

APPLICA INC
Form 10-K
March 07, 2003

Table of Contents

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 1-10177

APPLICA INCORPORATED

(Exact name of Registrant as specified in its charter)

Florida

59-1028301

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

5980 Miami Lakes Drive, Miami Lakes, Florida

33014

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (305) 362-2611

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, \$0.10 par value	New York Stock Exchange
Common Stock Purchase Rights	New York Stock Exchange

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. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of March 5, 2003, the aggregate market value of the voting stock (based on the closing price as reported by NYSE of \$4.89) held by non-affiliates of the Registrant was approximately \$98.1 million (based on reported ownership of all directors and executive officers of the Registrant). This determination does not, however, constitute an admission of affiliated status for any of these individual shareholders.

Edgar Filing: APPLICA INC - Form 10-K

As of March 5, 2003, there were 23,497,222 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The Registrant's Definitive Proxy Statement for its 2003 Annual Meeting of Stockholders will be filed with the Securities and Exchange Commission not later than 120 days after the end of the fiscal year covered by this Form 10-K pursuant to General Instruction G(3) of the Form 10-K. Information from such Definitive Proxy Statement will be incorporated by reference into Part III, Items 10, 11, 12 and 13 hereof.

TABLE OF CONTENTS

PART I

Risk Factors

PART II

Results of Operations

Liquidity and Capital Resources

New Accounting Pronouncements

PART III

Signatures

CERTIFICATION

CERTIFICATION

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SUPPLEMENTAL FINANCIAL DATA

SCHEDULE II

Second Amendment to Credit Agreement

Subsidiaries

Consent of Grant Thornton LLP

Certification of CEO - Schulman

Certification of CFO - Polistina

Table of Contents

As used in this Annual Report on Form 10-K, we, our, us, the Company and Applica refer to Applica Incorporated and its subsidiaries, unless the context otherwise requires.

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Such statements are indicated by words or phrases such as anticipates, projects, management believes, Applica believes, intends, expects, and similar words or phrases. Such forward-looking statements are subject to certain risks, uncertainties or assumptions and may be affected by certain other factors, including the specific factors set forth in Risk Factors below. Should one or more of these risks, uncertainties or other factors materialize, or should underlying assumptions prove incorrect, actual results, performance, or achievements of Applica may vary materially from any future results, performance or achievements expressed or implied by such forward-looking statements. All subsequent written and oral forward-looking statements attributable to Applica or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements in this paragraph. Applica disclaims any intention or obligation to publicly announce the results of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

PART I

Item 1. Business

Overview

Applica Incorporated is a Florida corporation that was incorporated in 1963. Applica is a manufacturer, marketer and distributor of a broad range of branded and private-label small electric consumer goods. In 1998, we acquired the Black & Decker Household Products Group and became a leading supplier of brand name small household appliances in North and Latin America. We also manufacture and distribute professional personal care products, home environment products, pet care products, including the LitterMaid® self-cleaning cat litter box, and pest control products. We manufacture and market products under licensed brand names, such as Black & Decker®, our own brand names, such as Windmere® and Applica®, and other private-label brand names. Our customers include mass merchandisers, specialty retailers and appliance distributors primarily in North America, Latin America and the Caribbean.

We operate manufacturing facilities in China and Mexico. In 2002, approximately 76% of the products sold by Applica were manufactured in such facilities. In addition, we manufacture products for other consumer product companies, which we refer to as contract manufacturing.

Applica's manufacturing operations are conducted by two wholly owned subsidiaries: Applica Durable Manufacturing Limited in China and Applica Manufacturing, S. de R.L. de C.V. in Mexico. The distribution, sales, and marketing operations are primarily handled through our U.S. operating subsidiary, Applica Consumer Products, Inc. Applica also has separate entities providing distribution, sales and marketing operations in Canada, Puerto Rico, Mexico, Chile, Argentina, Venezuela and Colombia.

During the fourth quarter of 2001, we adopted one business segment for financial reporting purposes. Previously, we had reported three business segments. See Note L Business Segment and Geographic Area Information to the Consolidated Financial Statements included in Schedule I to this Annual Report on Form 10-K for information regarding business segment data.

Business Strategy

We have combined top brand names and a reputation for quality, durability and innovation with our efficient, low-cost manufacturing capabilities. We expect to achieve growth and increase profitability by pursuing the following strategies:

Accelerate new product introductions and brand development. New products allow us to generate higher margins based on their uniqueness and desirability in the marketplace. We intend to drive increased revenues through innovation within our core kitchen appliance categories, using a number of new technologies and marketing

Table of Contents

platforms. We also intend to create or grow new categories in which there are smaller and more fragmented competitors. The linkage of the Black & Decker® brand with innovative and quality products has a proven track record of success that we intend to continue. Advertising investments in these new products drive both broader distribution and higher sales at our retail customers. Product development is being driven by our investment in human capital, the application of technologies and our investment in strategic development alliances. Brand development takes its form in integrated packaging and communication materials, as well as national advertising that is intended to generate direct sales while also creating increased consumer demand for our products at retail.

Additionally, as part of our focus on new products introductions and brand development, we are searching for other growth opportunities within and beyond our existing business. We believe that the industries in which we compete may provide growth opportunities through strategic acquisitions.

Create long-term cost and quality advantages for our customers. We will maintain a value chain that meets our cost and quality objectives by leveraging our world class manufacturing facilities with strategic sourcing. We will accomplish this by insuring that our manufacturing plants in China and Mexico remain competitive through continuous improvement and competitive benchmarking. Additionally, we will leverage our global sourcing and procurement efforts to partner with suppliers who have also committed to our continuous improvement philosophy. This symbiotic relationship will allow us to (a) fully capitalize on our combined strengths, (b) provide a foundation for new product development, (c) deliver quality consistent with the reputation of our brands, and (d) deliver at costs that are the most competitive in our industry.

Optimize our supply chain and customer service functions. We recognize that our retail customers are our most critical link to the consumer. We will continue to refine our supply chain management and customer service functions, improving our operations across all key functional areas. Our goal is to become a preferred supplier to our retail customers. We will also continue to upgrade our consumer service capabilities and improve our relationship with the consumer.

Products

Applica primarily manufactures and distributes five categories of products: small household appliances, professional personal care products, home environment products, pet products and pest control products. The following table sets forth the approximate amounts and percentages of Applica's net sales by product category during the periods shown:

	2002		2001		2000	
	Net Sales(1)	% of Total	Net Sales(1)	% of Total	Net Sales(1)	% of Total
Small Household Appliances(2)	\$477,000	73%	\$508,000	76%	\$523,000	75%
Professional Personal Care	64,000	10	61,000	9	58,000	8
Home Environment	36,000	6	34,000	6	35,000	5
Pet	36,000	5	32,000	5	25,000	4
Pest Control	16,000	3				
Other Products(2)	20,000	3	31,000	4	54,000	8

(1) Net sales numbers do not include contract manufacturing sales. For information regarding such sales, see Private Label and Contract Manufacturing below.

(2) Includes certain kitchen and retail personal care sales that Applica transitioned out of in 2000 and 2001.

The small household appliance group includes food preparation, cooking, beverage and garment care products and constitutes our largest product category. Applica provides customers in the small household appliances market with a broad product line at introductory and mid-tier price points. Our products in this category include toaster ovens, toasters, hand-held irons, blenders, can openers, coffee grinders, coffee makers, electric knives, skillets, griddles, waffle makers, deep fryers, food choppers, food processors, mixers, popcorn poppers, rice cookers

Table of Contents

and steamers, sandwich makers and other similar products. We also distribute vacuum cleaners under the Black & Decker® brand in Latin America.

The professional personal care group focuses mainly on product lines marketed under the Belson® brand and other private label brands, and includes hair dryers, curling irons, curling brushes, hairsetters, combs and brushes, shears and mirrors. The professional products are sold primarily to beauty salons and beauty supply stores. Applicca also sells a small number of professional personal care products to drug stores and mass merchandisers. In addition, we supply electric and non-electric amenities to the lodging industry under the Jerdon® and First Class brands. These products include wall-mounted hair dryers, lighted makeup and shaving mirrors, pulsating shower heads, coffee makers and other similar products.

Applicca has historically participated in the home environment category, which includes seasonal products such as fans and heaters, under the Windmere® brand name. This participation was targeted primarily at the opening price point segment of the marketplace. In 2001, Applicca entered the mid-price point segment of the market by launching a full array of ceramic heaters, heater fans and utility fans under the Black & Decker® brand. In addition, in January 2002, we launched a line of fans under the Black & Decker® brand. We will continue to focus on the mid-price point market by expanding the Black & Decker® brand into additional areas of the home environment category, while de-emphasizing products in the opening price point market. We believe that this will result in slower sales growth but better margins.

Applicca also manufactures and markets the LitterMaid® patented self-cleaning cat litter box. Because of the success of the LitterMaid® self cleaning cat box, we have introduced other products under this brand, including accessories such as the LitterMaid® privacy tent and replacement waste receptacles.

In spring of 2002, Applicca introduced an insect control product called Sonic Web that uses sub-sonic sound waves (among other attractants) to attract flying insects, including mosquitoes. The insects are then trapped and easily discarded. Applicca intends to continue to grow this category through promotional efforts and increased distribution. To supplement this entry into the pest control category, in May 2002, Applicca acquired Weitech, Inc., a leading designer and distributor of electronic pest control products that emit high frequency sound waves to repel a variety of pests.

Product Development

Consumer products. As part of our ongoing strategy to deliver new, innovative and relevant products to the consumer marketplace, we adhere to a well-defined product development process (PDP) focused on quality design, appropriate performance characteristics, and speed-to-market. We have a product development team dedicated to creating innovative products in and outside of our core categories. This internal process also helps manage the improvement of quality, performance and cost on existing products.

New products are those that require a new mold, have a new feature or benefit, or those that have not been in our product line previously. Adding features or providing a fresh look to existing products, either through design upgrades or creative packaging, is a necessity for maintaining consumer preferences, protecting existing retailer shelf space and maintaining acceptable price points. Applicca launched over 200 new products in 2002 and 90 new products in 2001, most of which were refreshes. Some of the new products launched in 2002 include the Arctic Twister, a product that allows consumers to mix ice cream with candy, nuts or fruits for a frozen at-home treat, the Sonic Web insect control product and a new high-end iron line called Prestige. New products launched in 2001 include the Gizmo can opener, the Chill Buster heater fan, the Heat Xtreme ceramic heater and the FryMate deep fryer. New consumer products constituted 18% of our sales in 2002 and 15% of the sales in 2001.

Professional products. For our Belson® and Jerdon® product lines, we work closely with both retailers and suppliers to identify consumer needs and preferences and to generate new product ideas. We evaluate new ideas and seek to develop and acquire new products and improve existing products to satisfy industry requirements and changing consumer preferences. We design the style, features and functionality of our products to meet customer requirements for quality, performance, product mix and pricing.

Table of Contents

Brands

As part of the acquisition of the Black & Decker Household Products Group, Applica licensed the Black & Decker brand for use in marketing small household appliances in North America, Latin America (excluding Brazil) and the Caribbean. In addition, Applica acquired certain Black & Decker sub-brands, including Toast R Oven, ProFinish and Quick N Easy, and licensed Spacemaker for under the cabinet kitchen appliances. Applica continues to develop new sub-brands for product differentiation at the retail level, including Gizmo , SmartBrew , Prestige , Chill Buster and Silent Force .

