SURGE COMPONENTS INC
Form 10-K
February 26, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended **November 30, 2015**

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

For the transition period from _______ to _______

Commission File No. 000-27688

SURGE COMPONENTS, INC.

(Exact name of registrant as specified in its charter)

Nevada	**11-2602030**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
95 East Jefryn Boulevard **Deer Park, New York**	**11729**
(Address of principal executive offices)	(Zip Code)

(631) 595-1818
(Registrant's telephone number, including area code)

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

Title of Each Class to be so Registered:	Name of each exchange on which registered
None	**None**

Securities registered under Section 12(g) of the Act:

Common Stock, Par Value $0.001

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files. Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	Accelerated Filer
Non-accelerated Filer (Do not check if a smaller reporting company)	Smaller reporting company

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

As of May 31, 2015, the aggregate market value of the issued and outstanding common stock held by non-affiliates of the registrant, based upon the closing price of the common stock, was approximately $5.6 million.

The Registrant's common stock outstanding as of February 26, 2016, was 9,999,125 shares of common stock.

SURGE COMPONENTS, INC.

TABLE OF CONTENTS

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements. All statements other than statements of historical facts contained in this report, including statements regarding our future results of operations and financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements.

In some cases, forward-looking statements can be identified by terms such as "may," "will," "should," "expects," "plans," "anticipates," "could," "intends," "target," "projects," "contemplates," "believes," "estimates," "predicts," "potential" or "continue" or the negative of these terms or other similar words. These statements are only predictions. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our business, financial condition and results of operations. We discuss many of the risks in greater detail under the heading "Risk Factors." Also, these forward-looking statements represent our estimates and assumptions only as of the date of the filing of this report. Except as required by law, we assume no obligation to update any forward-looking statements after the date of the filing of this report.

This report also contains estimates and other statistical data made by independent parties and by us relating to market size and growth and other industry data. This data involves a number of assumptions and limitations, and investors are cautioned not to give undue weight to such estimates. We have not independently verified the statistical and other industry data generated by independent parties and contained in this report and, accordingly, we cannot guarantee their accuracy or completeness. In addition, projections, assumptions and estimates of our future performance and the future performance of the industries in which we operate are subject to a high degree of uncertainty and risk due to a variety of factors, including those described in “Risk Factors” and elsewhere in this report. These and other factors could cause results to differ materially from those expressed in the estimates made by the independent parties and by us.

PART I

Item 1. Business.

References to "we," "us," "our", "our company" and "the company" refer to Surge Components, Inc. ("Surge" or the "Company") and, unless the context indicates otherwise, includes Surge's wholly-owned subsidiaries, Challenge/Surge, Inc. ("Challenge"), and Surge Components, Limited ("Surge Limited").

We were incorporated under the laws of the State of New York on November 24, 1981, and re-incorporated in Nevada on August 26, 2010. We completed an initial public offering of our securities in 1984 and a second offering in August 1996. Our principal executive offices are located at 95 East Jefryn Boulevard, Deer Park, New York 11729 and our telephone number is (631) 595-1818.

We are a supplier of electronic products and components. These products include capacitors, which are electrical energy storage devices, and discrete components, such as semiconductor rectifiers, transistors and diodes, which are single function low power semiconductor products that are packaged alone as compared to integrated circuits such as microprocessors. The products that we sell are typically utilized in the electronic circuitry of diverse products, including, but not limited to, automobiles, telecomm, audio, cellular telephones, computers, consumer electronics, garage door openers, household appliances, power supplies and security equipment. The products that we sell are sold to both original equipment manufacturers, commonly referred to as OEMs, who incorporate them into their products, and to distributors of the lines of products we sell, who resell these products within their customer base. Surge sells its products through three of the top four distributors for electronic components in the world and also supplies its products to subcontractors who manufacture for their customers. These channels open doors to Surge at customers which Surge may not have access to otherwise. The products that we sell are manufactured predominantly in Asia by approximately sixteen independent manufacturers. We only have one binding long-term supply agreement with one of our manufacturers, Lelon Electronics. We have an agreement to act as the exclusive sales agent utilizing independent sales representative organizations in North America to sell and market the products for one of such manufacturers, Lelon Electronics. When we act as a sales agent, we receive a commission from our supplier who sold the product to the customer that we introduced to our supplier. The amount of the commission is determined on a sale by sale basis depending on the profit margin of the product. Commission revenue totaled $266,525 and $509,273 for the fiscal years ended November 30, 2015 and November 30, 2014, respectively.

Challenge is engaged in the sale of electronic components. In 1999, Challenge began as a division to sell audible components. We have been able to increase the types of products that we sell because some of our suppliers introduced new products, and we also located other products from new suppliers. Our core products include buzzers, speakers, microphones, resonators, alarms, chimes, filters, and discriminators. We now also work with our suppliers to have our suppliers customize many of the products we sell for many customers through the customers’ own designs and those that we work with our suppliers to have our suppliers redesign for them at our suppliers’ factories. We have a design engineer on our staff with more than thirty years experience with these types of products, who works with our suppliers on such redesigns. We are continually looking to expand the line of products that we sell. In 2015, we hired a junior engineer to assist with the introduction of a new micro controller product line. We sell these products through independent representatives that earn a commission on the products we sell. We are also working with local, regional, and national distributors to sell these products to local accounts in every state.

In order for us to grow, we will depend on, among other things, the continued growth of the electronics and semiconductor industries, our ability to withstand intense price competition, our ability to obtain new clients, our ability to retain and attract sales and other personnel in order to expand our marketing capabilities, our ability to secure adequate sources of products, which are in demand on commercially reasonable terms, our success in managing growth, including monitoring an expanded level of operations.

Industry Background

The United States electronics distribution industry is composed of manufacturers, national and international distributors, as well as regional and local distributors. Electronics distributors market numerous products, including active components (such as transistors, microprocessors, integrated circuits and semiconductors), passive components (such as capacitors and audibles), and electro mechanical, interconnect (such as connectors and wire) and computer products. Surge focuses its efforts on the sale of capacitors, discrete components, and audible products.

The electronics industry has been characterized by intense price cutting and rapid technological changes and development, which could materially adversely affect our future operating results. In addition, the industry has been affected historically by general economic downturns, which have had an adverse economic effect upon manufacturers and end-users of the products that we sell, as well as distributors. Furthermore, the life-cycle of existing electronic products and the timing of new product development and introduction can affect the demand for electronic components, including the products that we sell. Accordingly, any downturn in the electronics industry in general could adversely affect our business and results of operations. There are forces of change such as price cutting, M&A of customers and centralization of purchasing by customers vs. localized, affecting the wholesale distribution industry, including the electronics industry. The industry has experienced a strong move by U.S. manufacturers to design products in the United States, but then shift manufacturing and purchasing to Asia to benefit from this low cost labor region using their own factory or a subcontractor. Surge has responded to this trend by setting up a Hong Kong corporation, Surge Components, Limited, and hiring a sales staff to better position the Company in the Asian markets. Due to rising transportation and employment costs in Asia, we have seen U.S. manufacturers start moving their manufacturing facilities to Mexico to reduce transportation costs and bring manufacturing much closer to home. At this time, however, none of our customers has moved its manufacturing facilities to Mexico.

Products

Surge supplies a wide variety of electronic components (some of which bear our private "Surge" label) which can be broadly divided into two categories—capacitors and discrete components. For Fiscal 2015 and Fiscal 2014, capacitors accounted for approximately 50% and 50% of Surge's sales, respectively, of which approximately 75% for each year was Lelon capacitors (discussed below). Discrete components accounted for Surge's remaining sales in Fiscal 2015 and Fiscal 2014. Capacitors and discrete components can be categorized based on various factors, including function, construction, fabrication and capacity.

We sell, under the name of the manufacturer, Lelon Electronics, aluminum electrolytic capacitors, which are capacitors that store and release energy into a circuit incrementally and are used in various applications, including but not limited to, computers, appliances, automotive, lighting, telecommunications devices and various consumer products. Our sales of products under the Lelon Electronics name accounted for approximately 40% of our total sales (and approximately 75% of our capacitor sales as noted above) in Fiscal 2015.

The principal products sold by Surge under the Surge name (except with respect to capacitors, which the Company also sells under the Lelon Electronics name as noted above) or by Challenge are set forth below.

Capacitors

A capacitor is an electrical energy storage device used in the electronics industry for varied applications, principally as elements of resonant circuits, coupling and bypass applications, blockage of DC current, frequency determining and timing elements, filters and delay-line components. All products are available in traditional leaded as well as surface mount (chip) packages. The product line of capacitors we sell includes:

Aluminum Electrolytic Capacitors- These capacitors, which are Surge's principal product, are storage devices used in power applications to store and release energy as the electronic circuitry demands. They are commonly used in power supplies and can be found in a wide range of consumer electronics products. Our supplier has one of the largest facilities for these products in Taiwan and China. These facilities are fully certified for the International Quality Standard ISO 9001 and QS9000, and TS16949, which means that they meet the strictest requirements established by the automotive industry and adopted throughout the world to ensure that the facility's manufacturing processes, equipment and associated quality control systems will satisfy specific customer requirements. This system is also intended and designed to facilitate clear and thorough record keeping of all quality control and testing information and to ensure clear communication from one department to another about the information (i.e., quality control, production or engineering). This certification permits us to monitor quality control/manufacturing process information and to respond to any customer questions.

Ceramic Capacitors- These capacitors are the least expensive, and are widely used in the electronics industry. They are commonly used to bypass or filter semiconductors in resonant circuits and are found predominantly in a wide range of low cost products including computer, telecom, appliances, games and toys.

Mylar Film Capacitors- These capacitors are frequently used for noise suppression and filtering. They are commonly used in telecommunication and computer products. Surge's suppliers in China have facilities fully certified for all of the above mentioned quality certifications.

