is not in conformity with generally accepted accounting principles (GAAP), but management analyzes the data in this manner because it is useful to them in understanding past financial performance and prospects for the future. Management also uses data adjusted in this manner for purposes of determining incentive compensation. Accordingly, management believes that presenting the analysis in this manner is also useful to shareholders in understanding the core business segment operating results and trends. Approximately half of our business is outside the U.S., therefore changes in exchange rates can have a significant effect on results of operations when presented in U.S. dollars. Management consistently analyzes sales, segment income and segment operating margins with and without the effects of foreign exchange translation and believes these comparisons are useful to shareholders. Changes in sales and segment income excluding foreign exchange effects are calculated using current year sales and segment income translated at prior year exchange rates. These additional measurements are not meant to be a substitute for measurements prepared in conformity with GAAP, nor to be considered in isolation.

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Following is an analysis of changes in total sales, segment income and operating margin for the Company for the first quarter of 2004 compared with the first quarter of 2003, showing the effect of foreign exchange translation.