The major portion of Applica s revenue is generated through the sale of small household appliances, with the Black & Decker® brand representing approximately 62% and 63% of Applica s total revenue in 2002 and 2001, respectively. The Black & Decker® brand has significant market share in the toaster oven, coffee maker and hand-held iron categories, as well as in can openers, hand mixers, food steamers, electric knives, food choppers and citrus juicers. In 2002 and 2001, we invested in national advertising to increase the awareness and preference levels among consumers.

Applica also participates in several small appliance categories such as cooking, food preparation, garment care and home environment under its Windmere® brand name. We use this brand to capitalize on the high unit volume potential of the opening price point segments within these categories.

The professional personal care category is targeted specifically at the salon segment under the Belson® brand and other private label programs. In addition, Applica continues to focus on both appliances and personal care products that are targeted to the hotel and hospitality industry through the distribution of the Jerdon® brand of products.

Applica also manufactures and markets several products under the LitterMaid® brand. The flagship LitterMaid® branded product is the patented self-cleaning cat litter box. We have also introduced other products under this brand, including accessories.

Applica also uses the Weitech brand to market a line of electronic pest control products, as well as several sub-brands, such as Mouse-X and Vermin-X®. Additionally, Sonic Web is the brand used to identify our mosquito control product. In February 2003, the Black & Decker® brand license was extended to certain electronic pest and insect control products, which we intend to launch in the fourth quarter of 2003.

Applica also has, and from time to time will enter into, licenses and other agreements that grant it the right to use other trademarks and trade names.

Strategic Alliances

Applica continues to pursue strategic alliances to further differentiate our products and to accelerate our growth. Such alliances can include brand development and product development alliances. Our current alliance with The Black & Decker Corporation encompasses brand development. Applica has worked closely with The Black & Decker Corporation to ensure that the Black & Decker® brand representation is seamless to the consumer.

In 2000, we entered into a joint product development relationship with a consumer products company to develop, manufacture and market new products into the mass market. We currently have an agreement related to a large product consumer category and are in the process of reviewing other opportunities for joint product development with this company in other household appliances categories. This relationship will be initially targeted to the Black & Decker® brand, but future expansion may assist in the development of new brands and wider categories for Applica. We anticipate that the first product developed pursuant to this alliance will be launched in the U.S. in the first quarter of 2004.

Raw Materials and Suppliers

The raw materials used to manufacture our products are available from numerous suppliers in quantities sufficient to meet our normal requirements. Applica s primary raw materials include plastic resin, electrical components, corrugated cardboard for cartons, aluminum and copper. Factors that are largely beyond our control,

Table of Contents

such as movements in commodity prices for specific raw materials, may affect the cost of these materials. As an example, our products require a substantial amount of plastic. Because the primary resource used in manufactured plastics is petroleum, the cost and availability of plastic varies to a great extent with the price of petroleum. Because the majority of our raw materials are commodity based, they are available from at least two or more independent suppliers. Applica is not dependent upon any single foreign source for such materials, although the cost from alternative sources may be higher. We do not maintain long-term purchase contracts with our suppliers.

Applica purchases approximately 24% of its finished products from outside suppliers, with no significant concentration with any one supplier. We do not maintain long-term purchase contracts with these suppliers.

Intellectual Property

Applica manufactures products with features for which we have filed or obtained licenses for trademarks, patents and design registrations in the United States and in several foreign countries. Our right to these patents and trademarks is a significant part of our business and our ability to create demand for our products is dependent to a large extent on our ability to capitalize on them. We also rely on unpatented proprietary manufacturing methodologies in our Mexican and Chinese manufacturing facilities.

As part of our acquisition of the Black & Decker Household Products Group in June 1998, we licensed the Black & Decker brand in North America, Latin America (excluding Brazil) and the Caribbean for specific household appliances. The license was on a royalty-free basis for core product categories through June 2003. In July 2001, Applica and The Black & Decker Corporation entered into an extension of the trademark license agreement through December 31, 2006. Under the agreement as extended, Applica agreed to pay certain fees and guaranteed minimum royalty payments to The Black & Decker Corporation of \$1.2 million in 2001, \$2.0 million in 2002, \$5.0 million in 2003 and \$12.5 million in each year thereafter through 2006. Renewals of the license agreement, if mutually agreed upon, are for five-year periods. If Black & Decker does not agree to renew the license agreement, Applica has 18 months to transition out of the brand name. No minimum royalty payments will be due during such transition period.

Upon request, Black & Decker may elect to extend the license to use the Black & Decker® brand to certain additional products. Such additional products are subject to royalty payments. In 2000 and 2001, Black & Decker extended the license to heaters, fans, humidifiers, dehumidifiers, air purifiers, deep fryers and bag sealers. In 2002, Black & Decker agreed to extend the license to ice cream makers and mixers. In February 2003, the license was further extended to certain electronic pest and insect control products.

Applica owns the LitterMaid® trademark for self-cleaning litter boxes and has extended the trademark for accessories such as a litterbox privacy tent and waste receptacles. Applica owns one patent and has exclusive licenses to three other patents covering the LitterMaid® litter box. The patents have been issued in the United States and a number of foreign countries.

Additional important brand names that we own include Applica®, Windmere®, Jerdon® and Belson®. The Windmere® brand is targeted to electric kitchen appliances and to home environment products at the opening price point segment. Belson® and Jerdon®, and its sub-brand First Class®, are targeted to the professional personal care and hospitality markets. In addition, we acquired certain Black & Decker® sub-brands, including Toast R Oven, ProFinish and Quick N Easy and licensed Spacemaker for under the cabinet kitchen appliances.

On December 31, 2002, Applica terminated its license agreement for the White Westinghouse trademark on small electronic appliances.

Manufacturing

Applica operates manufacturing facilities in the People's Republic of China and Mexico. Applica Durable Manufacturing Limited is Applica's wholly owned Hong Kong subsidiary. Its manufacturing operations are located in Bao An County, Guangdong Province of the China, which is approximately 60 miles northwest of central Hong Kong. The Chinese facilities include six manufacturing plants located within a six mile radius, constituting approximately 2.0 million square feet. These facilities operate as a vertically integrated manufacturing operation, with the capacity and expertise to handle most phases of product manufacturing, from design to component

Table of Contents

manufacturing through final assembly. The Chinese factories use computer-aided design and manufacturing software and state-of-the-art mold making machinery to shorten the time between product conception and final production. By manufacturing a majority of their own parts and testing at several points in the manufacturing process, our Chinese facilities are better able to ensure consistent quality. The Chinese manufacturing operations are certified under ISO 9001 standards. The factories in China are operated under contracts with the local government.

Applica Manufacturing, S. de R.L. de C.V., is Applica's wholly owned Mexican manufacturing subsidiary, located in Queretaro, Mexico, which is approximately 150 miles northwest of Mexico City. The factory constitutes approximately 290,000 square feet of floor space and manufactures Black & Decker® branded products for distribution to both North America and Latin America. Its capabilities include product design and tool fabrication. The Mexican facility is certified under ISO 9001 standards. This location primarily manufactures irons, blenders, coffee makers and toaster ovens.

Private Label Manufacturing and Contract Manufacturing

Applica offers a number of products in the small appliance, personal care and home environment categories for private label branding by retailers. Private label brands are those brands that are specific to a certain retailer. In addition, Applica works with key retailers to supply product development and manufacturing expertise to the development of lines, such as the Home Essentials line at Kmart Corporation.

Our Chinese manufacturing facility also serves as a contract manufacturer for a range of small appliances, including air cleaners, oral care products and vacuum cleaners, which it sells to small appliance companies primarily in the United States. Our Mexican manufacturing facility initiated a contract manufacturing program in 2001 and is currently providing manufacturing support for an outside development project, as well as a private label program for the Latin American market.

The approximate amounts of Applica's contract manufacturing sales during 2002, 2001 and 2000 were \$79.2 million, \$61.4 million and \$53.3 million, respectively.

In late 2002, we de-emphasized production of products for customers which would be in direct competition with products produced for sale under our brands and are now focusing efforts on the development of projects that are complimentary in nature. This shift will result in a significant decrease in contract manufacturing sales for 2003.

Customers

Applica markets its products primarily through mass merchandisers, but also distributes to home improvement warehouses, specialty retailers, warehouse clubs, drug and grocery stores, department stores, television shopping channels, pet supply retailers, beauty supply stores, catalogers, independent distributors and military post exchange outlets, as well as through e-commerce websites. In 2002, Applica's top three customers were Wal-Mart, Target and Kmart. These customers accounted for approximately 39%, 38% and 36% of net sales in 2002, 2001 and 2000, respectively. Wal-Mart accounted for 25%, 24% and 21% of our net sales in 2002, 2001 and 2000, respectively, and was our only customer that accounted for more than 10% of net sales in such years.

In January 2002, Kmart Corporation and certain of its U.S. subsidiaries filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code. Kmart is one of Applica's top three customers. Kmart has indicated that it intends to reorganize on a fast-track basis and has targeted emergence from Chapter 11 in April 2003. In 2002 and 2001, Applica had sales of \$43.5 million and \$49.4 million to Kmart Corporation.

Additionally, in January 2002, Service Merchandise Company, Inc. announced that it would cease continuing business operations and file a plan of liquidation. Service Merchandise filed bankruptcy in March 1999 but was unable to complete its planned business reorganization. In 2002, Applica had no sales to Service Merchandise. In 2001, Applica had sales of \$10.8 million to Service Merchandise.

In July 2002, Aisenstein & Gordon, Inc. (A&G), a distributor, announced that it would cease continuing business operations and undertake an out-of-court liquidation. In 2002 and 2001, Applica had sales of \$2.7 million and \$7.1 million, respectively, to A&G.

Table of Contents

In January 2003, PHD, Inc., a distributor and significant customer of Applica, was placed into involuntary bankruptcy, which PHD voluntarily converted to a liquidation under Chapter 11 of the U.S. Bankruptcy Code. In 2002 and 2001, Applica had sales of \$13.4 million and \$12.9 million, respectively, to PHD, Inc. and its subsidiaries.

Sales, Marketing and Distribution

Applica's products are sold principally by an internal sales staff. Each sales manager has primary coverage responsibility for certain retail accounts. We also use independent sales representatives, primarily in Central America and the Caribbean. In addition to directing our marketing efforts toward retailers, we sell certain of our products directly to consumers through infomercials and our Internet website. Our marketing department is responsible for product and category analysis, pricing strategy, promotions, key cooperative partnerships and overall category development. We use media advertising, cooperative advertising and collateral materials to promote our products and develop brand awareness.

We distribute our line of household appliances, home environment products and pet and pest control products to retailers, including mass merchandisers, department stores, home improvement stores, warehouse clubs, drug chains, catalog stores and discount and variety stores. We market our professional personal care lines, professional salon appliances and hair care accessories to beauticians, barbers and stylists primarily through distributors in the United States and through professional beauty and barber retail stores in the U.S. and to the hospitality industry.

Our policy is to maintain an inventory base to service the rapid delivery requirements of our customers. Because of manufacturing lead times and our seasonal sales, it is necessary that we purchase products and thereby increase inventories based on anticipated sales and forecasts provided by our customers and our sales personnel.

Backlog

Applica's backlog consists of commitments to order and orders for our products, which are typically subject to change and cancellation until shipment. Customer order patterns vary from year to year, largely because of annual differences in consumer acceptances of product lines, product availability, marketing strategies, inventory levels of retailers and differences in overall economic conditions. As a result, comparisons of backlog as of any date in a given year with backlog at the same date in a prior year are not necessarily indicative of sales for that entire given year. As of December 31, 2002, Applica had a backlog of approximately \$36.0 million compared to \$40.4 million as of December 31, 2001. We do not believe that the amount of backlog orders is a significant factor in our business.