Discrete Components

Discrete components, such as semiconductor rectifiers, transistors and diodes, are packaged individually to perform a single or limited function, in contrast to integrated circuits, such as microprocessors and other "chips", which contain from only a few diodes to as many as several million diodes and other elements in a single package, and are usually designed to perform complex tasks. Surge almost exclusively distributes discrete, low power semiconductor components rather than integrated circuits.

The product line of discrete components we sell includes:

Rectifiers- Low power semiconductor rectifiers are devices that convert alternating current, or AC power, into one directional current, or DC power, by permitting current to flow in one direction only. They tend to be found in most electrical apparatuses, especially those drawing power from an AC wall outlet. All products are available in traditional leaded as well as surface mount (chip) packages. Surge's rectifier suppliers all have the aforementioned certifications, giving us an opportunity to market the products that we sell to the automotive industry.

Transistors- These products send a signal to the circuit for transmission of waves. They are commonly used in applications involving the processing or amplification of electric current and electric signals, including data, television, sound and power. All products are available in traditional leaded as well as surface mount (chip) packages. Surge sells many types of ISO 9002 transistors, including power transistors, designed for large currents to safely dissipate large amounts of power.

Diodes- Diodes are two-lead or surface mount components that allow electric current to flow in only one direction. They are used in a variety of electronic applications, including signal processing and direction of current. All products are available in traditional leaded as well as surface mount (chip) packages. Diodes sold include:

Circuit Protection Devices- Our circuit protection devices include transient voltage suppressors and metal oxide varistors, which protect circuits against switching, lightning surges and other uncontrolled power surges and/or interruptions in circuits. Transient voltage suppressors, which offer a higher level of protection for the circuit, are required in telecommunication products and are typically higher priced products than the metal oxide varistors, which are more economically priced and are used in consumer products. All products are available in traditional leaded as well as surface mount (chip) packages.

Audible Components- These include audible transducers, Piezo buzzers, speakers, and microphones, which produce an audible sound for, and are used in back-up power supplies for computers, alarms, appliances, smoke detectors, automobiles, telephones and other products which produce sounds. Challenge has initiated marketing relationships with certain Asian manufacturers of audible components to sell these products worldwide. All products are available in traditional leaded as well as surface mount (chip) packages.

New Products- We periodically introduce new products, which are intended to complement our existing product lines. These products are ones that are commonly used in the same circuit designs as other of the products that we sell and will further provide a one- stop-shop for the customer. Some of these products are common items used in all applications and others are niche items with a focus towards a particular application. These new products include fuses, printed circuit boards and switches. All products are available in traditional leaded as well as surface mount (chip) versions.

Inventory

In order to adequately service our customers' needs, we believe that it is necessary to maintain large inventories, which makes us more susceptible to price and technology changes. At any given time, we attempt to maintain a one-to-two month inventory on certain products in high demand for customers and at least one month for other products. Our inventory currently contains more than 100 million component units consisting of more than 3,000 different part numbers. The products that we sell range in sales price from less than one cent for a commercial diode to more than $2.00 for high power capacitors and semiconductors. As of November 30, 2015, we maintained inventory valued at $3,199,463.

Because of the experience of our management, including Ira Levy and Steven Lubman, we believe that we know the best prices to buy the products we sell and as a result we generally waive rights to manufacturers' inventory protection agreements (including price protection and inventory return rights), and thereby bear the risk of increases in the prices charged by our manufacturers and decreases in the prices of products held in our inventory or covered by purchase commitments. If prices of components, which we hold in inventory decline, or if new technology is developed that displaces products that we sell, our business could be materially adversely affected. The Company has experienced very little impact from customer design changes and slowdown but this can potentially increase due to economic conditions and customer-specific business conditions. If our customers experience these changes, our business could be adversely affected.

Product Availability

Surge obtains substantially all of its products from manufacturers in Asia, while Challenge historically purchases its products both domestically and from Asia. However, in Fiscal 2015 and Fiscal 2014, Challenge purchased approximately 95% and 93%, respectively, of its products overseas as a result of Challenge's introduction of new product lines. Of the total goods purchased by Surge and Challenge in Fiscal 2015, those foreign manufactured products were supplied from manufacturers in Taiwan (58%), Hong Kong (9%), elsewhere in Asia (29%) and overseas outside of Asia (less than 1%). The Company purchases its products from approximately sixteen different manufacturers.

Most of the facilities that manufacture products for Surge have obtained International Quality Standard ISO 9002 and other certifications. We typically purchase the products that we sell in United States currency in order to minimize the risk of currency fluctuations. In most cases, Surge utilizes two or more alternative sources of supply for each of its products with one primary and one complementary supplier for each product. Surge's relationships with many of its suppliers date back to the commencement of our import operations in 1983. We have established payment terms with our manufacturers of between 30 and 60 day open account terms.

We only have one agreement with a supplier, Lelon Electronics, which is terminable by either party upon six months notice to the other party. We have an agreement to act as the sales agent in North America for one of our manufacturers, Lelon Electronics. While we believe that we have established close working relationships with our principal manufacturers, our success depends, in large part, on maintaining these relationships and developing new supplier relationships for our existing and future product lines. Because of the lack of long- term contracts, we may not be able to maintain these relationships.

For Fiscal 2015 and Fiscal 2014, one of Surge's vendors, Lelon Electronics, accounted for approximately 56% and 49% of Surge's consolidated purchases. The loss of or a significant disruption in the relationship with Lelon Electronics, which is our major supplier, could have a material adverse effect on our business and results of operations until a suitable replacement could be obtained.

The Company has a written agreement with Lelon Electronics regarding the supply of inventory for the Company’s customers. The Company purchases products under both the Company’s name and Lelon’s brand name for the Company’s inventory in order to supply the Company’s customers. For the majority of purchases from Lelon Electronics, the Company takes title to the products, houses them in the Company’s warehouse and sells directly to the Company’s customers. There is no right of return on the products purchased from Lelon and the Company accepts all credit risk with regards to sales of these products.

The components business has, from time to time, experienced periods of shortages in product supply, usually as the result of demand exceeding available supply. When these shortages occur, suppliers tend to either increase prices and or reduce the number of units sold to given customers. Should there be shortages in the future, such shortages may benefit our business if we get preferential supply from our manufacturers. It could also have an adverse effect upon our business, in the case that our manufacturers don’t have enough capacity to provide enough components. Conversely, due to poor market demand, there could be an excess of components in the market, causing stronger competition and an erosion of prices. Currently, demand in the industry is down regarding product availability for customers in most market segments.

Marketing and Sales

Surge's sales efforts are directed towards Original Equipment Manufacturer (OEM) customers in numerous industries where the products that we sell have wide application. Surge currently employs ten sales and marketing personnel, not including two of its executive officers, who are responsible for certain key customer relationships.

We use independent sales representatives or organizations, which often specialize in specific products and areas and have specific knowledge of and contacts in particular markets. As of November 30, 2015, we had representation agreements with approximately 30 sales representative organizations. Sales representative organizations, which are generally paid a 5% commission on net sales, are generally responsible in their respective geographic markets for identifying customers and soliciting customer orders. Pursuant to arrangements with our independent sales representatives, they are permitted to represent other electronics manufacturers, but are generally prohibited from carrying a line of products competitive with the products that we sell. These arrangements can be terminated on written notice by either party or if breached by either party. These organizations normally employ between one and twelve sales representatives. The individual sales representatives employed by the sales organizations generally possess an expertise which enhances the scope of our marketing and sales efforts. This permits us to avoid the significant costs associated with creating a direct marketing network. We have had relationships with certain sales organizations since 1988 and continue to engage new sales organizations as needed. We believe that additional sales organizations and representatives are available to us, if required.

We have initiated a formal national distribution program to attract more distributors to promote the products that we sell. We expect this market segment to contribute significantly to our sales growth over time.

Many customers require their suppliers to have a local presence and Surge's network of independent sales representatives are responsive to these needs. Surge formed a Hong Kong corporation, Surge Components, Limited and hired a regional sales manager to service the Hong Kong/Greater China region customers.

Other marketing efforts include generation and distribution of catalogs and brochures of the products we sell and attendance at trade shows. We have produced an exhibit for display at electronics trade shows throughout the year. The products that we sell have been exhibited at the electronic distribution show in Las Vegas, and we intend to continue our commitment and focus on the distribution segment of the industry by our visibility at the Electronic Distributor Trade Show. In addition, we have updated our website to make it more informative and user friendly. Our search engines have been improved so that customers can find us more easily and we have developed a new portal system to help with lead management and disbursement.

Customers

The products that we sell are sold to distributors and OEMs in such diverse industries as the automotive, computer, communications, cellular telephones, consumer electronics, garage door openers, security equipment, audio equipment, telecomm products, computer related products, power supply products, utility meters and household appliances industries. We request our distributors to provide point of sales reporting, which enables us to gain knowledge of the breakdown of industries into which the products that we sell are sold. One of our customers, TTI, accounted for 17% of net sales for Fiscal 2015 and 8% of net sales for Fiscal 2014. Our discrete components are often sold to the same clients as our capacitors. These OEM customers typically accept samples for evaluation and, if approved, we work towards procuring the next orders for these items.

Typically, we do not maintain contracts with our customers and generally sell products pursuant to customer purchase orders. Although our customer base has increased, the loss of our largest customers as well as, to a lesser extent, the loss of any other material customer, could have a materially adverse effect on our operations during the short-term until we are able to generate replacement business, although we may not be able to obtain such replacement business. Because of our contracts and good working relationships with our distributors, we offer the OEMs, when purchasing through distributors, extended payment terms, just-in- time deliveries and one-stop shopping for many types of electronic products.