Seasonality

Our business is highly seasonal, with operating results varying from quarter to quarter. We have historically experienced higher revenues in the third and fourth quarters of the fiscal year, primarily due to increased demand by customers in late summer for back-to-school sales and in the fall for holiday sales. The majority of our sales occur from July through November.

Competition

The sale of small electric consumer goods is characterized by intense competition. Competition is based on price and quality, as well as access to retail shelf space, product design, brand names, new product introductions and marketing support and distribution strategies. Applica competes with various domestic and international manufacturers and distributors, some of which have substantially greater financial and other resources than those of Applica. We believe that our future success will depend upon our ability to develop and distribute reliable products that incorporate developments in technology and satisfy customer tastes with respect to style and design. It will also depend on our ability to market a broad offering of products in each category at competitive prices.

Primary competitive brands in the household appliance market include Hamilton Beach, Procter Silex, Sunbeam, Mr. Coffee, Oster, General Electric, Rowenta, DeLonghi, Salton, Kitchen Aid, Cuisinart, Krups, Braun and Rival. In addition, we compete with retailers who use their own private label brands for household appliances. Primary competitive brands in the professional personal care market include Conair, Helen of Troy and Remington

Table of Contents

and in the home environment market include Holmes, Patton, Pelonis, Honeywell, Duracraft, Bionaire and Lakewood Primary competitive brands in the pet and pest market include Sunbeam, Coleman, Lentek and Mosquito Magnet.

Regulation

As a manufacturer and distributor of consumer products, we are subject to the Consumer Products Safety Act, which empowers the Consumer Products Safety Commission to exclude from the market products that are found to be unsafe or hazardous. Under certain circumstances, the Consumer Products Safety Commission could require us to repurchase or recall one or more of our products. In February 2002, Applica Consumer Products, Inc., in cooperation with the Consumer Products Safety Commission, voluntarily recalled approximately 2.1 million Black & Decker® two-slice and four-slice toasters. Applica's Canadian operating subsidiary, Applica Canada Corporation, also recalled approximately 180,000 of these toasters in Canada.

Laws regulating certain consumer products also exist in some cities and states, as well as in other countries in which we sell our products. We believe that we are in satisfactory compliance with all of the laws and regulations applicable to us.

Throughout the world, most federal, state, provincial and local authorities require safety regulation certification prior to marketing electrical appliances in those jurisdictions. Within the United States, Underwriters Laboratory, Inc. (UL) is the most widely recognized certification body for electrical appliances. UL is an independent, not-for-profit corporation engaged in the testing of products for compliance with certain public safety standards. We endeavor to have our products designed to meet the certification requirements of, and to be certified in, each of the jurisdictions in which they are sold.

Certain of the products sold by Applica in the United States are also subject to the Fair Packaging and Labeling Act. We believe that in addition to complying with the Fair Packaging and Labeling Act, we comply with the applicable rules and regulations of the Federal Trade Commission and other federal and state agencies with respect to the content of advertising and other trade practices.

Employees

As of March 5, 2003, Applica had approximately 15,500 full-time employees, which included approximately 13,000 employed at Applica's operations in Hong Kong and China, approximately 500 employed in North America and approximately 2,000 employed in Mexico and South America. From time to time, Applica also uses the services of seasonal employees.

In connection with the acquisition of the Black & Decker Household Products Group, Applica Manufacturing, S. de R.L. de C.V., Applica's Mexican manufacturing subsidiary, assumed the obligations of Black & Decker, S.A. de C.V. under a collective bargaining agreement with the Single Workers Union of Black & Decker of the State of Queretaro, C.T.M. covering approximately 1,500 employees at our manufacturing plant in Queretaro, Mexico. The wage provisions of this collective bargaining agreement were renegotiated in February 2003. To date, the union has not engaged in strikes or work stoppages against Applica. We believe that our relationships with both union and non-union employees continue to be good.

In June 2002, Applica closed its offices in Shelton, Connecticut and consolidated the engineering, sales and marketing functions at its Miami Lakes location. Certain back-office and supply chain functions in Canada and Latin America were also consolidated. These consolidations resulted in the reduction of approximately 70 employees worldwide.

Termination of Common Stock Purchase Rights Plan

On February 25, 2002, the Board of Directors of Applica Incorporated voted to terminate Applica's Common Stock Purchase Rights Plan. The plan will be terminated by redeeming the rights that were issued under the Amended and Restated 1995 Common Stock Purchase Rights Agreement. The rights will be redeemed at a price of \$.00001 per right, payable in cash. There is currently one right attached to each outstanding share of common stock. The rights are represented by the certificates for common stock and do not trade separately. Shareholders do not

Table of Contents

have to take any action to receive the redemption payment and do not have to surrender stock certificates. As a result of the redemption, the rights cannot become exercisable and the Amended and Restated 1995 Common Stock Purchase Right Agreement will be terminated.

Other Matters

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to these reports, are available via our website. The website address is www.applicainc.com. All required reports are made available on the website as soon as reasonably practicable after they are electronically filed with the Securities and Exchange Commission.

Risk Factors

You should carefully consider the following risk factors, together with the other information contained in this annual report on Form 10-K, in evaluating us and our business before purchasing our securities. In particular, you should note that this annual report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. If any of the events or circumstances described in the following risks actually occurs, our business, financial condition or results of operations could be materially adversely affected. The risks listed below are not the only risks that we face. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations.

Uncertainties Regarding The Impact Of Terrorist Activities, The Current War On Terrorism And The Threat Of War With Iraq Could Have A Material Adverse Effect On Our Business.

The recent terrorist activities and the current war on terrorism, as well as the potential war with Iraq, have had an adverse effect on consumer confidence and spending patterns in the United States, which in turn had a significant impact on our performance. Unforeseen inventory adjustments or changes in purchasing patterns by consumers and major customers could reduce our sales. Additionally, war with Iraq could result in increased petroleum prices. Because the primary resource used in manufactured plastics is petroleum, our cost of goods will increase with the price of petroleum.

The Failure Of Our Growth Strategy Could Have A Material Adverse Effect On Our Business.

As part of our growth strategy, we plan to:

- accelerate new product introductions and brand development;
- create long-term cost and quality advantages for our customers; and
- optimize our supply chain and customer service functions.

We cannot assure you that our strategic objectives will be realized or, if realized, will result in increased revenue, profitability or market presence. Executing our strategy may also place a strain on our production, information systems and other resources. To manage growth effectively, we must maintain a high level of manufacturing quality and efficiency, continue to enhance our operational, financial and management systems, including our database management, inventory control and distribution systems, and expand, train and manage our employee base. We cannot assure you that we will be able to effectively manage our growth in any one or more of these areas.

If We Are Unable To Renew The Black & Decker® Trademark License Agreement, Our Business Could Be Adversely Affected.

As part of the acquisition of the Black & Decker Household Products Group, we licensed the Black & Decker brand for use in marketing small household appliances in North America, Latin America (excluding Brazil) and the Caribbean. The majority of our revenue is generated through the sale of Black & Decker® branded products, which represented approximately 62% and 63% of our total revenue in 2002 and 2001, respectively. In 2001, Applicca and The Black & Decker Corporation extended the trademark license agreement through December 31,

Table of Contents

2006. Renewals, if mutually agreed upon, are for five-year periods and will require the payment of minimum royalties, which royalty rates have previously been negotiated.

We Depend On Purchases From Several Large Customers And Any Significant Decline In These Purchases Or Pressure From These Customers To Reduce Prices Could Have A Negative Effect On Our Business.

Due to the consolidation of the retail industry, our customer base has become relatively concentrated. Wal-Mart Stores, Inc., our largest single customer, accounted for approximately 25% of our 2002 net sales, 24% of our 2001 net sales and 21% of our 2000 net sales. Our top three customers accounted for approximately 39%, 38% and 36% of net sales in 2002, 2001 and 2000, respectively. Although we have long-established relationships with many of our customers, we do not have any long-term supply contracts and purchases are generally made using individual purchase orders. As a result, we must receive a continuous flow of new orders from our large, high-volume retail customers. However, we cannot assure you that we can continually meet the needs of our customers. In addition, failure to obtain anticipated orders or delays or cancellations of orders or significant pressure to reduce prices from key customers could have a material adverse effect on us.

The Bankruptcy Or Financial Difficulty Of Any Major Customer Or Fluctuations In The Financial Condition Of The Retail Industry Could Adversely Affect Our Business.

We sell our products to distributors and retailers, including mass merchandisers, department stores and wholesale clubs. The financial difficulties of our customers or the loss of, or a substantial decrease in, the volume of purchases by a major customer could have a material adverse effect on us. Additionally, a significant deterioration in the financial condition of the retail industry in general could have a material adverse effect on our sales and profitability.

Recently, several larger retail chains and distributors have declared bankruptcy or liquidated, two of which were large customers of ours. We continually monitor and evaluate the credit status of our customers and attempt to adjust sales terms as appropriate. Despite these efforts, a bankruptcy filing by a key customer could have a material adverse effect on us.

Our Business Is Very Sensitive To The Strength Of The U.S. Retail Market And Weakness In This Market Could Adversely Affect Our Business.

The strength of the retail economy in the United States has a significant impact on our performance. Weakness in consumer confidence and poor financial performance by mass merchandisers, warehouse clubs, department stores or any of our other customers could have a material adverse effect on us. The current general slowdown in the retail sector has resulted in, and we expect it to continue to result in, additional pricing and marketing support pressures on us. Additionally, the risks of terrorist attacks and potential hostilities could prolong or worsen the current economic downturn. If such conditions continue or worsen, it could have a material adverse effect on our business, financial condition and results of operations.

In addition, as a result of the desire of retailers to more closely manage inventory levels, there is a growing trend among retailers to make purchases on a just-in-time basis. This requires us to shorten our lead time for production in certain cases and more closely anticipate demand, which could in the future require the carrying of additional inventories.

Our Business Can Be Adversely Affected By Fluctuations In Cost And Availability Of Raw Materials And Components.

Raw materials and components constitute a significant portion of our cost of goods. Factors that are largely beyond our control, such as movements in commodity prices for the specific materials we require, may affect the future cost of raw materials and components. As an example, our products require a substantial amount of plastic. Because the primary resource used in manufactured plastics is petroleum, the cost and availability of plastic varies to a great extent with the price of petroleum. In addition, any inability of our suppliers to timely deliver raw materials or components or any unanticipated changes in our suppliers could be disruptive and costly to us. Our ability to select reliable suppliers who provide timely deliveries of quality materials and components will impact our success in

Table of Contents

meeting customer demand. Any significant failure by us to obtain raw materials on a timely basis at an affordable cost or any significant delays or interruptions of supply would have a material adverse effect on us.

Our Business Involves The Potential For Product Recalls And Product Liability Claims Against Us.

As a manufacturer and distributor of consumer products, we are subject to the Consumer Products Safety Act, which empowers the Consumer Products Safety Commission to exclude from the market products that are found to be unsafe or hazardous. Under certain circumstances, the Consumer Products Safety Commission could require us to repurchase or recall one or more of our products. Additionally, laws regulating certain consumer products exist in some cities and states, as well as in other countries in which we sell our products, and more restrictive laws and regulations may be adopted in the future. Any repurchase or recall of our products could be costly to us and could damage our reputation. If we were required to remove, or we voluntarily removed, our products from the market, our reputation could be tarnished and we might have large quantities of finished products that could not be sold.

We also face exposure to product liability claims in the event that one of our products is alleged to have resulted in property damage, bodily injury or other adverse effects. Although we maintain product liability insurance in amounts that we believe are reasonable, we cannot assure you that we will be able to maintain such insurance on acceptable terms, if at all, in the future or that product liability claims will not exceed the amount of insurance coverage. Additionally, we do not maintain product recall insurance. As a result, we cannot assure you that product recalls or product liability claims will not have a material adverse effect on us.

Additionally, we are a defendant in three asbestos lawsuits in which the plaintiffs have alleged injury as the result of exposure to asbestos in hair dryers distributed by us over 20 years ago. Although we never manufactured such products, asbestos was used in certain hair dryers sold by us prior to 1979. In addition to Applica, there are numerous defendants named in these lawsuits, many of whom actually manufactured asbestos containing products. At this time, we have not confirmed coverage under our insurance policies for the asbestos lawsuits, but we are currently undertaking research to ascertain if coverage can be identified.

Finally, our results of operations are susceptible to adverse publicity regarding the quality or safety of our products. In particular, product recalls or product liability claims challenging the safety of our products may result in a decline in sales for a particular product. This could be true even if the claims themselves are ultimately settled for immaterial amounts. We cannot assure you that this type of adverse publicity will not occur or that product liability claims will not be made in the future.

We Operate A Significant Portion Of Our Business Outside Of The United States Which Subjects Us To Additional Risks.

We manufacture a significant number of the products we sell in China and Mexico and obtain a significant proportion of the raw materials used in the manufacturing of our products outside the United States. We also have certain products manufactured by contract manufacturers outside of the United States. In addition, our strategy includes increasing sales to customers outside of the United States, including Latin America. International operations are subject to risks including, among others:

- labor unrest;
- political instability;
- lack of developed infrastructure;
- longer payment cycles and greater difficulty in collecting accounts;
- restrictions on transfers of funds;
- import and export duties and quotas;
- changes in domestic and international customs and tariffs;
- unexpected changes in regulatory environments;
- difficulty in complying with a variety of foreign laws;
- difficulty in obtaining distribution and support; and
- potentially adverse tax consequences.

Table of Contents

Labor in China and Mexico has historically been readily available at relatively low cost as compared to labor costs available in other nations. Both countries have experienced social, political and economic change in recent years. We cannot assure you that labor will continue to be available to us in China or Mexico at costs consistent with historical levels. A substantial increase in labor costs could have a material adverse effect on us. We could also be adversely affected by the imposition of austerity measures intended to reduce inflation, the inadequate development or maintenance of infrastructure or the unavailability of adequate power and water supplies, transportation, raw materials and parts, or a deterioration of the general political, economic or social environment in the foreign countries where we do business, particularly China and Mexico. The foregoing factors may have a material adverse effect on our ability to increase or maintain our international sales or importing activities, our financial condition or the results of our operations.

Additionally, our manufacturing facilities in China are operated under contracts with the local government. If changing conditions in China result in the termination of one or more of the lease agreements by the local government, it could have a material adverse effect on our business.

Our Business Could Be Adversely Affected By Changes In Trade Relations With China.

China gained Permanent Normal Trade Relations (PNTR) with the United States when it acceded to the World Trade Organization, effective January 2002. The United States imposes the lowest applicable tariffs on exports from PNTR countries to the United States. In order to maintain its WTO membership, China has agreed to several requirements, including the elimination of caps on foreign ownership of Chinese companies, lowering tariffs and publicizing its laws. No assurance can be given that China will meet these requirements and remain a member of the WTO, or that its PNTR trading status will be maintained. If China's WTO membership is withdrawn or if PNTR status for goods produced in China were removed, there could be a substantial increase in tariffs imposed on goods of Chinese origin entering the United States, including those manufactured by us, which would adversely impact our sales.

Our Business Could Be Adversely Affected By Currency Fluctuations In Our International Operations.

While we transact business predominantly in U.S. dollars and most of our revenues are collected in U.S. dollars, a substantial portion of our costs, such as payroll, rent and indirect operational costs, are denominated in other currencies, such as Chinese renminbi, Hong Kong dollars and Mexican pesos. In addition, while a small portion of our revenues are collected in foreign currencies, such as Canadian dollars, Argentine pesos, Colombian pesos, Chilean pesos and Venezuelan bolivars, a significant portion of the related cost of goods sold are denominated in U.S. dollars. Changes in the relation of these and other currencies to the U.S. dollar will affect our cost of goods sold and operating margins and could result in exchange losses. The impact of future exchange rate fluctuations on our results of operations cannot be accurately predicted. There can be no assurance that the dollar foreign exchange rates will be stable in the future or that fluctuations in financial markets will not have a material adverse effect on us.

Our Business Could Be Adversely Affected By Retailer Inventory Management Or The Failure of Our Logistical Systems.

Changes in retailer inventory management strategies could make inventory management more difficult for us. Because of our significant reliance on our factory in China, our production lead times are relatively long. Therefore, we generally commit to production in advance of customer orders. If retailers significantly change their inventory management strategies or if they or we fail to forecast customer or consumer demand accurately, we may encounter difficulties in filling customer orders or in liquidating excess inventories, or may find that customers are canceling orders or returning products. Distribution difficulties may have an adverse effect on our business by increasing the amount of inventory and the cost of warehousing inventory. Any of these results could have a material adverse effect on us.

Additionally, our business operations are dependent on our logistical systems, which include our order management system and our computerized warehouse network. Any interruption in our logistical systems would impact our ability to procure our products from our factories and suppliers, transport them to our distribution facilities, store them and deliver them to our customers on time and in the correct amounts.

Table of Contents

Our Future Success Requires Us To Develop New And Innovative Products On A Consistent Basis In Order To Increase Revenues And We May Not Be Able To Do So.

We believe that our future success depends in part upon our ability to continue to make innovations in our existing products and to develop, manufacture and market new products, which generally carry higher margins. We cannot assure you that we will be successful in the introduction, marketing and manufacture of any new products or product innovations or that we will be able to develop and introduce in a timely manner innovations to our existing products that satisfy customer needs or achieve market acceptance.

We Rely Heavily On Our Manufacturing Facilities To Manufacture And Assemble Our Products. An Extended Interruption In The Operation Of Any Facility Could Have An Adverse Impact On Our Operating Results.

Approximately 76% of our net sales are derived from products manufactured or assembled at our manufacturing facilities located in China and Mexico. These manufacturing facilities are subject to hazards that could result in material damage to any such facility. Any such damage to either facility, or prolonged interruption in the operations of either facility for repairs, labor disruption or other reasons, would have a material adverse effect on us.

We Are Subject To Several Production-Related Risks Which Could Jeopardize Our Ability To Realize Anticipated Sales And Profits.

To realize sales and operating profits at anticipated levels we must manufacture, source and deliver high quality products in a timely manner. Among others, the following factors can have a negative effect on our ability to do these things:

- labor difficulties;
- scheduling and transportation difficulties;
- substandard product quality, which can result in higher warranty, product liability and product recall costs;
- delays in development of quality new products;
- changes in laws and regulations, including changes in tax rates, accounting standards, environmental laws and occupational health and safety laws; and
- changes in the availability and costs of labor.

The Infringement Or Loss Of Our Proprietary Rights Could Have An Adverse Effect On Our Business.

We believe that our rights in owned and licensed names are a significant part of our business and that our ability to create demand for our products is dependent to a large extent on our ability to exploit these trademarks. There can be no assurance as to the breadth or degree of protection that these trademarks may afford us, or that we will be able to successfully leverage our trademarks in the future. The costs associated with protecting our intellectual property rights, including litigation costs, may be material. We also cannot be sure that we will be able to successfully assert our intellectual property rights or that these rights will not be invalidated, circumvented or challenged. Any inability to do so, particularly with respect to names in which we have made significant capital investments, or a successful intellectual property challenge or infringement proceeding against us, could have a material adverse effect on us. In addition, because our business strategy is heavily dependent upon the use of brand names, adverse publicity with respect to products that are not sold by us, but bear the same brand names, could have a material adverse effect on us.

We also rely on unpatented proprietary manufacturing methodologies and there can be no assurance that others may not independently develop the same or similar technology or otherwise obtain access to our technology. If we are unable to maintain the proprietary nature of our technologies, our business, financial condition and results of operations could be materially adversely affected. Additionally, we manufacture our products with features for which we have filed or obtained licenses for patents and design registrations in the United States and in several foreign countries. With respect to our applications for patents, there can be no assurance that any patents will be obtained. If obtained, there can be no assurance that such patents will afford us commercially significant protection of our technologies or that we will have adequate resources to enforce our patents.

Table of Contents

Our Operating Results Can Be Affected By Seasonality.

Our business is highly seasonal with operating results varying from quarter to quarter. We experience higher revenues in the third and fourth quarters of each fiscal year primarily due to increased demand by customers for our products in the late summer for back-to-school sales and in the fall for holiday sales. This seasonality has also resulted in additional interest expense to us during the third and fourth quarters of each fiscal year due to an increased need to borrow funds to maintain sufficient working capital to finance such increased demand.

We Compete With Other Large Companies That Produce Similar Products.

The markets for our products are highly competitive. We believe that competition is based upon several factors, including price, quality, access to retail shelf space, product features and enhancements, brand names, new product introductions, marketing support and distribution systems. We compete with established companies, a number of which have substantially greater facilities, personnel, financial and other resources than we have. We also compete with our retail customers, who use their own private label brands, and importers and foreign manufacturers of unbranded products. Some competitors may be willing to reduce prices and accept lower profit margins to compete with us. As a result of this competition, we could lose market share and sales. We cannot assure you that we will be able to compete successfully against current and future sources of competition or that the competitive pressures we face will not adversely affect our profitability.

Our Debt Agreements Contain Covenants That Restrict Our Ability To Take Certain Actions.

Our credit facility and the indenture for our 10% notes impose restrictions that affect, among other things, our ability to incur debt, pay dividends, sell assets, create liens, make capital expenditures and investments, and otherwise enter into certain transactions outside the ordinary course of business. The credit facility also requires us to maintain a minimum borrowing base availability and meet certain financial tests. Our ability to continue to comply with these covenants and restrictions may be affected by events beyond our control. The breach of any of these covenants or restrictions would result in a default under the credit facility and the indenture, in which case our lenders could elect to declare all amounts borrowed thereunder, together with accrued interest, to be due and payable, foreclose on the assets securing the debt or cease to provide additional revolving loans or letters of credit, which could have a material adverse effect on our business.

Our Business Can Be Adversely Affected By Newly Acquired Businesses Or Product Lines.

Applica may acquire partial or full ownership in businesses or may acquire rights to market and distribute particular products or lines of products. The acquisition of a business or of the rights to market specific products or use specific product names may involve a financial commitment by Applica, either in the form of cash or stock consideration. In the case of a new license such commitments are usually in the form of prepaid royalties and future minimum royalty payments. There is no guarantee that we will acquire businesses and develop products that will contribute positively to our earnings. Anticipated synergies may not materialize, cost savings may be less than expected, sales of products may not meet expectations, and acquired businesses may carry unexpected liabilities.

Government Regulations Could Adversely Impact Our Operations.

Throughout the world, most federal, state, provincial and local authorities require Underwriters Laboratory, Inc. or other safety regulation certification prior to marketing electrical appliances in those jurisdictions. Most of our products have such certifications. However, there can be no assurance that our products will continue to meet such specifications. Many foreign, federal, state and local governments also have enacted laws and regulations that govern the labeling and packaging of products and limit the sale of product containing certain materials deemed to be environmentally sensitive. A determination that we are not in compliance with such rules and regulations could result in the imposition of fines or an award of damages to private litigants.