Competition

We conduct business in the highly competitive electronic components industry. We expect this industry to remain competitive. We face intense competition in both our selling efforts and purchasing efforts from the many companies that manufacture or distribute electronic components. Our principal competitors in the sale of capacitors include Nichicon, Panasonic, Illinois Capacitor, NIC, AVX, Murata, Epcos, United Chemicon, Rubycon, Vishay and Kemet. Our principal competitors in the sale of discrete components include Vishay, General Semiconductor Division, General Instrument Corp., OnSemi, Inc., Microsemi Corp., Diodes, Inc. and Littlefuse, and Copper Bussman Division. Our principal competition in the audible business include AVX, Murata, Panasonic, Projects Unlimited, International Components Corp. and Star Micronics. Many of these companies are well established with substantial expertise, and have much greater assets and greater financial, marketing, personnel, and other resources than we do. Many larger competing suppliers also carry product lines which we do not carry. Generally, large semiconductor manufacturers and distributors do not focus their direct selling efforts on small to medium sized OEMs and distributors, which constitute many of our customers. As our customers become larger, and as the market becomes more competitive, our competitors may find it beneficial to focus direct selling efforts on those customers, which could result in our facing increased competition, the loss of customers or pressure on our profit margins. We are finding increased competition from manufacturers located in Asia due to the increased globalization nature of the business. There can be no assurance that we will be able to continue to compete effectively with existing or potential competitors. Other factors that will affect our success in these markets include our continued ability to attract additional experienced marketing, sales and management talent, and our ability to expand our support, training and field service capabilities. Additionally, since the tsunami and earthquake in Japan in 2012, our competitors have established manufacturing facilities in China enabling them to be more competitive by lowering their labor rates and manufacturing costs. Also, as the world continues to become global and customers have easier access to suppliers in Asia, our business could be adversely affected since foreign suppliers are traveling to the United States and interacting with customers more often, where previously they communicated via long-distance. Also, the internet enables customers to meet and interact with suppliers through Google and other search engines which customers had not previously done.

Customer Service

We have customer service employees whose time is dedicated largely to responding to customer inquiries such as price quote requests, delivery status of new or existing purchase orders, changes of existing order dates, quantities, dates, etc. We intend to increase our customer service capabilities, as necessary.

Foreign Trade Regulation

Most products sold by Surge are manufactured in Asia, including such countries as Taiwan, South Korea, Hong Kong, India, Japan and China. The purchase of goods manufactured in foreign countries is subject to a number of risks, including economic disruptions, transportation delays and interruptions, foreign exchange rate fluctuations, impositions of tariffs and import and export controls, and changes in governmental policies, any of which could have a material adverse effect on our business and results of operations. Potential concerns may include drastic devaluation of currencies, loss of supplies and increased competition within the region.

From time to time, protectionist pressures have influenced United States trade policy concerning the imposition of significant duties or other trade restrictions upon foreign products. We cannot predict whether additional United States customs quotas, duties, taxes or other charges or restrictions will be imposed upon the importation of foreign components in the future or what effect such actions could have on our business, financial condition or results of operations.

Our ability to remain competitive with respect to the pricing of imported components could be adversely affected by increases in tariffs or duties, changes in trade treaties, strikes in air or sea transportation, and possible future United States legislation with respect to pricing and import quotas on products from foreign countries. Our ability to remain competitive could also be affected by other governmental actions related to, among other things, anti-dumping legislation and international currency fluctuations. While we do not believe that any of these factors adversely impact our business at the present time, there can be no assurance that these factors will not materially adversely affect us in the future. Any significant disruption in the delivery of merchandise from our suppliers, substantially all of whom are foreign, could have a materially adverse impact on our business and results of operations.

Government Regulation

Various laws and regulations relating to safe working conditions, including the Occupational Safety and Health Act, are applicable to our company. We believe we are in substantial compliance with all material federal, state and local laws and regulations regarding safe working conditions. We believe that the cost of compliance with such governmental regulations is not material.

We are subject to the United States Foreign Corrupt Practices Act, which generally prohibits United States companies from engaging in bribery or other prohibited payments to foreign officials for the purpose of obtaining or retaining business. Foreign companies, including some that may compete with us, are not subject to these prohibitions. If our employees or other agents are found to have engaged in such practices, we could suffer severe penalties and other consequences that may have a material adverse effect on our business, financial condition and results of operations. To the Company’s knowledge, none of our employees or other agents have engaged in such practices.

Environmental and Regulatory Compliance

We are subject to various environmental laws and regulations relating to the protection of the environment, including those governing the handling and management of certain chemicals used in electronic components.

We do not believe that compliance with these laws and regulations will have a material adverse effect on our capital expenditures, earnings, or competitive position.

Patents, Trademarks and Proprietary Information

With respect to the products that we sell, we have no patents, trademarks or copyrights registered in the United States Patent and Trademark Office or in any state. Additionally to the best of our knowledge the manufacturers of the products that we sell do not have patents, trademarks or copyrights registered in the United States Patent and Trademark Officer or in any state. We rely on the know-how, experience and capabilities of our management personnel. Although we believe that the products do not and will not infringe patents or trademarks, or violate proprietary rights of others, it is possible that infringement of existing or future patents, trademarks or proprietary rights of others may occur. In the event that the products that we sell infringe proprietary rights of others, these products may have to be modified or redesigned by the manufacturer of these products. However, there can be no assurance that any infringing products will be able to be modified or redesigned in a way that does not infringe on the proprietary rights of others, which could have a material adverse effect upon our operations. In addition, there can be no assurance that we will have the financial or other resources necessary to enforce or defend a patent infringement or proprietary rights violation action. Moreover, if the products we sell infringe patents, trademarks or proprietary rights of others, we could, under certain circumstances, become liable for damages, which also could have a material adverse effect on our business.

Backlog

As of November 30, 2015, our backlog was approximately $5,762,331, as compared with $6,353,521 at November 30, 2014. Substantially all backlog is expected to be shipped by us within 90 to 180 days. Year to year comparisons of backlog are not necessarily indicative of future operating results.

Employees

As of November 30, 2015, Surge and Challenge employed 33 persons, two of whom are employed in executive capacities, ten are engaged in sales, three in engineering, three in purchasing, three in administrative capacities, five in customer service, two in accounting and five in warehousing. None of our employees is covered by a collective bargaining agreement, and we consider our relationship with our employees to be good.

Item 1A. Risk Factors

An investment in our common stock involves a high degree of risk. An investor should carefully consider the risks described below as well as other information contained in this annual report on Form 10-K. If any of the following risks actually occur, our business, financial condition or results of operations could be materially adversely affected, the value of our common stock could decline, and an investor may lose all or part of his or her investment.

Risks Related to our Business

We have an agreement with only one of our suppliers and we depend on a limited number of suppliers

We have an agreement with only one of our suppliers (Lelon Electronics), which agreement is terminable by either party upon notice to the other party. Lelon Electronics accounted for approximately 56% and 49% of the Company's consolidated purchases. We also act as the exclusive sales agent in North America for Lelon Electronics. While we believe that we have established close working relationships with our principal suppliers, our success depends, in large part, on maintaining these relationships and developing new supplier relationships for our existing and future product lines. There is no assurance that we will be able to maintain these relationships. While we believe that there are alternative semiconductor and capacitor suppliers whose replacement products may be acceptable to our customers, the loss of, or a significant disruption in the relationship with, one or more of our major suppliers would likely have a material adverse effect on our business and results of operations.

We need to maintain large inventories in order to succeed and as a result, price fluctuations could harm us.

In order to adequately service our customers, we believe that it is necessary to maintain a large inventory of products. Accordingly, we attempt to maintain a one-to-two month inventory of those products which we supply to our customers. As a result of our strategic inventory purchasing policies, under which we order products to obtain preferential pricing, we generally waive the right to manufacturers' inventory protection agreements (including price protection and inventory return rights). As a result, we bear the risk of increases in the prices charged by our manufacturers to the Company and decreases in the prices we are able to charge our customers. If prices of components which we hold in inventory decline or if new technology is developed that displaces products which we sell, our business could be materially adversely affected. Typically the Company has experienced very little impact from customer design changes and slowdown but this can potentially increase due to economic conditions and specific customers business conditions. If our customers experience these changes, our business could be adversely affected.

Our operations would be adverse effected if we lose certain of our customers.

For Fiscal 2015, approximately 17% of our net sales were derived from sales to one customer. Although our customer base has increased, the loss of our largest customers as well as, to a lesser extent, the loss of any other material customer, would be expected to have a materially adverse effect on our operations until we are able to generate replacement business, although we may not be able to obtain such replacement business.

We may not be able to compete against large competitors who have better resources.

We face intense competition, in both our selling efforts and purchasing efforts, from the many companies that manufacture or distribute electronic components and semiconductors. Our principal competitors in the sale of capacitors include Nichicon, Panasonic, Illinois Capacitor, NIC, AVX, Murata, Epcos, United Chemicon, Rubycon, Vishay and Kemet, General Semiconductor Division, General Instrument Corp., OnSemi, Inc., Microsemi Corp., Diodes, Inc. and Littlefuse, and Copper Bussman Division. Many of these companies are well established with substantial expertise, and have much greater assets and greater financial, marketing, personnel, and other resources than we do. Many larger competing suppliers also carry product lines which we do not carry. Generally, large semiconductor manufacturers and distributors do not focus their direct selling efforts on small to medium sized OEMs and distributors, which constitute most of our customers. As our customers become larger, however, our competitors may find it beneficial to focus direct selling efforts on those customers, which could result in our facing increased competition, the loss of customers or pressure on our profit margins. There can be no assurance that we will be able to continue to compete effectively with existing or potential competitors.

Our business will be adversely affected if there is a shortage of components.