Item 2. Properties

The following table sets forth the principal operating facilities of Applica:

Table of Contents

Location	Description	Area (Sq. Feet)
Miami Lakes, Florida	Headquarters, general administration, sales office, engineering offices, warehouse and distribution	140,000 Owned 40,000 Leased
Man Fung, China	Manufacturing and distribution	250,000 Leased
Sai Po Yuen, China	Manufacturing and distribution	208,000 Leased
Man Cheung Po, China	Manufacturing and distribution	605,000 Leased
Pok Kong, China	Manufacturing and distribution	437,000 Leased
Sun Kiu, China	Manufacturing and distribution	358,000 Leased
Gong He, China	Manufacturing, distribution and warehouse	63,000 Leased
Queretaro, Mexico	Manufacturing, warehouse and office	290,000 Owned
Little Rock, Arkansas	Warehouse and distribution	807,000 Leased
Toronto, Canada	Canada headquarters, sales office, warehouse and distribution	109,000 Leased
Hong Kong, China	Durable headquarters and general administration	49,000 Leased

Our facilities in China are operated under contracts with the local government.

We lease additional warehouse and office space in the United States, Canada and Latin America pursuant to short-term contracts. We also contract with third party distribution providers that furnish full service warehousing and shipping services. In 2002, Applica had such arrangements in Tennessee, Mexico, Colombia, Venezuela, Chile, Peru and Argentina. Service contracts are typically short-term in nature, stable in pricing, and provide for specific performance requirements related to customer service. We are currently pursuing additional third party distribution services in California to provide service to customers with significant shipping activity in the western United States, and to provide overflow seasonal warehouse space.

We believe our current facilities are adequate to meet our needs in the foreseeable future. If necessary, we may, from time to time, acquire or lease additional facilities for warehousing and/or other activities.

Applica closed its Shelton, Connecticut office in the third quarter of 2002 and is currently pursuing sublease arrangements for the 100,000 square feet of office space located there. Additionally, in the first quarter of 2003, Applica consolidated its sales office and warehouse space in Toronto, Canada and is currently pursuing sublease arrangements for the 10,000 square feet of sales office space.

Item 3. Legal Proceedings

Toaster Recall. In February 2002, Applica Consumer Products, Inc., in cooperation with the Consumer Products Safety Commission, voluntarily recalled approximately 2.1 million Black & Decker® T1200 and T1400 toasters. Applica's Canadian operating subsidiary, Applica Canada Corporation, also recalled approximately 180,000 of these toasters in Canada. Management charged 2001 operations with an estimated reserve of \$13.4 million for these recalls and does not believe the ultimate liability will be materially different.

Currently, three lawsuits have been filed in connection with property damage or bodily injury relating to the recalled toasters (one of which has been settled) and several other claims have been made. We believe that the amount of ultimate liability of these claims, if any, is not likely to have a material effect on our business, financial condition or results of operations. However, as the outcome of litigation is difficult to predict, significant changes in the estimated exposures could occur.

Other Matters. Applica is subject to other legal proceedings, products liability claims and other claims that arise in the ordinary course of our business. In the opinion of management, the amount of ultimate liability, if any, in excess of applicable insurance coverage, is not likely to have a material effect on the financial condition, results of operations or liquidity of Applica. However, as the outcome of litigation or other claims is difficult to predict, significant changes in the estimated exposures could occur.

Table of Contents

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of Applica s security holders during the fourth quarter of the year ended December 31, 2002.

-17-

Table of Contents**PART II****Item 5. Market for the Registrant's Common Stock and Related Stockholder Matters**

Applica's common stock, \$0.10 par value, is listed for trading on the New York Stock Exchange under the symbol APN. The following tables set forth, for the periods indicated, the range of high and low closing prices for the common stock as reported on the New York Stock Exchange:

	Closing Price	
	High	Low
2001		
First quarter	\$ 7.65	\$4.63
Second quarter	\$ 9.59	\$6.05
Third quarter	\$11.30	\$7.48
Fourth quarter	\$ 9.45	\$6.40
2002		
First quarter	\$ 9.90	\$5.00
Second quarter	\$12.40	\$8.44
Third quarter	\$12.20	\$4.30
Fourth quarter	\$ 6.45	\$4.26

At March 5, 2003, there were approximately 900 holders of record of our common stock. The number of holders of record of the common stock includes nominees of various depository trust companies for an undeterminable number of individual stockholders.

Dividends. We are prohibited from declaring or paying cash dividends on our capital stock under the terms of our debt agreements. We did not pay any common stock dividends in 2002 or 2001, and we do not anticipate paying dividends in the foreseeable future. We intend to retain future earnings to finance the expansion of our operations and for general corporate purposes.

Termination of Common Stock Purchase Rights Plan. On February 25, 2002, the Board of Directors of Applica Incorporated voted to terminate Applica's Common Stock Purchase Rights Plan. The plan will be terminated by redeeming the rights that were issued under the Amended and Restated 1995 Common Stock Purchase Rights Agreement. The rights will be redeemed at a price of \$.00001 per right, payable in cash. There is currently one right attached to each outstanding share of common stock. The rights are represented by the certificates for common stock and do not trade separately. Shareholders do not have to take any action to receive the redemption payment and do not have to surrender stock certificates. As a result of the redemption, the rights cannot become exercisable and the Amended and Restated 1995 Common Stock Purchase Right Agreement will be terminated.

Table of Contents**Item 6. Selected Financial Data**

The selected financial data presented below is derived from our audited financial statements and should be read in conjunction with Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations below and the Consolidated Financial Statements and related notes thereto included in Schedule I to this Annual Report on Form 10-K.

	2002	2001	2000	1999	1998
(Dollars in thousands, except per share data)					
Statement of Operations:					
Net sales	\$ 727,356	\$ 727,044	\$ 748,751	\$ 718,309	\$ 474,356
Equity in net earnings (loss) of joint ventures	\$ (1,498)	\$ (128)	\$ (777)	\$ (12,894)	\$ 1,621
Earnings (loss) before income taxes and cumulative effect of change in accounting principle	\$ 9,878	\$ (24,292)	\$ (22,758)	\$ 21,020	\$ 40,368
Income tax expense (benefit)	\$ 4,826	\$ 4,146	\$ (1,542)	\$ 4,177	\$ 11,616
Cumulative effect of change in accounting principle, net of tax benefit of \$42,447	\$ (78,829)				
Effective tax rate	48.9%	(17.1)%	6.8%	19.9%	28.7%
Net earnings (loss)	\$ (73,777) ⁽¹⁾	\$ (28,438) ⁽²⁾	\$ (21,216) ⁽³⁾	\$ 16,843 ⁽⁴⁾	\$ 28,752 ⁽⁵⁾
Balance Sheet:					
Working capital	\$ 192,776	\$ 228,124	\$ 276,981	\$ 263,315	\$ 267,434
Current ratio	2.8	3.0	3.3	3.1	3.0
Property, plant and equipment, net	\$ 76,963	\$ 82,337	\$ 78,200	\$ 75,983	\$ 76,077
Total assets	\$ 521,665	\$ 633,684	\$ 707,935	\$ 714,310	\$ 742,737
Long-term debt and other long terms liabilities	\$ 195,371	\$ 225,726	\$ 260,147	\$ 243,807	\$ 287,306
Shareholders' equity	\$ 219,128	\$ 293,939	\$ 324,474	\$ 343,397	\$ 324,018
Per Share Data:					
Earnings (loss) per common share - basic	\$ (3.15) ⁽¹⁾	\$ (1.23) ⁽²⁾	\$ (0.92) ⁽³⁾	\$ 0.75 ⁽⁴⁾	\$ 1.43 ⁽⁵⁾
Earnings (loss) per common share - diluted	\$ (3.10) ⁽¹⁾	\$ (1.23) ⁽²⁾	\$ (0.92) ⁽³⁾	\$ 0.72 ⁽⁴⁾	\$ 1.33 ⁽⁵⁾
Cash dividends paid					
Book value at year end	\$ 9.33	\$ 12.61	\$ 14.06	\$ 15.17	\$ 14.67
Return on average equity	(28.8)%	(9.2)%	(6.4)%	5.1%	11.2%

(1) In January 2002, Applica applied the provisions of SFAS 142 - Goodwill and Other Intangible Assets. Based on its impairment tests, Applica recognized an adjustment of \$121.3 million (\$78.8 million, or \$3.31 per share, net of tax on a full year and fully diluted basis) in the first quarter of 2002 to reduce the carrying value of goodwill to its implied fair value. In addition, repositioning expenses of \$10.6 million relating to the infrastructure consolidation were incurred. These expenses did not qualify for accrual at December 31, 2001.

(2) In the fourth quarter of 2001, Applica took charges relating to several events in the aggregate amount of \$28.2 million. These charges included \$6.8 million relating to its infrastructure consolidation. In addition, \$5.2 million of such charges related to Applica's execution of a new four-year senior secured revolving credit facility and the write-off of fees and expenses associated with the terminated credit facility. Also included in the charge were \$1.5 million relating to the devaluation of the Argentinean peso and \$1.0 million related to the settlement of the shareholder class action litigation.

Table of Contents

- (3) Includes primarily non-cash charges totaling \$37.7 million (\$32.6 million, or \$1.42 per share, net of tax). Such charges include a repositioning charge of \$34.1 million, of which \$30.1 million was included in cost of goods sold and \$4.0 million was included in selling, general and administrative expenses. Such charges also include a loss on asset held for sale of \$3.6 million. The \$32.6 million after-tax effect of the charges has been adjusted to include a tax valuation allowance of approximately \$4.5 million related to certain U.S. foreign tax credits, contributions and state net operating loss carryforwards, which expire in five years or less
- (4) Includes an adjustment of \$1.5 million (\$0.9 million after tax) related to the reversal of a portion of the 1998 repositioning charge. Also includes a charge of \$12.6 million (\$8.3 million after tax) for the write-down of Applica's remaining investment in a joint venture.
- (5) Includes a one-time, primarily non-cash repositioning charge of \$17.2 million, of which \$7.7 million is included in cost of goods sold. Also includes an after tax gain on the sale of Applica's equity interest in Salton, Inc. of \$27.5 million.

-20-

Table of Contents

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Applica is a manufacturer, marketer and distributor of a broad range of branded and private-label small electric consumer goods. In 1998, Applica acquired the Black & Decker Household Products Group and became a leading supplier of brand name small household appliances in North and Latin America. We also manufacture and distribute professional personal care products, home environment products, pet care products, including the LitterMaid® self-cleaning cat litter box, and pest control products. We manufacture and market products under licensed brand names, such as Black & Decker®, our own brand names, such as Applica® and Windmere®, and other private-label brand names. Our customers include mass merchandisers, specialty retailers and appliance distributors primarily in North America, Latin America and the Caribbean.

We operate manufacturing facilities in China and Mexico. In 2002, approximately 76% of the products sold by Applica were manufactured in such facilities. In addition, we manufacture products for other consumer products companies, which we refer to as contract manufacturing.

In May 2002, Applica acquired Weitech, Inc. for a total of \$20 million, including cash and notes. Weitech designs, manufactures and distributes products that emit high frequency sound waves to repel a variety of pests. Weitech products are sold through mass market retailers, specialty retailers and mail order catalogs, primarily in the United States. The results of operations of Weitech, Inc. were included in the accompanying consolidated statement of operations from the date of the acquisition.