The components business has, from time to time, experienced periods of extreme shortages in product supply, generally as the result of demand exceeding available supply. When these shortages occur, suppliers tend to either increase prices or reduce the number of units sold to customers. We believe that because of our large inventory and our relationships with our manufacturers, we have not been adversely affected by shortages in certain discrete semiconductor components. However, in the future shortages may have an adverse effect upon our business especially if we were to reduce inventory to cut costs and reduce risks of obsolescence.

Our success depends on key personnel whose continued service is not guaranteed.

Our continued success and our ability to manage anticipated future growth depend, in large part, upon the efforts of key personnel, particularly Ira Levy and Steven Lubman, our chief executive officer and vice president, respectively, who have extensive industry knowledge and relationships and exercise substantial influence over our operations. The loss of services of one or both of these individuals, or our inability to attract and retain highly qualified personnel, could adversely affect our business, and weaken our relationships with su Cash Non-Cash Reversal Balance Dec. 31, 2004 Charges Payments Write-Off of Charges March 31, 2005

Termination payments and other employee costs	$20.7	$6.8	$(11.0)	$	$(0.2)	$16.3
Asset impairments		10.4		(10.4)		
Other	2.8	3.2	(1.2)	(2.2)		2.6
	$23.5	$20.4	$(12.2)	$(12.6)	$(0.2)	$18.9

The operational consolidation reserve balance at the end of December 31, 2004 consisted of $19.2 million related to plans initiated in 2004 and $4.3 million related to plans from 2003. During 2004 the Company incurred charges related to operational consolidation activities in each of its businesses as more fully described in our Form 10-K for the year ended December 31, 2004. The total cost of the 2004 actions was $46.4 million and included the elimination of 1,695 jobs.

In the first quarter of 2005, the Company recorded $20.4 million of operational consolidation expenses, $16.8 million was included in cost of sales and $3.6 million was included in selling and administrative expenses. $14.7 million related to 2005 programs and $5.7 related to programs that were initiated in 2004 as detailed below. In addition, the Company recorded a $0.2 million operational consolidation benefit in 2005 associated with the reversal of severance associated with a Bath and Kitchen plan initiated in 2003.

As part of continuing efforts to rationalize manufacturing capabilities and respond to changing market conditions, Air Conditioning decided to seek a buyer for its Rockingham, NC manufacturing facility and to close the facility by the end of the third quarter of 2005, if no buyer is found. Air Conditioning incurred $12.8 million of operational consolidation expenses during the three months ended March 31, 2005. $10.4 million of this amount was for the impairment of goodwill and other long-lived assets and $0.1 million was for severance. The balance of the $2.3 million charge was associated with a plan to transfer production to a lower cost facility in North America and salaried severance. Air Conditioning expects to incur an additional $2 million during 2005 to complete the Rockingham plan. Air Conditioning expended $2.4 million of cash on operational consolidation activities in the first quarter of 2005 of which $1.4 million related to plans initiated in 2005 and $1.0 million related to prior period plans.

Bath and Kitchen incurred $3.9 million of operational consolidation expenses during the three months ended March 31, 2005, $1.7 million associated with job eliminations and $2.2 million related to the reorganization of an administrative process that took place in 2004. Bath and Kitchen expended $5.6 million of cash on operational consolidation activities in the first quarter of 2005 of which $0.7 million related to plans initiated in 2005 and $4.9 million related to prior period plans.

The Vehicle Controls business incurred $3.7 million of operational consolidation expenses during the three months ended March 31, 2005 associated with the continued relocation of a plant to a lower cost location and other job elimination programs each of which were initiated in 2004.

Vehicle Controls expects to incur $5.9 million during 2005 to complete the plans outstanding mentioned above. Vehicle Controls expended $4.2 million of cash on operational consolidation activities in the first quarter of 2005 of which $0.2 million related to plans initiated in 2005 and $4 million related to prior period plans.

The Company expects that essentially all of the $18.9 million balance as of March 31, 2005 will be utilized by the end of 2005. The accrued termination payments and other employee costs are for severance and other related payments expected to be made after termination.

Note 9. Post-retirement Benefits

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

	Three Months Ended March 31,			
	2005	2005	2004	2004
(Dollars in millions)	Pension Benefits	Health & Life Ins. Benefits	Pension Benefits	Health & Life Ins. Benefits
Service cost-benefits earned during the period	$ 13.8	$ 2.2	$ 12.5	$ 2.5
Interest cost on the projected benefit obligation	20.5	4.4	21.2	4.8
Less assumed return on plan assets	(18.5)		(15.4)	
Amortization of prior service cost	1.5	(1.1)	1.6	(1.1)
Amortization of net (gain) loss	3.3	1.7	3.3	2.1
Defined benefit plan cost	$ 20.6	$ 7.2	$ 23.2	$ 8.3
Accretion expense reflected in Other expense (income)	$ 2.0	$ 4.4	$ 5.8	$ 4.8

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

The Company expects to contribute $53 million to the domestic pension plans and $25 million to non-U.S. plans in 2005. In the first quarter of 2005, $6.2 million was contributed to foreign plans and $0.3 million was contributed to domestic plans.

In May 2004, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. SFAS 106-2, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003* which addresses the accounting and disclosures required as a result of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) enacted on December 8, 2003. The Act introduces a prescription drug benefit under Medicare as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least equivalent to Medicare. Provisions of the Act will provide eligible plan sponsors with a subsidy that the Company expects to use to decrease the benefit obligation and net post-retirement benefit cost of its plans. Under the FSP, which was effective for the Company in the third quarter of 2004, the decrease in the benefit obligation upon initial adoption was accounted for as an actuarial gain of $0.1 million.

Table of Contents

Note 10. Supplemental Consolidating Condensed Financial Information

All of the Company s Senior Notes were issued by its 100%-owned subsidiary, American Standard Inc. (ASI). American Standard Companies Inc. (the Parent Company) and American Standard International Inc. (ASII) fully and unconditionally guarantee the payment obligations under these securities (the Company s Public Debt). In lieu of providing separate financial statements for ASI, the Company has included the accompanying consolidating condensed financial information. The following supplemental financial information sets forth, on a consolidating basis, unaudited statements of income and unaudited statements of cash flows for the three months ended March 31, 2005 and 2004, and unaudited balance sheets as of March 31, 2005 and December 31, 2004 for the Parent Company, ASI, ASII and the subsidiaries of the Parent Company which are not subsidiaries of ASI or ASII (the Other Subsidiaries). None of the Other Subsidiaries guarantees the Public Debt of ASI. The equity method of accounting is used to reflect investments of the Parent Company in ASI and Other Subsidiaries.

CONSOLIDATING CONDENSED STATEMENTS OF INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2005

(Dollars in millions)	Parent Company	ASI	ASII	Other Subsidiaries	Eliminations	Consolidated Total
Sales	$	$ 1,138.6	$ 1,315.7	$ 3.2	$ (117.2)	$ 2,340.3
Costs and expenses and other expense:						
Cost of sales		835.3	1,005.2	3.1	(117.2)	1,726.4
Selling and administrative expenses		243.3	207.8	(0.9)		450.2
Other expense		28.2	(20.8)	(0.4)		7.0
Interest expense		27.4	2.2			29.6
Intercompany interest expense (income)		2.5	(2.5)			
Total expenses		1,136.7	1,191.9	1.8	(117.2)	2,213.2
Income before income taxes and equity in net income of consolidated subsidiaries		1.9	123.8	1.4		127.1
Income taxes		(11.4)	13.6			2.2
Income before equity in net income of consolidated subsidiaries		13.3	110.2	1.4		124.9
Equity in net income of consolidated subsidiaries	124.9				(124.9)	
Net income	$ 124.9	$ 13.3	$ 110.2	$ 1.4	$ (124.9)	$ 124.9

Table of Contents

Note 10. Supplemental Consolidating Condensed Financial Information (continued)

CONSOLIDATING CONDENSED BALANCE SHEETS
AS OF MARCH 31, 2005

(Dollars in millions)	Parent Company	ASI	ASII	Other Subsidiaries	Eliminations	Consolidated Total
ASSETS						
Current assets:						
Cash and cash equivalents	$ 0.4	$ 12.6	$ 223.7	$ 3.4	$	$ 240.1
Accounts receivable, net		472.6	690.1	29.0		1,191.7
Inventories		595.9	620.2			1,216.1
Proceeds due from debt commitment		198.2				198.2
Other current assets		146.3	284.3	10.5		441.1
Total current assets	0.4	1,425.6	1,818.3	42.9		3,287.2
Facilities, net		575.1	1,003.7			1,578.8
Goodwill, net		102.8	1,034.4			1,137.2
Investment in subsidiaries	1,975.5				(1,975.5)	
Long-term asbestos indemnity receivable		366.0				366.0
Other assets		543.2	200.1	22.2		765.5
Total assets	$ 1,975.9	$ 3,012.7	$ 4,056.5	$ 65.1	$ (1,975.5)	$ 7,134.7
LIABILITIES AND SHAREHOLDERS (DEFICIT) EQUITY						
Current liabilities:						
Loans payable to banks	$	$ 95.0	$ 20.2	$	$	$ 115.2
Current maturities of long-term debt		1.6	0.9			2.5
Obligation to fund debt commitment		198.2				198.2
Other current liabilities		875.2	1,332.2	16.8		2,224.2
Total current liabilities		1,170.0	1,353.3	16.8		2,540.1
Long-term debt		1,527.1	107.1			1,634.2
Reserve for post-retirement benefits		281.6	446.9			728.5
Intercompany accounts, net	1,107.1	142.8	(1,140.7)	(109.2)		
Long-term portion of asbestos indemnity liability		680.1				680.1

Other long-term liabilities		348.9	198.4	135.7		683.0
Total liabilities	1,107.1	4,150.5	965.0	43.3		6,265.9
Total shareholders equity (deficit)	868.8	(1,137.8)	3,091.5	21.8	(1,975.5)	868.8
Total liabilities and shareholders equity (deficit)	$ 1,975.9	$ 3,012.7	$ 4,056.5	$ 65.1	$ (1,975.5)	$ 7,134.7

17

Table of Contents

Note 10. Supplemental Consolidating Condensed Financial Information (continued)

CONSOLIDATING CONDENSED STATEMENTS OF CASH FLOW
FOR THE THREE MONTHS ENDED MARCH 31, 2005

(Dollars in millions)	Parent Company	ASI	ASII	Other Subsidiaries	Eliminations	Consolidated Total
Cash provided (used) by:						
Operating activities:						
Net income	$ 124.9	$ 13.3	$ 110.2	$ 1.4	$ (124.9)	$ 124.9
Adjustments to reconcile net income to net cash provided by operations:						
Depreciation and amortization		27.2	42.3			69.5
Equity in earnings of affiliates, net of dividends received		(4.8)	(2.5)			(7.3)
Non-cash stock compensation		15.8				15.8
Gain on sale of property, plant and equipment		0.1	(1.4)			(1.3)
Equity in net income of subsidiary	(124.9)				124.9	
Changes in assets and liabilities:						
Accounts receivable		1.1	(51.7)	(1.9)		(52.5)
Inventories		(102.2)	(43.3)			(145.5)
Accounts payable		44.4	(13.8)	(0.1)		30.5
Other accrued liabilities		63.0	98.0	(6.1)		154.9
Post-retirement benefits		6.2	1.4			7.6
Net asbestos indemnity liability		2.4				2.4
Other long-term liabilities		18.8	(43.7)	4.3		(20.6)
Other assets		(155.0)	(78.7)	5.3		(228.4)
Net cash provided by operating activities		(69.7)	16.8	2.9		(50.0)
Investing activities:						
Purchase of property, plant and equipment		(22.7)	(21.0)			(43.7)
Investments in affiliated companies			(7.9)			(7.9)
Investments in computer software		(5.9)	(4.2)			(10.1)

Loan to unconsolidated joint venture, net		(1.9)				(1.9)
Proceeds from the disposal of property/equipment		3.1	2.1			5.2
Other		(0.4)				(0.4)
Net cash used by investing activities		(27.8)	(31.0)			(58.8)
Financing activities:						
Proceeds from issuance of long-term debt			0.4			0.4
Repayments of long-term debt			(0.5)			(0.5)
Net change in revolving credit facility		174.0	61.1			235.1
Net change in other short-term debt		44.0	(5.4)			38.6
Purchases of treasury stock	(140.3)					(140.3)
Dividend payments	(32.1)					(32.1)
Net change in intercompany accounts	155.2	(102.1)	(50.8)	(2.3)		
Proceeds from exercise of stock options	15.7					15.7
Proceeds from foreign exchange forward contracts		0.2				0.2
Other common stock issued or reacquired, net	1.8	2.6				4.4
Net cash used by financing activities	0.3	118.7	4.8	(2.3)		121.5
Effect of exchange rate changes on cash and cash equivalents			(2.0)			(2.0)
Net increase (decrease) in cash and cash equivalents	0.3	21.2	(11.4)	0.6		10.7
Cash and cash equivalents at beginning of year	0.1	(8.6)	235.1	2.8		229.4
Cash and cash equivalents at end of year	$ 0.4	$ 12.6	$ 223.7	$ 3.4	$	$ 240.1

Table of Contents

Note 10. Supplemental Consolidating Condensed Financial Information (continued)

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

(Dollars in millions)	Parent Company	ASI	ASII	Other Subsidiaries	Eliminations	Consolidated Total
Sales	$	$ 1,094.4	$ 1,200.7	$ 2.5	$ (112.6)	$ 2,185.0
Costs and expenses and other expense:						
Cost of sales		807.9	898.3	1.8	(112.6)	1,595.4
Selling and administrative expenses		222.6	198.2			420.8
Other expense		14.8	2.1			16.9
Interest expense		25.8	3.5			29.3
Intercompany interest expense (income)		1.6	(1.6)			
Total expenses		1,072.7	1,100.5	1.8	(112.6)	2,062.4
Income before income taxes and equity in net income of consolidated subsidiaries		21.7	100.2	0.7		122.6
Income taxes		8.6	27.4	2.0		38.0
Income before equity in net income of consolidated subsidiaries		13.1	72.8	(1.3)		84.6
Equity in net income of consolidated subsidiaries	84.6				(84.6)	
Net income	$ 84.6	$ 13.1	$ 72.8	$ (1.3)	$ (84.6)	$ 84.6

19

Table of Contents

Note 10. Supplemental Consolidating Condensed Financial Information (continued)

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

(Dollars in millions)	Parent Company	ASI	ASII	Other Subsidiaries	Eliminations	Consolidated Total
Cash provided (used) by:						
Operating activities:						
Net income	$ 84.6	$ 13.1	$ 72.8	$ (1.3)	$ (84.6)	$ 84.6
Adjustments to reconcile net income to net cash provided (used) by operations:						
Depreciation and amortization		23.9	39.4			63.3
Equity in earnings of affiliates, net of dividends received		(3.5)	(1.9)			(5.4)
Non-cash stock compensation		14.9				14.9
Equity in net income of subsidiaries	(84.6)				84.6	
Other		(0.3)				(0.3)
Changes in assets and liabilities:						
Accounts receivable		19.6	(141.4)	1.3		(120.5)
Inventories		(49.4)	(47.0)			(96.4)
Accounts payable		82.0	43.7	0.4		126.1
Other accrued liabilities and taxes		19.7	(56.2)	(2.9)		(39.4)
Post-retirement benefits		11.4	1.9			13.3
Net asbestos indemnity liability		(2.8)				(2.8)
Other current and long-term assets		2.9	12.4	(22.6)		(7.3)
Other long-term liabilities		5.2	2.5	1.0		8.7
Net cash provided (used) by operating activities		136.7	(73.8)	(24.1)		38.8
Investing activities:						
Purchase of property, plant and equipment		(9.2)	(17.2)			(26.4)
Investments in computer software		(6.6)	(5.1)			(11.7)
		(23.4)				(23.4)

Loan to unconsolidated joint venture, net						
Net cash used by investing activities		(39.2)	(22.3)			(61.5)
Financing activities:						
Proceeds from issuance of long-term debt			0.1			0.1
Repayments of long-term debt			(0.2)			(0.2)
Net change in revolving credit facility		119.0	(5.2)			113.8
Net change in other short-term debt		75.0	38.8			113.8
Purchases of treasury stock	(143.4)					(143.4)
Net change in intercompany accounts	130.3	(224.6)	69.7	24.6		
Proceeds from exercise of stock options	12.0					12.0
Proceeds from settlement of foreign exchange forward contracts		4.7				4.7
Other	1.5	0.7				2.2
Net cash used by financing activities	0.4	(25.2)	103.2	24.6		103.0
Effect of exchange rate changes on cash and cash equivalents			0.3			0.3
Net increase (decrease) in cash and cash equivalents	0.4	72.3	7.4	0.5		80.6
Cash and cash equivalents at beginning of year	0.1	(70.4)	179.5	2.5		111.7
Cash and cash equivalents at end of year	$ 0.5	$ 1.9	$ 186.9	$ 3.0	$	$ 192.3

Note 10. Supplemental Consolidating Condensed Financial Information (continued)

CONSOLIDATING CONDENSED BALANCE SHEETS AS OF DECEMBER 31, 2004

(Dollars in millions)	Parent Company	ASI	ASII	Other Subsidiaries	Eliminations	Consolidated Total
ASSETS						
Current assets:						
Cash and cash equivalents	$ 0.1	$ (8.6)	$ 235.1	$ 2.8	$	$ 229.4
Accounts receivable, net		473.2	654.2	27.1		1,154.5
Inventories		493.6	593.6			1,087.2
Other current assets		236.8	167.7	14.2		418.7
Total current assets	0.1	1,195.0	1,650.6	44.1		2,889.8
Facilities, net		570.6	1,046.0			1,616.6
Goodwill, net		107.2	1,074.8			1,182.0
Investment in subsidiaries	1,871.3				(1,871.3)	
Long-term asbestos indemnity receivable		365.1				365.1
Other assets		519.0	245.4	23.9		788.3
Total assets	$ 1,871.4	$ 2,756.9	$ 4,016.8	$ 68.0	$ (1,871.3)	$ 6,841.8
LIABILITIES AND SHAREHOLDERS (DEFICIT) EQUITY						
Current liabilities:						
Loans payable to banks	$	$ 51.0	$ 25.6	$	$	$ 76.6
Current maturities of long-term debt		1.6	0.6			2.2
Other current liabilities		963.1	1,281.7	23.1		2,267.9
Total current liabilities		1,015.7	1,307.9	23.1		2,346.7
Long-term debt		1,379.5	49.6			1,429.1
Reserve for post-retirement benefits		275.5	468.6			744.1
Intercompany accounts, net	941.1	235.4	(1,082.8)	(93.7)		
Long-term portion of asbestos indemnity liability		683.4				683.4
Other long-term liabilities		323.5	253.4	131.3		708.2
Total liabilities	941.1	3,913.0	996.7	60.7		5,911.5
Total shareholders equity (deficit)	930.3	(1,156.1)	3,020.1	7.3	(1,871.3)	930.3

Total liabilities and shareholders equity (deficit)	$ 1,871.4	$ 2,756.9	$ 4,016.8	$ 68.0	$ (1,871.3)	$ 6,841.8

Table of Contents

Note 11. Debt

On March 29, 2005 the Company executed an agreement with several purchasers to sell senior notes with a principal amount of $200 million with a maturity date of April 1, 2015. The commitment to sell these notes is reflected in other current liabilities and the expected proceeds from the commitment are reflected in other current assets in the accompanying consolidated balance sheet. The senior notes associated with this commitment were issued on April 1, 2005 and resulted in proceeds to the Company of $198.2 million. The senior notes bear an interest rate of 5 1/2% and interest is payable semi-annually on April 1 and October 1 of each year. The Company, at its option, may at any time and from time to time redeem all or a portion of the senior notes for an amount equal to the principal amount of the notes redeemed plus a make whole premium. The proceeds from the issuance of the notes were used to repay the majority of the $208 million of 7 3/8% senior notes that matured on April 15, 2005.