Forward Looking Statements

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Such statements are indicated by words or phrases such as anticipates, projects, management believes, Applica believes, intends, expects, and similar words or phrases. Such forward-looking statements are subject to certain risks, uncertainties or assumptions and may be affected by certain other factors, including the specific factors set forth in Item 1. Business Risk Factors. Should one or more of these risks, uncertainties or other factors materialize, or should underlying assumptions prove incorrect, actual results, performance, or achievements of Applica may vary materially from any future results, performance or achievements expressed or implied by such forward-looking statements. All subsequent written and oral forward-looking statements attributable to Applica or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements in this paragraph. Applica disclaims any intention or obligation to publicly announce the results of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

Use of Estimates and Critical Accounting Policies

The preparation of Applica's financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and revenues and expenses during the period. Future events and their effects cannot be determined with absolute certainty; therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to our financial statements. Management continually evaluates its estimates and assumptions, which are based on historical experience and other factors that are believed to be reasonable under the circumstances. These estimates and Applica's actual results are subject to the risk factors listed above under Item 1 Business Risk Factors.

Management believes that the following may involve a higher degree of judgment or complexity:

Collectibility of Accounts Receivable. Applica's allowance for doubtful accounts is based on management's estimates of the creditworthiness of its customers, current economic conditions and historical information, and, in the opinion of management, is believed to be an amount sufficient to respond to normal business conditions. Management sets specific reserves for customers in bankruptcy and other reserves for the remaining customers based upon historical collection experience. Should business conditions deteriorate or any major customer default on its

Table of Contents

obligations to Applica, this allowance may need to be significantly increased, which would have a negative impact upon Applica's operations. For example, during the fourth quarter of 2002, management increased the allowance by \$4.3 million as the result of the further deterioration of one of Applica's significant customers.

Reserves on Inventories. Applica establishes a reserve based on historical experience and specific reserves when it is apparent that the expected realizable value of an inventory item falls below its original cost. A charge to operations results when the estimated net realizable value of inventory items declines below cost. Management regularly reviews Applica's investment in inventories for declines in value.

Income Taxes. Significant management judgment is required in developing Applica's provision for income taxes, including the determination of foreign tax liabilities, deferred tax assets and liabilities and any valuation allowances that might be required against the deferred tax assets. At December 31, 2002 and 2001, Applica had deferred tax assets in excess of deferred tax liabilities of \$83.2 million and \$41.9 million, respectively. Applica determined that it was more likely than not that \$73.0 million and \$31.7 million of such assets will be realized, resulting in a valuation allowance of \$10.2 million in 2002 and 2001. Applica evaluates quarterly its ability to realize its deferred tax assets and adjusts the amount of its valuation allowance, if necessary. Applica operates within multiple taxing jurisdictions and is subject to audit in those jurisdictions. Because of the complex issues involved, any claims can require an extended period to resolve. In management's opinion, adequate provisions for income taxes have been made.

Goodwill. On an annual basis, management assesses the composition of Applica's assets and liabilities, as well as the events that have occurred and the circumstances that have changed since the most recent fair value determination. If events occur or circumstances change that would more likely than not reduce the fair value of goodwill below its carrying amount, goodwill will be tested for impairment. Applica will recognize an impairment loss if the carrying value of the asset exceeds the fair value determination. During the first quarter of 2002, Applica recorded a write-down of its goodwill of \$121.3 million (\$78.8 million, net of tax).

Long-Lived Assets. Applica reviews long-lived assets and certain identifiable intangibles held and used for possible impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In evaluating the fair value and future benefits of its intangible assets, management performs an analysis of the anticipated undiscounted future net cash flows of the individual assets over the remaining amortization period. Applica recognizes an impairment loss if the carrying value of the asset exceeds the expected future cash flows. For example, in the fourth quarter of 2000, Applica recorded a \$3.2 million write-down of certain intangible assets associated with Kmart Corporation's decision to terminate its long-term supply contract for White-Westinghouse electronic products and Applica's intention not to re-market such products to another company. In the fourth quarter of 2001, an additional write-down of \$1.2 million was recorded as a result of a bankruptcy petition filed by Kmart Corporation. In 2002, the Company abandoned leasehold improvements at its China facility. These leaseholds related to streamlining its manufacturing and distribution and had a net book value of \$2.5 million. In addition, with the closing of the Shelton, Connecticut office, the Company disposed of certain leasehold and other fixed assets with a net book value of \$1.1 million.

Reserves for Product Liability Claims and Litigation. Applica is subject to various legal proceedings, product liability claims and other claims in the ordinary course of its business. Management estimates the amount of ultimate liability, if any, with respect to such matters in excess of applicable insurance coverage based on historical claims experience and current claim amounts, as well as other available facts and circumstances. As the outcome of litigation is difficult to predict and significant estimates are made with regard to future events, significant changes from estimated amounts could occur. For example, Applica increased its reserve for product liability claims and litigation by \$1.0 million in 2002.

Product Recall Liability. Applica is subject to potential product recalls. We estimate the amount of ultimate liability based on discussions with the Consumer Product Safety Commission and historical claims experience. For example, in February 2002, we voluntarily recalled our Black & Decker® branded T1200 and T1400 toasters. We charged the 2001 operations with an estimated reserve of \$13.4 million for this recall. Applica has charged \$8.7 million against this reserve through December 31, 2002. While we believe that the reserve is adequate, there can be no assurance that significant future adjustments will not be required.

Table of Contents

Other Estimates. Applica makes a number of other estimates in the ordinary course of business relating to sales returns and allowances, warranty reserves, and reserves for promotional incentives. Historically, past changes to these estimates have not had a material impact on our financial condition. However, circumstances could change which may alter future expectations.

Results of Operations

The operating results of Applica expressed as a percentage of sales and other revenues are set forth in the table below:

	Year Ended December 31,		
	2002	2001	2000
Net sales	100.0%	100.0%	100.0%
Cost of sales:			
Cost of goods sold	68.1	71.0	68.6
Repositioning charges and other charges	—	1.8	4.0
Gross profit	31.9	27.2	27.4
Selling, general and administrative expenses:			
Operating expenses	26.8	25.6	25.5
Repositioning charges and other charges	1.4	2.1	0.5
Operating earnings (loss)	3.7	(0.5)	1.4
Other income (expense)	(2.1)	(2.8)	(3.8)
Loss on asset held for sale	—	—	(0.5)
Earnings (loss) before equity in net earnings (loss) of joint venture and income taxes	1.6	(2.8)	(4.3)
Equity in net earnings (loss) of joint ventures	(0.2)	0.0	(0.1)
Earnings (loss) before income taxes and cumulative effect of change in accounting principle	1.4	(3.3)	(3.0)
Income tax expense (benefit)	0.7	0.6	(0.2)
Earnings (loss) before cumulative effect of change in accounting principle	0.7	(3.9)	(2.8)
Cumulative effect of change in accounting principle, net of tax	(10.8)	—	—
Net earnings (loss)	(10.1)%	(3.9)%	(2.8)%

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Net Sales. Sales for Applica remained flat at \$727.4 million compared to \$727.0 million in 2001. For the year, increases in contract manufacturing of \$17.8 million, or 29.0%, and sales of pest control products of \$15.7 million were offset by decreases in (a) sales of Windmere® branded and other products of \$16.2 million, or 8.9%, (b) sales of White Westinghouse® products of \$8.6 million, or 36.9%, and (c) sales of Black & Decker® branded products of \$8.3 million, or 1.8%. No pest control products were sold in 2001. In 2002, sales of Black & Decker® branded products increased \$7.1 million in North American, but decreased \$15.4 million in Latin America. Sales to Wal-Mart, our largest customer, accounted for 24.5% and 24.3% of total sales for the 2002 and 2001 periods, respectively.

Edgar Filing: APPLICA INC - Form 10-K

In June 2000, the Kmart Corporation exercised its option to terminate its long-term supply contract with Applica for the sale of White-Westinghouse® consumer electronic products in the United States. The termination was effective on June 30, 2002. On December 31, 2002, Applica terminated the White Westinghouse license agreement. Sales of White Westinghouse branded products totaled \$14.7 million in 2002 and \$23.3 million in 2001.

In January 2002, Kmart Corporation and certain of its U.S. subsidiaries filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code. Kmart is one of Applica's top three customers. Kmart has indicated that it intends to reorganize on a fast-track basis and has targeted emergence from Chapter 11 in

-23-

Table of Contents

April 2003. In 2002 and 2001, Applica had sales of \$43.5 million and \$49.4 million to Kmart Corporation and, at the date of the bankruptcy filing, Applica had outstanding receivables of approximately \$5.0 million.

In July 2002, Aisenstein & Gordon, Inc. (A&G), a distributor, announced that it would cease continuing business operations and undertake an out-of-court liquidation. In 2002 and 2001, Applica had sales of \$2.7 million and \$7.1 million, respectively, to A&G. Applica had outstanding receivables from A&G of approximately \$1.7 million and, in connection with the liquidation, received approximately \$160,000 on such receivables.

In January 2003, PHD, Inc., a distributor and significant customer of Applica, was placed into involuntary bankruptcy, which PHD voluntarily converted to a liquidation under Chapter 11 of the U.S. Bankruptcy Code. In 2002 and 2001, Applica had sales of \$13.4 million and \$12.9 million, respectively, to PHD, Inc. and its subsidiaries. At the date of the bankruptcy filing, Applica had outstanding receivables of approximately \$4.3 million, which were fully reserved at December 31, 2002.

Management anticipates that reduced contract manufacturing orders and continued weakness in Latin America will negatively affect sales in 2003, which management believes will be offset by higher sales of Black & Decker® branded products and pest control products. Additionally, sales will be negatively affected during the first quarter as the result of higher overall inventory at two of our significant customers, resulting from the slow holiday season.

Gross Profit Margin. Applica's gross profit margin was 31.9% in 2002 as compared to 27.2% for 2001. Excluding the \$13.4 million in recall charges recorded as cost of sales in 2001, Applica's gross profit margin for 2001 was 29.0%. The gross profit margins increased as Applica experienced an improved product mix during 2002 and higher production levels at its manufacturing facilities.

In 2003, management anticipates that margins will remain similar to 2002 levels as the result of continued price degradation in core product categories and higher petroleum prices, offset by the continued improvement in product mix and new product introductions.

Selling, General and Administrative Expenses.

Operating Expenses. Operating expenses for Applica increased \$8.6 million, or 4.6%, in 2002 to \$195.0 million as compared to \$186.4 in 2001. Such expenses increased as a percentage of sales to 26.8% from 25.6% in the 2001 period. In 2002, advertising and promotion expenses increased \$10.3 million, largely as the result of increased television promotion to support new product introductions. Additionally, (a) our bad debt expenses increased by \$6.6 million, as we experienced the credit deterioration of two of our major distributors, (b) we experienced a \$2.2 million foreign exchange loss primarily related to the devaluation of certain Latin American currencies, (c) payroll and severance expenses increased by \$1.5 million and (d) selling and other expenses increased by \$400,000. These increases were offset by decreases in amortization expense of \$10.9 million primarily as the result of the adoption of SFAS 142, *Goodwill and Other Intangible Assets* and the write down of White Westinghouse related intangibles. Additionally, distribution and freight costs decreased by \$1.5 million during 2002 as the result of our supply chain management program.

Estimated expenses under the license agreement with The Black & Decker Corporation will increase by approximately \$4.0 million in 2003 and an additional \$7.5 million in 2004. Additionally, we anticipate that insurance and freight expenses will increase by approximately \$3.0 million as a result of increases in rates in 2003. These increases should be offset by decreases in expenses of approximately \$3.0 million resulting from the 2002 infrastructure consolidation and lower bad debt expense.