Table of Contents

Note 12. Segment Data

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

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Sales:		
Air Conditioning Systems and Services	$ 1,257.2	$ 1,163.3
Bath and Kitchen	604.1	601.4
Vehicle Control Systems	479.0	420.3
Total sales	$ 2,340.3	$ 2,185.0
Segment income:		
Air Conditioning Systems and Services	$ 87.6	$ 93.0
Bath and Kitchen	44.8	50.3
Vehicle Control Systems	69.7	58.9
Total segment income	202.1	202.2
Equity in net income of unconsolidated joint ventures	7.8	6.5
	209.9	208.7
Interest expense	29.6	29.3
Corporate and other expenses	53.2	56.8
Income before income taxes	127.1	122.6
Income taxes	2.2	38.0
Net income applicable to common shares	$ 124.9	$ 84.6

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

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

Financial Results Overview

Sales, net income and earnings per diluted share in the first quarter of 2005 all increased when compared to the first quarter of 2004. Earnings were $.57 per diluted share, up 50% from $.38 per diluted share a year ago. Sales were $2.340 billion, up 7% from $2.185 billion a year ago. Net income rose to $124.9 million from $84.6 million, up 48%. The Company benefited from volume increases, improved pricing and productivity improvements and the benefits from prior operational consolidations which were partially offset by continued commodity cost escalations and short term production issues affecting Bath and Kitchen in Europe. The Company continued to invest in marketing and new product development. Net income in the first quarter of 2005 included benefits of $36.4 million associated with the resolution of tax contingencies and the impact of certain non-U.S. tax planning initiatives on prior tax years. Net income in the quarter included $20.4 million of operational consolidation expenses ($14.8 million net of $5.6 million of tax benefits), see Note 8 of Notes to Financial Statements. The following discussion and

Table of Contents

analysis addresses year-over-year changes in the line items shown in the Summary Segment and Income Statement Data in Note 13 of Notes to Financial Statements. Approximately half of the Company s business is outside the U.S., therefore changes in exchange rates can have a significant effect on results of operations when presented in U.S. dollars. Year-over-year changes in segment sales and segment income and, in certain cases, segment operating margins, for 2005 compared with 2004 are presented both with and without the effects of foreign exchange translation. Presenting results of operations excluding the translation effects of foreign exchange amounts is not in conformity with generally accepted accounting principles (GAAP), but management analyzes the data in this manner because it is useful to them in understanding operational performance of the business. Management also uses data adjusted in this manner for purposes of determining incentive compensation. Accordingly, management believes that presenting the analysis in this manner is also useful to shareholders in understanding the core business segment operating results and trends. Changes in sales and segment income excluding foreign exchange effects are calculated using current year sales and segment income translated at prior year exchange rates. These additional measurements are not meant to be a substitute for measurements prepared in conformity with GAAP, nor to be considered in isolation.

Following is an analysis of changes in total sales, segment income and operating margin for the Company for the first quarter of 2005 compared with the first quarter of 2004, showing the effect of foreign exchange translation.

	Three Months Ended March 31	Three Months Ended March 31, 2005		Excluding foreign exchange translation	
(Dollars in millions)	2004 Reported	2005 Reported	Percentage Change Reported	2005 Adjusted Amount	Percentage change Adjusted
Segment sales	$ 2,185.0	$ 2,340.3	7.1%	$ 2,288.4	4.7%
Segment income	$ 202.2	$ 202.1	0%	$ 196.6	(2.8)%
Segment operating margin	9.3%	8.6%	(0.7) pts.	8.6%	(0.7)pts.

Sales in the first quarter of 2005 were $2.340 billion, an increase of 7.1% (4.7% excluding favorable foreign exchange translation effects) from $2.185 billion in the first quarter of 2004. Sales increased 8.1% for Air Conditioning Systems and Services, 0.4% for Bath and Kitchen and 14.0% for Vehicle Control Systems. The Company as a whole benefited from price increases and volume gains.

Segment income was $202.1 million for the first quarter of 2005, essentially flat (down 2.8% excluding favorable foreign exchange translation effects) with $202.2 million in the first quarter of 2004. Segment income decreased 5.8% for Air Conditioning Systems and Services, 10.9% for Bath and Kitchen and increased 18.3% for Vehicle Control Systems. Segment income benefited from price increases, higher volume and improvements in our productivity initiatives and the benefits associated with prior operational consolidations, offset by higher investments in marketing and product development, increased commodity costs and other cost escalations and short-term production issues affecting Bath and Kitchen in Europe. 2005 segment income also included the adverse impact of $20.4 million ($14.8 million net of a $5.6 million tax benefit, or

$.07 per diluted share) of operational consolidation expenses primarily associated with Air Conditioning Systems and Services decision to seek a buyer for its Rockingham, NC manufacturing facility and to close the facility by the end of the third quarter if no buyer is found.

Following is an analysis of changes in sales, segment income and operating margin for Air Conditioning Systems and Services for the first quarter of 2005 compared with the first quarter of 2004, showing the effect of foreign exchange translation.

		Three Months Ended March 31, 2005			
				Excluding foreign exchange translation	
(Dollars in millions)	Three Months Ended March 31, 2004 Reported	2005 Reported	Percentage Change Reported	2005 Adjusted Amount	Percentage Change Adjusted
Segment sales	$ 1,163.3	$ 1,257.2	8.1%	$ 1,245.3	7.0%
Segment income	$ 93.0	$ 87.6	(5.8)%	$ 87.1	(6.3)%
Segment operating margin	8.0%	7.0%	(1.0) pts.	7.0%	(1.0) pts.

Sales of Air Conditioning Systems and Services increased 8.1% (7% excluding favorable foreign exchange translation effects) to $1.257 billion for the first quarter of 2005 from $1.163 billion for the first quarter of 2004. Our commercial equipment sales, which represent about 25% of total Company sales, increased 8.3% on a global basis. This was the fourth consecutive quarter of growing commercial equipment sales at an accelerated rate. In addition, the commercial equipment market benefited from about a 2% price increase during the first quarter of 2005. Within the commercial equipment segment, global unitary sales were up 10%, and applied sales were up 6.4%. In the first quarter of 2005, there were some pockets of strength in markets that are important to the Company such as commercial office buildings, which increased 11%; industrial manufacturing, which increased 14%; and lodging, which increased 19%. Sales were also up modestly, by 5.6% in the parts, services and solutions business as cold weather in key parts of the U.S. and Europe limited service activity and the related parts sales. Sales also benefited substantially from price increases. The Company announced additional price increases in the quarter in each region in the range of 3-5%. The commercial equipment market in the U.S. was up overall an estimated 5%-6% year over year, consisting of 1-2% growth in price and 4-5% growth in volume. This follows a full year 2004 increase of 4%, which did not include increases in price and marked the first annual increase in the commercial market since the year 2000. In the Americas, total orders were up 6% following the fourth quarter year over year increase of 26%, as customers pre-bought in anticipation of the price increase mentioned above. Internationally, markets in Europe were only up 1-2%, resulting in our sales increasing 1.6%. The Middle East region was very strong. In Asia, the Chinese market continued to grow while the remainder of the Asia/Pacific region overall remains healthy. Globally, orders were also up 6% versus the prior year. Internationally, orders were up 5% in the first quarter, on top of 10% and 20% growth in the first quarter of 2004 and 2003, respectively. We ended the quarter with a backlog of $690 million, up 7.5% from the first quarter of last year and 4.1% above the fourth quarter of 2004. This marks the fifth consecutive quarter of year over year backlog growth.

Table of Contents

Sales of our residential products continued to grow strongly, up 10.8% year over year. This increase included gains from price, volume and mix driven by a shift in sales to higher efficiency models. Residential inventory builds are consistent with the anticipated seasonal demand and inventory levels at distributors are at or below five year averages. Because of our focus on high-efficiency, premium systems, and foregoing some low margin business, our unitary and light commercial segments only maintained market share.

Segment income of Air Conditioning Systems and Services decreased 5.8% (6.3% excluding foreign exchange translation effects) to $87.6 million in the first quarter of 2005 from $93.0 million in the first quarter of 2004. Margins were 7.0% in the first quarter of 2005, compared with 8.0% for the first quarter of 2004. Segment income in 2005 included $12.8 million of operational consolidation expenses primarily associated with the rationalization of the Rockingham, North Carolina manufacturing facility. $1.7 million relates to severance, $10.4 million are non-cash charges associated with asset write-offs and $0.7 million is for other liabilities. These actions are expected to result in additional charges of approximately $2 million during the remainder of 2005 and will yield cost savings of approximately $1.9 million in 2005 and $3.8 million in 2006. Strength in price, volume, mix and productivity improvements offset commodity cost increases, higher labor costs and investments in marketing and product development. While we continued to achieve results from our productivity initiatives, we would have expected to do better in this area and are working to improve results from these ongoing initiatives.

Following is an analysis of changes in sales, segment income and operating margin for Bath and Kitchen for the first quarter of 2005 compared with the first quarter of 2004, showing the effect of foreign exchange translation.