Repositioning and Other Charges. In the fourth quarter of 2001, Applica took charges relating to several events in the aggregate amount of \$14.8 million. These charges included \$6.8 million relating to Applica's decision to consolidate its Shelton, Connecticut office with the headquarters located in Miami Lakes, Florida, as well as certain back-office and supply chain functions in Canada and Latin America. In addition, \$5.2 million of such charges related to Applica's execution of a new four-year senior secured revolving credit facility and the write-off of fees and expenses associated with the terminated credit facility. Also included in the charge were \$1.5 million relating to the devaluation of the Argentinean peso and \$1.0 million related to the settlement of the shareholder class

Table of Contents

action litigation. In 2002, Applica incurred repositioning expenses of \$10.6 million relating to the consolidation. These expenses did not qualify for accrual at December 31, 2001.

For additional information regarding SFAS 142, see Note D of the Notes to Consolidated Financial Statements included in Schedule I of this Form 10-K.

Interest Expense. Interest expense decreased by \$4.9 million, or 21.8%, to \$17.6 million for 2002, as compared to \$22.5 million for 2001. Such decrease was largely the result of the reduction of debt and lower interest rates.

Gain on Litigation Settlement. In September 2002, Applica and Salton, Inc. entered into a settlement agreement in the matter Salton, Inc. v Windmere-Durable Holdings, Inc. and Windmere Corporation, which was filed in the United States District Court, Northern District of Illinois in January 2001. In connection with such settlement, Applica reported a one-time gain of \$557,000 in the third quarter of 2002.

Equity in Net Earnings (Loss) of Joint Ventures. The equity in net earnings (loss) of joint ventures increased from a \$128,000 loss in 2001 to a \$1.5 million loss in 2002. This increase was due to Applica's losses of approximately \$1.5 million related to its investment in a Florida limited liability company. Applica has no additional commitments or exposure related to this investment. During 2002, Applica did not reflect any equity in net earnings (loss) related to its investment in Anasazi Partners, L.P. Anasazi's investments include certain privately traded securities whose values have been estimated by the general partner in the absence of readily ascertainable market values. Fair value of these securities may differ significantly from the values that would have been used had a ready market for the securities existed.

Taxes. Applica's tax expense is based on an estimated annual aggregation of the taxes on earnings of each of its foreign and domestic operations. For 2002, Applica had an effective tax rate of 48.9%. The change in tax rate from 2001 resulted from additional tax expense of \$10.1 million in 2001 due to the repatriation of previously untaxed earnings. In addition, in 2002 Applica incurred additional permanent differences, such as foreign exchange translation losses. Applica expects its future effective tax rate to approximate 40%.

The earnings of subsidiaries in Canada, Mexico and Latin America (other than Chile) are generally taxed at rates comparable to or higher than 35%, the United States statutory rate. In addition, commencing on January 1, 2002, the earnings of Applica's Hong Kong subsidiary are also taxed at the United States statutory rate of 35% due to Applica's intent not to permanently reinvest the earnings outside of the United States. Applica does not make tax provisions for the undistributed earnings of its foreign subsidiaries that it expects will be permanently reinvested in its operations outside of the United States.

For additional information regarding taxes, see Note I of the Notes to Consolidated Financial Statements included in Schedule I of this Annual Report on Form 10-K.

Cumulative Effect of Change in Accounting Principle. In January 2002, Applica applied the provisions of SFAS 142, Goodwill and Other Intangible Assets and performed a transitional fair valued based impairment test. Based on its impairment tests, Applica recognized an adjustment of \$121.3 million (\$78.8 million, or \$3.31 per share, net of tax on a fully diluted basis) in the first quarter of 2002 to reduce the carrying value of goodwill to its implied fair value. Under SFAS 142, the impairment adjustment was reflected as a cumulative effect of change in accounting principle.

Earnings Per Share. Basic shares for the periods ended December 31, 2002 and 2001 were 23,415,186 and 23,135,222, respectively. Included in diluted shares is the dilutive effect of common stock equivalents relating to options of 403,275 for the period ended December 31, 2002. All common stock equivalents were excluded from the per share calculations in 2001 as Applica incurred a net loss before cumulative effect of change in accounting principle in the period and such inclusion would have been anti-dilutive.

Table of Contents**Year Ended December 31, 2001 Compared to Year Ended December 31, 2000**

Sales. Sales for Applica decreased 2.9% to \$727.0 million from \$748.8 million for the year ended December 31, 2001. The change was primarily the result of a decrease of \$40.1 million in sales of product categories that were exited in the fourth quarter of 2000, a decrease of \$3.5 million in sales of electronic products and a \$2.2 million decrease in Windmere® branded and other product sales. The decrease was primarily offset by a \$8.5 million increase in sales of Black & Decker® branded products, an increase of \$8.2 million in contract manufacturing sales and a \$7.3 million increase in sales of LitterMaid pet products. Sales to Wal-Mart, our largest customer, accounted for 24.3% and 21.4% of total sales for the 2001 and 2000 periods, respectively.

In January 2002, Kmart Corporation and certain of its U.S. subsidiaries filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code. Kmart Corporation is one of Applica's top three customers. In 2001, Applica had sales of \$49.4 million to Kmart Corporation and, as of the date of the bankruptcy filing, Applica had outstanding receivables of approximately \$5.0 million. Additionally, in January 2002, Service Merchandise Company, Inc. announced that it would cease continuing business operations and file a plan of liquidation. Service Merchandise filed bankruptcy in March 1999 but was unable to complete its planned business reorganization. In 2001, Applica had sales of \$10.8 million to Service Merchandise. As of the date of the announcement, the outstanding receivables to Service Merchandise were immaterial.

Cost of Sales Repositioning and Other Charges. Applica Consumer Products, Inc., in cooperation with the Consumer Products Safety Commission, voluntarily recalled approximately 2.1 million Black & Decker® two-slice and four-slice toasters. Applica's Canadian operating subsidiary, Applica Canada Corporation, also recalled approximately 180,000 of these toasters in Canada. In connection therewith, Applica took a charge of \$13.4 million relating to the estimated expenses of such recalls.

In the fourth quarter of 2000, Applica entered into a relationship with a consumer packaged goods company to develop, manufacture and distribute new products. In conjunction with the development relationship, Applica expanded its existing manufacturing capacity, exited various non-strategic product lines, including certain retail personal care items, and re-allocated company resources. These activities resulted in charges totaling \$34.1 million in the fourth quarter of 2000. These charges were primarily non-cash. Charges associated with the write down of inventory and other equipment totaled \$30.1 million and were recorded as cost of sales.

Gross Profit Margin. Applica's gross profit margin was 27.2% in 2001 as compared to 27.4% in 2000. Excluding the \$13.4 million in recall charges recorded as cost of sales in 2001 and \$30.1 million portion of repositioning charges recorded as cost of sales in 2000, Applica's gross profit margin was 29.0% in 2001 as compared to 31.4% in 2000. The decrease in the gross profit margin was primarily the result of lower production at Applica's manufacturing facilities, as Applica continued to reduce its inventory levels, along with higher raw material costs in the first quarter of 2001. Additionally, as a result of the slow economic environment, consumers purchased fewer higher-priced, higher-margin products and more lower-priced, lower-margin products during the year.

Selling, General and Administrative Expenses.

Operating Expenses. Operating expenses before repositioning and other charges for Applica decreased by \$4.5 million, or 2.4%, in 2001 to \$186.4 million. Such expenses as a percentage of sales remained flat in 2001 and 2000. In 2001, freight and distribution expenses decreased by \$3.2 million as the result of our supply chain initiatives, which were implemented in the fourth quarter of 2000. Additionally, selling and other expenses decreased by \$1.8 million as the result of the consolidation of our external and internal sales forces.

Repositioning and Other Charges. In the fourth quarter of 2001, Applica took charges relating to several events in the aggregate amount of \$14.8 million. These charges included \$6.8 million relating to Applica's decision to consolidate its Shelton, Connecticut office with the headquarters located in Miami Lakes, Florida, as well as certain back-office and supply chain functions in Canada and Latin America. In addition, \$5.2 million of such charges related to Applica's execution of a new four-year senior secured revolving credit facility and the write-off of fees and expenses associated with the terminated credit facility. Also included in the charge were

Table of Contents

\$1.5 million relating to the devaluation of the Argentinean peso and \$1.0 million related to the settlement of the shareholder class action litigation.

In addition to the \$30.1 million charged to cost of sales in 2000, the fourth quarter repositioning charges included other primarily non-cash charges of \$4.0 million, of which \$3.2 million related to the write down of certain intangible assets associated with Kmart Corporation's decision to terminate its long-term supply contract for White-Westinghouse® electronic products and Applica's intention not to re-market these products to another company.

Loss On Asset Held For Sale. In 2000, Applica determined to exit and sell substantially all of the assets of a non-strategic business and, as a result, recorded a loss of \$3.6 million based on the expected realizable value of the asset. The business was sold in June 2001 and no additional gain or loss was recognized.

Interest Expense. Interest expense decreased by \$7.8 million, or 25.7%, to \$22.5 million for 2001, as compared to \$30.3 million for 2000. The decrease was the result of the reduction of debt levels throughout 2001 and lower interest rates.

Taxes. Applica's tax expense is based on an aggregation of the taxes on earnings of each of its foreign and domestic operations. In 2001 and 2000, it included additional U.S. taxes on repatriated foreign earnings in excess of the amounts that were otherwise taxable in the U.S. The earnings of subsidiaries in Canada, Mexico and Latin America (other than Chile) are generally taxed at rates comparable to or higher than 35%, the United States statutory rate. Income tax rates in Hong Kong and Chile range between 8% and 16%.

In 2001, Applica had a tax expense of \$4.1 million and an effective tax rate of 17.1%, compared to a tax benefit of \$1.5 million and an effective tax rate of 6.8% in 2000. The tax expense resulted from taxes paid to foreign jurisdictions and additional U.S. taxes on repatriated foreign earnings in excess of the amounts otherwise taxable in the U.S. In 2001 and 2000, Applica repatriated \$31.4 million and \$16.3 million, respectively, from its foreign operations.

In 2001, Applica decided that future earnings of certain of its foreign operations would not be reinvested but rather would be repatriated to the United States. No provision has been made for U.S. taxes on the remaining undistributed earnings of the foreign operations of approximately \$169.0 million at December 31, 2001 and \$182.9 at December 31, 2000, as it is anticipated that such earnings would be reinvested in their respective operations or in other foreign operations.

Per Share Data. All common stock equivalents have been excluded from the per share calculations in 2001 as Applica incurred a net loss in the period and such inclusion would have been anti-dilutive.

Liquidity and Capital Resources

At December 31, 2002, Applica's working capital was \$192.8 million, as compared to \$228.1 million at December 31, 2001. At December 31, 2002 and 2001, Applica's current ratio was 2.8 to 1 and 3.0 to 1, respectively, and its quick ratio was 1.5 to 1 and 1.8 to 1, respectively. The decrease in the current and quick ratios primarily reflected the use of the cash from the decrease in accounts receivable to repay long-term debt.

Cash balances decreased by \$8.0 million to \$7.7 million for the year ended December 31, 2002. Cash balances decreased by \$1.1 million to \$15.7 million for the year ended December 31, 2001.