	Three Months Ended March 31,	Three Months Ended March 31, 2005		Excluding foreign exchange translation	
(Dollars in millions)	2004 Reported	2005 Reported	Percentage Change Reported	2005 Adjusted Amount	Percentage Change Adjusted
Segment sales	$ 601.4	$ 604.1	0.4%	$ 587.2	(2.4)%
Segment income	$ 50.3	$ 44.8	(10.9)%	$ 43.4	(13.7)%
Segment operating margin	8.4%	7.4%	(1.0)pts.	7.4%	(1.0)pts.

Sales of Bath and Kitchen increased 0.4% (down 2.4% excluding favorable foreign exchange translation effects) to $604.1 million in the first quarter of 2005 from $601.4 million in the first quarter of 2004. Sales were down 0.4% in Europe which is our largest region, virtually flat in the Americas and up 3% in Asia (excluding favorable foreign exchange translation effects). The sales decrease in Europe was primarily the result of product availability issues. Sales in the Americas were impacted by the timing of orders partially offset by the continued strong performance of Champion toilets.

Segment income of Bath and Kitchen decreased 10.9% (down 13.7% excluding favorable foreign exchange translation effects) to $44.8 million in the first quarter of 2005 from $50.3 million in the first quarter of 2004. Margins decreased to 7.4% in the first quarter of 2005 from 8.4% in the first quarter of 2004 both with and without the effects of foreign exchange translation.

26

Table of Contents

Segment income was adversely impacted by production issues in Europe which translated to higher costs and lost revenues. The Company has put in place a number of actions to resolve these issues and believes that most of these issues will be resolved by the end of the second quarter. Bath and Kitchen benefited from favorable pricing and improvements from its productivity initiatives, which helped offset commodity cost escalations, higher labor costs and increased investments in marketing and new product development. Segment income in 2005 included $3.9 million of operational consolidation expenses associated with job eliminations and costs associated with the reorganization of an administrative process. These actions are expected to yield annualized cost savings of $0.7 million. The Company expects to complete these activities by the end of 2005.

Following is an analysis of changes in sales, segment income and operating margin for Vehicle Control Systems for the first quarter of 2005 compared with the first quarter of 2004, showing the effect of foreign exchange translation.

	Three Months Ended March 31,			Three Months Ended March 31, 2005 Excluding foreign exchange translation	
			Percentage	2005	Percentage
(Dollars in millions)	2004 Reported	2005 Reported	Change Reported	Adjusted Amount	Change Adjusted
Segment sales	$ 420.3	$ 479.0	14.0%	$ 456.0	8.5%
Segment income	$ 58.9	$ 69.7	18.3%	$ 66.1	12.2%
Segment operating margin	14.0%	14.6%	0.6pts.	14.5%	0.5pts.

Sales of Vehicle Control Systems for the first quarter of 2005 were $479 million, an increase of 14% (8.5% excluding the favorable effects of foreign exchange) from $420.3 million in the first quarter of 2004. Our strong momentum in this business continued. The improvement was primarily driven by global increases in truck and bus production, increased content per vehicle, including new applications, and strong aftermarket growth. Sales in Europe, our largest market, increased 11.2% (5% excluding the favorable effects of foreign exchange). This increase was driven by a 12.3% increase (excluding the favorable effects of foreign exchange) in sales to our truck and bus original equipment manufacturing customers, outperforming the Western European truck and bus market, which we believe grew an estimated 8% in the quarter. Total European sales also benefited from improved aftermarket sales, which increased 13.4% (excluding the favorable effects of foreign exchange) in the first quarter. The improved overall sales performance in Europe included the negative impact of some passenger platform expirations and modest performance in the trailer market. Sales increased 28% in North America, in line with the U.S. truck and bus market increase of 30%. In Asia and Latin America, our sales increased 10.8% and 42.7%, respectively, also outperforming the combined growth of the truck and bus markets in those regions. Vehicle Control Systems backlog at the end of the quarter was $789 million, up 18.3% (13% excluding favorable foreign exchange translation effects) from the first quarter of last year.

Segment income for Vehicle Control Systems for the first quarter of 2005 increased 18.3% (12.2% excluding favorable foreign exchange translation effects) to $69.7 million from $58.9 million in the first quarter of 2004. Segment margins increased to 14.6% from 14.0% in the

27

first quarter of 2004 (14.5% excluding the favorable effects of foreign exchange). Segment income benefited from volume growth, increased productivity, and benefits from prior operational consolidations. These gains were partially offset by higher labor costs and investments in marketing and new product development. Segment income also included $3.7 million of operational consolidation expenses associated with the continued relocation of manufacturing activities of a plant to a lower cost location and other job elimination programs, each of which were initiated in 2004. $3.4 million of the operational consolidation expenses recognized in 2005 relate to severance. These actions are expected to result in additional charges of approximately $5.9 million during the remainder of 2005 and will yield cost savings of $2.9 million in 2005 and $8.5 million in 2006. The Company expects to complete these plans by 2005.

Other Summary Segment and Income Data Items

Equity in net income of unconsolidated joint ventures increased to $7.8 million in the first quarter of 2005 from $6.5 million in the first quarter of 2004. The increase primarily resulted from the performances of our air conditioning compressor joint venture in the U.S. and our Meritor WABCO joint venture in the U.S. The improved performance of our Meritor WABCO joint venture was largely due to an increase in purchases by our European operations.

Interest expense increased $0.3 million in the first quarter of 2005 compared with the first quarter of 2004. The impact of higher interest rates slightly exceeded the benefit of lower average debt balances.

Corporate and other expenses in the first quarter of 2005 decreased $3.6 million from the first quarter of 2004 due principally to realized foreign exchange transaction gains, lower asbestos indemnity expenses and favorable post-retirement benefit costs partially offset by higher insurance costs and fees related to the sale of accounts receivable under our existing receivable securitization programs. Corporate and other expenses, shown in the Summary Segment and Income Statement Data table in Note 13 of Notes to Financial Statements, primarily include some of the expenses classified as selling and administrative expenses in the Unaudited Summary Consolidated Statement of Income on page 2. Corporate and other expenses also include certain items classified in Other expense (income) in the Unaudited Summary Consolidated Statement of Income. Period-to-period changes in the significant components of Other expense (income) are explained by the comments in this paragraph on corporate expenses, and in the first paragraph of this section on equity in net income of unconsolidated joint ventures.

The income tax provision for the first quarter of 2005 was $2.2 million, or 1.7% of pre-tax income, compared with a provision of $38.0 million, or 31% of pre-tax income in the first quarter of 2004. The reduction to the effective income tax rate resulted primarily from the resolution of tax contingencies and the impact of certain non-U.S. tax planning initiatives on prior tax years. In addition, we have agreed with the tax authorities that a significant tax refund is due the Company. However, such refund is still subject to final government review. If approved, the Company will recognize any related financial benefits at that time.

We expect the Company s effective income tax rate to be in the range of 29% to 31%, excluding the impact of the resolution of prior year tax contingencies, changes in tax rules and regulations and assuming no significant changes in the geographic distribution of the Company s earnings.

Table of Contents

Liquidity and Capital Resources

Cash flow used by operating activities was $50 million in the first quarter of 2005 as compared to cash flows provided by operating activities of $38.8 million in the first quarter of 2004, a decrease of $88.8 million. The decrease was primarily driven by higher working capital of $76.7 million, including higher inventory levels. Inventory management continues to be an important focus area and the Company plans to make improvements in this area throughout the remainder of 2005. Net income improved by $40.3 million in the first quarter of 2005 as compared with the first quarter of 2004, but was offset by higher tax and incentive compensation payments and the non-cash impact of the resolution of tax contingencies and non-U.S. tax planning initiatives.

In investing activities, we made capital expenditures of $43.7 million for the first quarter of 2005. This compared with capital expenditures of $26.4 million in the first quarter of 2004. The increase in capital expenditures resulted from capital outlays associated with our new 13 SEER air conditioning product offerings, restructuring a product line in the Air Conditioning Systems and Services segment and expanding our air conditioning compressor manufacturing operations. The Company also spent $7.9 million to purchase the rights of an operation in Asia previously held by a minority shareholder. In 2004, the Company made a $23.4 million loan to an unconsolidated joint venture. The impact of the above items resulted in essentially the same cash flows from investing activities in 2005 as 2004.

In the first quarter of 2005, the excess of cash used by operating and investing activities was $108.8 million and was funded by cash provided by financing activities of $121.5 million. Financing activities consisted of net borrowings of $274.1 million and proceeds realized from the exercise of stock options of $15.7 million. This was partly offset by purchases of approximately 3.2 million shares of our common stock for $140.3 million pursuant to our share repurchase program and dividend payments of $32.1 million. In the first quarter of 2004 the excess of cash used by investing activities over cash provided by operating activities totaled $22.7 million and was funded by net cash provided by financing activities of $103.0 million. Financing activities in 2004 consisted principally of net borrowings of $227.7 million, proceeds realized from the exercise of stock options of $12 million, proceeds from settlement of foreign exchange forward contracts of $4.7 million, and other miscellaneous transactions, partly offset by purchases of approximately 4.0 million shares of our common stock for $143.4 million pursuant to our share repurchase program.

The Company anticipates paying a dividend of $0.15 per share of common stock in the second quarter of 2005, subject to the approval of the Board of Directors at its May 3, 2005 Board meeting.

The Company has one primary bank credit agreement. That agreement provides the Company and certain subsidiaries (the Borrowers) with a senior, unsecured, five-year $1 billion multi-currency revolving credit facility that expires in November 2006. The Company also has a Euro-denominated, 364-day bank credit agreement of $51.7 million (at March 31, 2005 exchange rates) that expires on October 31, 2005, that was not fully utilized as of March 31, 2005. Debt outstanding under that agreement was classified as long-term debt in the balance sheet as of March 31, 2005, because the Company had the ability and the intent to renew it or to refinance it with borrowings under the five-year facility. In addition, the Company has other lines of credit for $20.7 million.