The net cash provided by operating activities totaled \$54.0 million in 2002 and \$87.9 million in 2001. The 2002 period reflected decreases in accounts receivable. The 2001 period reflected reductions in inventory.

Cash used in investing activities totaled approximately \$31.5 million for the period, as compared to \$23.2 million for 2001, and reflected the acquisition of Weitech, Inc. in 2002 for \$17.0 million in cash, as well as the purchase of equipment at Applica's manufacturing facilities and tooling for new products.

Table of Contents

Cash used in financing activities totaled approximately \$30.6 million in 2002 and \$65.8 million in 2001 reflecting the continued reduction of debt levels.

Applica's primary sources of liquidity are its cash flow from operations and borrowings under its credit facility. In 2001, Applica replaced its revolving credit and term debt facilities with a new \$205 million four-year asset-based senior secured revolving credit facility. As of March 3, 2003, Applica was borrowing approximately \$30.8 million under the facility and had approximately \$57.8 million available for future cash borrowings. Advances under the facility are primarily based upon percentages of outstanding eligible accounts receivable and inventories. The credit facility includes a \$10.0 million sublimit for the issuance of letters of credit, with approximately \$538,439 outstanding under the limit as of March 3, 2003. All amounts outstanding under the credit facility are payable on December 28, 2005.

At Applica's option, interest accrues on the loans made under the credit facility at either:

LIBOR (adjusted for any reserves), plus a specified margin which is determined by Applica's leverage ratio and was set at 2.35% at December 31, 2002 and 2.25% at March 1, 2003 (3.79% at December 31, 2002 and 3.59% at March 3, 2003); or

the Base Rate (which is Bank of America's prime rate), plus a specified margin, which is determined based upon Applica's leverage ratio and was set at 0.35% at December 31, 2002 and 0.25% at March 3, 2003 (4.60% at December 31, 2002 and 4.50% at March 3, 2003).

Management expects its borrowing margins to decrease to 2.00% (for LIBOR loans) and 0.0% (for Base Rate loans) after our first quarter 2003 results are reported to our senior lenders during May 2003. This decrease will result if we continue to improve our leverage ratio.

Swing loans up to \$15.0 million bear interest at the Base Rate plus a specified margin, which is determined based on Applica's leverage ratio and was set at 0.35% at December 31, 2002 and 0.25% at March 3, 2003 (4.60% at December 31, 2002 and 4.50% at March 3, 2003).

In July 1998, Applica issued \$130.0 million in Senior Subordinated Notes. The notes bear interest at a rate of 10%, payable semiannually, and mature on July 31, 2008. The notes are general unsecured obligations of Applica Incorporated and rank subordinate in right of payment to all senior debt of Applica and rank pari passu in right of payment to all future subordinated indebtedness of Applica. The notes may be redeemed at the option of Applica, in whole or in part, on or after July 31, 2003 at various redemption prices. See Note G of the Consolidated Financial Statements included in Schedule I to this Annual Report on Form 10-K for more detailed information regarding Applica's borrowings.

On September 28, 2002, Applica entered into credit approved receivables purchasing agreements with CIT Group/Commercial Services, Inc. (CIT). The agreements allow Applica to transfer to CIT, without recourse, approved receivables of specified customers under certain circumstances, including the bankruptcy of covered customers. Applica remains the servicer of the approved receivables and pays fees based upon a percentage of the gross face amount of each approved receivable. These arrangements are strictly for the purpose of insuring selected receivables. On January 17, 2003, the agreement covering receivables from a significant customer was converted into a full notification agreement under which CIT has agreed to purchase all approved receivables of such customer.

In April 2002, Applica Consumer Products, Inc. entered into a five-year \$6.0 million mortgage loan on Applica's executive offices located in Miami Lakes, Florida. The loan bears interest at an annual rate of 7.25%, with monthly principal and interest payments based on a 20-year amortization. A final balloon payment is due at the end of the term. The loan is secured by a mortgage on the property and the building located thereon.

Certain of Applica's foreign subsidiaries have approximately \$18.4 million in trade finance lines of credit, payable on demand, which are secured by the subsidiaries' tangible and intangible property, and in some cases, a guarantee by the parent company, Applica Incorporated. As of December 31, 2002, there were no amounts outstanding under the working capital lines and \$1.7 million outstanding under the letter of credit lines. As of

Table of Contents

March 3, 2003, there was \$2.5 million outstanding under the working capital lines and \$1.0 million under the letter of credit lines.

Applica's aggregate capital expenditures for the year ended December 31, 2002 were \$19.3 million, as compared to \$23.3 million for 2001. Applica anticipates that the total capital expenditures for 2003 will be approximately \$19.0 million, which includes the cost of equipment at our manufacturing facilities and tooling for new products. Applica plans to fund such capital expenditures from cash flow from operations and, if necessary, borrowings under its credit facility.

At December 31, 2002, debt as a percent of total capitalization was 47.0%, as compared to 43.4% at December 31, 2001.

Applica's ability to make scheduled payments of principal of, or to pay the interest on, or to refinance, its indebtedness, or to fund planned capital expenditures, product research and development expenses and marketing expenses will depend on its future performance, which, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory, and international and United States domestic political factors and other factors that are beyond its control. Based upon the current level of operations and anticipated cost savings and revenue growth, we believe that cash flow from operations and available cash, together with available borrowings under its credit facility and other facilities, will be adequate to meet our future liquidity needs for at least the next several years. There can be no assurance that Applica's business will generate sufficient cash flow from operations, that anticipated revenue growth and operating improvements will be realized or that future borrowings will be available under the credit facility in an amount sufficient to enable Applica to service its indebtedness, including the outstanding 10% notes, or to fund its other liquidity needs. In addition, there can be no assurance that Applica will be able to effect any needed refinancing on commercially reasonable terms or at all.

For information regarding related party transactions, see Note N to the Consolidated Financial Statements included in Schedule I to this Annual Report on Form 10-K.

Applica is also involved in certain ongoing litigation. See Item 3. Legal Proceedings above.

Effect of Inflation

Our results of operations for the periods discussed have not been significantly affected by inflation.

Currency Matters

While we transact business predominantly in U.S. dollars and most of our revenues are collected in U.S. dollars, a substantial portion of our costs, such as payroll, rent and indirect operational costs, are denominated in other currencies, such as Chinese renminbi, Hong Kong dollars and Mexican pesos. In addition, while a small portion of our revenues are collected in foreign currencies, such as Canadian dollars, Argentine pesos, Colombian pesos, Chilean pesos and Venezuelan bolivars, a significant portion of the related cost of goods sold are denominated in U.S. dollars. Changes in the relation of these and other currencies to the U.S. dollar will affect our cost of goods sold and operating margins and could result in exchange losses. The impact of future exchange rate fluctuations on our results of operations cannot be accurately predicted. There can be no assurance that the dollar foreign exchange rates will be stable in the future or that fluctuations in financial markets will not have a material adverse effect on our business, financial condition and results of operations.

From time to time, Applica uses forward exchange and option contracts to reduce fluctuations in foreign currency cash flows related to third party raw materials and other operating purchases, as well as trade receivables. The purpose of Applica's foreign currency management activity is to reduce the risk that anticipated cash flows and earnings from foreign currency denominated transactions may be adversely affected by changes in exchange rates.

For additional information on exchange rate sensitivity, see Item 7A. Quantitative and Qualitative Disclosures about Market Risk below.

Table of Contents

New Accounting Pronouncements

In July 2002, the FASB issued Statement No. 146, *Accounting for Restructuring Costs*, (SFAS 146). SFAS 146 applies to costs associated with an exit activity (including restructuring) or with a disposal of long-lived assets. Those activities can include eliminating or reducing product lines, terminating employees and contracts and relocating plant facilities or personnel. SFAS 146 is effective prospectively for exit or disposal activities initiated after December 31, 2002, with earlier adoption encouraged. Management does not believe the adoption of this standard will have a material impact on the financial statements.

In December 2002, the FASB issued Statement No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure* (SFAS 148). SFAS 148 amends FASB Statement No. 123, *Accounting for Stock-Based Compensation*, to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. Additionally, SFAS 148 requires prominent disclosures about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. SFAS 148 also amends APB Opinion No. 28, *Interim Financial Reporting*, to require disclosures about such effects in interim financial information. Applica currently accounts for its stock-based compensation awards to employees and directors under the accounting prescribed by Accounting Principles Board Opinion No. 25 and provides the disclosures required by SFAS No. 123. Applica currently intends to continue to account for its stock-based compensation awards to employees and directors under the accounting prescribed by Accounting Principles Board Opinion No. 25 and will adopt the additional disclosure provisions of SFAS 148 during the first quarter of its year ending December 31, 2003.

In December 2002, the FASB issued Interpretation 45 (FIN 45), *Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. For a guarantee subject to FASB Interpretation 45, a guarantor is required to:

measure and recognize the fair value of the guarantee at inception (for many guarantees, fair value will be determined using a present value method); and

provide new disclosures regarding the nature of any guarantees, the maximum potential amount of future guarantee payments, the current carrying amount of the guarantee liability, and the nature of any recourse provisions or assets held as collateral that could be liquidated and allow the guarantor to recover all or a portion of its payments in the event guarantee payments are required.

The disclosure requirement of this Interpretation is effective for financial statements for fiscal years ending after December 15, 2002 and did not have a material effect on Applica financial statements. The initial recognition and measurement provision are effective prospectively for guarantees issued or modified on or after January 1, 2003, which should not have a material effect on Applica's financial statements.

Item 7 A. Quantitative and Qualitative Disclosures About Market Risk.

Applica is exposed to the impact of interest rate changes and foreign currency fluctuations. In the normal course of business, we employ established policies and procedures to manage our exposure to changes in interest rates and foreign currencies using a variety of financial instruments.

Interest Rate Sensitivity. Our primary market risk exposure with respect to interest rates is changes in short- and long-term interest rates in the United States. Certain of Applica's debt arrangements represent floating rate debt and accordingly, we are subject to interest rate risk. Applica uses interest rate risk management contracts to reduce the impact of changes in interest rates on our floating rate debt. Our objectives in managing exposure to interest rate changes are to limit the impact of interest rate changes on earnings and cash flows and to lower overall borrowing costs. To achieve these objectives, we primarily use interest rate swaps to manage net exposure to interest rate changes related to Applica's portfolio of borrowings. Applica maintains fixed rate debt as a percentage of its net debt between a minimum and maximum percentage, which is set by policy.

The table below provides information regarding Applica's derivative financial instruments and other financial instruments that are sensitive to changes in interest rates, including interest rate swaps and debt obligations. For debt obligations, the table presents principal cash flows and related weighted average interest rates by expected

Table of Contents

maturity dates. For interest rate swaps, the table presents notional amounts and weighted average interest rates by expected (contractual) maturity dates. Notional amounts are used to calculate the contractual payments expected to be exchanged under the contract. Weighted average variable rates are based on implied forward rates in the yield curve at the reporting date.

At December 31, 2002

	Expected Maturity Date						Total	Fair Value(5)
	2003	2004	2005	2006	2007	Thereafter		
(Dollars in thousands)								
Liabilities:								
Long-Term Debt:								
Fixed Rate	143	153	3,166	178	5,282	130,000	138,912	138,262
Average Interest Rate	7.25%	7.25%	6.07%(1)	7.25%	7.25%	10.0%		
Variable Rate				55,070			55,070	55,070
Average Interest Rate				(2)				
Interest Rate Contracts:								
Interest Rate Swaps:								
Pay Fixed (3):	15,000						15,000	(328)
Average Pay Rate	4.8%							
Average Receive Rate	5.0%							