Table of Contents

The primary bank credit agreement contains various covenants that limit, among other things, priority indebtedness, liens, sale and leaseback transactions, subsidiary indebtedness, certain fundamental business changes and the making of certain investments, loans and advances. The covenants also require the Company to meet certain financial tests: ratio of consolidated debt to EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization), and consolidated free cash flow to interest expense. The Company is currently in compliance with the covenants contained in the credit agreement.

On March 29, 2005 the Company executed an agreement with several purchasers to sell senior notes with a principal amount of $200 million with a maturity date of April 1, 2015. The commitment to sell these notes is reflected in other current liabilities and the expected proceeds from the commitment are reflected in other current assets in the accompanying consolidated balance sheet. The senior notes associated with this commitment were issued on April 1, 2005 and resulted in proceeds to the Company of $198.2 million. The senior notes bear an interest rate of 5 1/2% and interest is payable semi-annually on April 1 and October 1 of each year. The Company, at its option, may at any time and from time to time redeem all or a portion of the senior notes for an amount equal to the principal amount of the notes redeemed plus a make whole premium. The proceeds from this issuance of the notes were used by the Company to repay the majority of the $208 million of 7 3/8% senior notes that matured on April 15, 2005.

At March 31, 2005, our total indebtedness was $1,751.9 million. We had remaining borrowing capacity under our primary bank credit agreement at March 31, 2005, of $702.9 million after reduction for borrowings of $220.1 million and $77 million of outstanding letters of credit. We have $8.2 million available under other bank credit facilities after reduction for letters of credit usage of $12.5 million. In addition, we had $184.6 million available at March 31, 2005, under overdraft facilities that can be withdrawn by the banks at any time. In addition, we had other outstanding letters of credit issued by other banks of $58.9 million as of March 31, 2005.

We believe that the amounts available from operating cash flows, funds available under our credit agreements and future borrowings under the remaining $540 million of a $1 billion shelf registration statement filed with the Securities and Exchange Commission in 1998 and access to public and private debt markets will be sufficient to meet our expected operating needs and planned capital expenditures for the foreseeable future.

Off-Balance Sheet Arrangements

The Company employs several means to manage its liquidity and is not dependent upon any one source of funding. In addition to funds available from operating cash flows, bank credit agreements and the public debt and equity markets as described above, the Company uses two principal off-balance sheet techniques: operating leases and receivables financing arrangements. Operating leases are employed as an alternative to purchasing certain property, plant and equipment. Receivables financing arrangements are used to reduce borrowing costs. Future rental commitments under all non-cancelable leases have not changed significantly from the amounts disclosed in the Company s Annual Report on Form 10-K for the year ended December 31, 2004. To reduce its borrowing cost, during 2002 the Company established new accounts receivable financing facilities in Europe and the U.S., and terminated a previously existing arrangement in the U.S. The facility in Europe expires in May 2005 and the facility in the U.S. expires in September of 2005. The Company anticipates renewing these facilities subject to Board of Directors approval. The amounts of receivables sold under these securitization programs have not changed significantly from the amounts disclosed in the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

Table of Contents

The Company has commitments and performance guarantees, including energy savings guarantees totaling $63.6 million extending from 2005 to 2022, under long-term service and maintenance contracts related to its air conditioning equipment and system controls. Through March 31, 2005 the Company has only experienced one insignificant loss under such arrangements and considers the probability of any significant future losses to be unlikely. We also guarantee debt of third parties in the amount of $1.8 million as of March 31, 2005.

Aggregate Contractual Obligations

We have contractual obligations for long-term debt, operating leases, purchase obligations, unfunded pension and post-retirement benefit plans and certain other long-term liabilities that were summarized in a table of aggregate contractual obligations in our 2004 Annual Report on Form 10-K. There have been no material changes to those obligations since December 31, 2004. See Note 11 of the accompanying notes to financial statements for a discussion of the debt commitment entered into by the Company during the first quarter of 2005.

Information Concerning Forward Looking Statements

Certain of the statements contained in this report (other than the historical financial data and other statements of historical fact), including, without limitation, statements as to management s expectations and beliefs, are forward-looking statements. Forward-looking statements are made based upon management s good faith expectations and beliefs concerning future developments and their potential effect upon the Company. There can be no assurance that future developments will be in accordance with such expectations or that the effect of future developments on the Company will be those anticipated by management. Forward-looking statements can be identified by the use of words such as believe, expect, plans, strategy, prospects, estimate, project, anticipate, intends and other wo meaning in connection with a discussion of future operating or financial performance. This Report on Form 10-Q includes important information as to risk factors in the sections titled Legal Proceedings and Management s Discussion and Analysis of Financial Condition and Results of Operations. Many important factors could cause actual results to differ materially from management s expectations, including:

the level of end market activity in the Company s Air Conditioning Systems and Services and Bath and Kitchen businesses and the level of truck and bus production in the Company s Vehicle Control Systems markets;

the extent to which the Company will be able to realize the estimated savings from Materials Management and Six Sigma initiatives;

additional developments may occur that could affect the Company s estimate of asbestos liabilities and recoveries, such as the nature and number of future claims, the average cost of disposing of such claims, average annual defense costs, the amount of insurance recovery, legislation or legal decisions affecting claims, criteria or payout;

unpredictable difficulties or delays in the development of new product technology;

changes in U.S. or international economic conditions, such as inflation, interest rate fluctuations, foreign exchange rate fluctuations or recessions in the Company s markets;

Table of Contents

pricing changes to the Company s supplies or products or those of its competitors, and other competitive pressures on pricing and sales;

increased difficulties in obtaining the supply of basic materials such as steel, aluminum, copper, clays, electronics and energy necessary to avoid disruptions of operations;

increased difficulties in obtaining a consistent supply of those basic materials at pricing levels which will not have an adverse effect on results of operations;

labor relations; integration of acquired businesses;

difficulties in obtaining or retaining the management and other human resource competencies that the Company needs to achieve its business objectives;

the impact on the Company or a segment from the loss of a significant customer or a few customers;

risks generally relating to the Company s international operations, including governmental, regulatory or political changes;

changes in environmental, health or other regulations that may affect one or more of the Company s current products or future products;

assumptions made related to post-retirement benefits, including rate of return on plan assets, the discount rate applied to projected benefit obligations and the rate of increase in the health care cost trend rate;

changes in laws or different interpretations of laws that may affect the Company s expected effective tax rate for 2005;

the outcome of lawsuits and other contingencies;

adoption of new accounting pronouncements promulgated by the FASB or other accounting standard setting agencies;

transactions or other events affecting the need for, timing and extent of the Company s capital expenditures; and

the extent to which the Company will be able to realize the estimated savings from operational consolidation programs.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There were no material changes to the disclosure on this matter made in the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

Item 4. Controls and Procedures

The Company has established a Disclosure Controls Committee that assists the Chief Executive Officer and Chief Financial Officer in their evaluation of the Company s disclosure controls and procedures. Our Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by this report, that our disclosure controls and procedures, as defined in the Securities Exchange Act of 1934, Rule 13a-15(e), are effective to ensure that the information required to be disclosed in the reports that the Company files or submits under the Securities Act of 1934 is recorded, processed summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. There have been no changes in our internal control over financial reporting during the most recent fiscal quarter that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

There have been no significant changes since December 31, 2004. See Note 6 of Notes to Financial Statements for the discussion of legal proceedings.

Item 2. Unregistered Sales of Equity Securities, and Use of Proceeds

The Company s Board of Directors has on several occasions since 1998 approved expenditures under a program to purchase shares of the Company s common stock in the open market. The Company has continually stated publicly since 1998 its intention to repurchase shares of its common stock pursuant to those authorizations. On February 3, 2005, the Company s Board of Directors approved $400 million to purchase shares of the Company s common stock in the open market. As of March 31, 2005, the unexpended authorization on the current program totaled $313,125,967. A summary of the repurchase activity for the first quarter of 2005 follows.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs (a)
January 1-January 31 (b)	1,010,699	$ 39.77	885,700	$ 27,219,801
February 1-February 28	988,900	$ 45.05	988,900	$ 382,669,756
March 1-March 31	1,478,200	$ 47.05	1,478,200	$ 313,125,967
Total first quarter	3,477,799(c)	$ 44.54	3,352,800	

(a) As of December 31, 2004, the Company had one unexpended authorization by the Board of Directors under its share repurchase program. The authorization by the Board of Directors on December 4, 2003, approved the purchase of shares in an amount not to exceed $250,000,000 with no expiration date. The unexpended balance of $62,446,908 under that authorization as of December 31, 2004, was used to repurchase shares in the first quarter of 2005.

(b) Includes 124,999 shares that were returned to the Company by the Chief Executive Officer to satisfy his withholding tax liabilities upon the vesting of 250,000 shares of restricted stock.

(c) All share repurchases were effected in accordance with the safe harbor provisions of Rule 10b-18 of the Securities Exchange Act.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits.

The exhibits listed on the accompanying Index to Exhibits are filed as part of this quarterly report on Form 10-Q.

Table of Contents

SIGNATURE

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

AMERICAN STANDARD COMPANIES INC.

/s/ Richard S. Paradise

Richard S. Paradise
Vice President and Controller
(Principal Accounting Officer)

April 29, 2005

Table of Contents

AMERICAN STANDARD COMPANIES INC.

INDEX TO EXHIBITS

(The File Number of the Registrant, American Standard Companies Inc. is 1-11415)

Exhibit No.	Description
12	Ratio of Earnings to Fixed Charges
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002