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RAYTECH CORP  
Form 10-Q  
August 13, 2003

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

FORM 10-Q

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

For the Quarter Ended June 29, 2003, or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-9298

RAYTECH CORPORATION

-----  
(Exact Name of Registrant as Specified in its Charter)

Delaware  
-----  
(State or other Jurisdiction of  
Incorporation or Organization)

06-1182033  
-----  
(I.R.S. Employer  
Identification No.)

Suite 295, Four Corporate Drive  
Shelton, Connecticut  
-----  
(Address of Principal Executive Offices)

06484  
-----  
(Zip Code)

203-925-8023  
(Registrant's Telephone Number)

-----  
(Former name, former address and former fiscal year,  
if changed since last report)

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

Yes  No   
-----

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

Yes  No   
-----

Indicate by check mark whether the Registrant has filed all documents and

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reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes X                      No  
---                              -----

As of August 4, 2003, 41,737,306 shares of common stock were outstanding and the aggregate market value of these shares (based upon the closing price of Raytech common stock on the New York Stock Exchange) on such date held by non-affiliates was approximately \$23.2 million.

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

| At  | June 29, 2003<br>(unaudited) | December 29,<br>2002 |
|---|------------------------------|----------------------|
| <hr/>   |                              |                      |
| ASSETS  |                              |                      |
| Current assets  |                              |                      |
| Cash and cash equivalents                                       | \$ 14,995                    | \$ 19,983            |
| Restricted cash   | 4,028                        | 2,027                |
| Trade accounts receivable, less allowance<br>of \$890 and \$824 | 31,245                       | 26,640               |
| Inventories, net  | 33,159                       | 34,057               |
| Income taxes receivable   | 1,826                        | 4,793                |
| Other current assets  | 5,420                        | 5,078                |
| Total current assets  | 90,673                       | 92,578               |
| <hr/>   |                              |                      |
| Property, plant and equipment                                   | 138,353                      | 131,378              |
| Less accumulated depreciation                                   | (33,463)                     | (25,257)             |
| Net property, plant and equipment                               | 104,890                      | 106,121              |
| <hr/>   |                              |                      |
| Intangible assets, net  | 69,449                       | 70,562               |
| Deferred income taxes   | 21,921                       | 21,906               |
| Other assets  | 2,956                        | 3,054                |
| Total assets  | \$289,889                    | \$294,221            |
| <hr/>   |                              |                      |
| LIABILITIES   |                              |                      |
| Current liabilities   |                              |                      |
| Notes payable and current portion of long-term debt             | \$ 13,582                    | \$ 15,091            |
| Current portion of pension obligation                           | 8,030                        | 8,030                |
| Accounts payable  | 15,309                       | 15,089               |
| Accrued liabilities   | 24,700                       | 26,258               |
| Payable to the PI Trust   | 3,823                        | 4,793                |
| Total current liabilities                                       | 65,444                       | 69,261               |
| <hr/>   |                              |                      |
| Long-term debt  | 4,645                        | 4,293                |
| Pension obligation  | 11,529                       | 12,815               |
| Postretirement benefits other than pension                      | 14,309                       | 13,800               |
| Deferred payable to the PI Trust                                | 42,356                       | 42,356               |

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|  |            |            |
|--|------------|------------|
| Other long-term liabilities  | 867        | 827        |
| -----  |            |            |
| Total liabilities  | 139,150    | 143,352    |
| -----  |            |            |
| Minority interest  | 9,251      | 8,759      |
| Commitments and contingencies  |            |            |
| SHAREHOLDERS' EQUITY   |            |            |
| Capital stock  |            |            |
| Cumulative preferred stock, no par value,<br>5,000,000 shares authorized, none issued and<br>outstanding             | --         | --         |
| Common stock, par value \$1.00, 50,000,000 shares<br>authorized, 41,737,306 and 41,701,554 issued and<br>outstanding | 41,737     | 41,701     |
| Additional paid in capital   | 117,574    | 117,458    |
| Accumulated deficit  | (10,014)   | (8,402)    |
| Accumulated other comprehensive loss   | (7,809)    | (8,647)    |
| -----  |            |            |
| Total shareholders' equity   | 141,488    | 142,110    |
| -----  |            |            |
| Total liabilities and shareholders' equity   | \$ 289,889 | \$ 294,221 |
| =====  |            |            |

The accompanying notes are an integral part of these statements.

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RAYTECH CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share data)  
(unaudited)

| For the 13 Weeks Ended   | June 29, 2003 | June 30, 2002<br>(as revised) |
|--|---------------|-------------------------------|
| -----  |               |                               |
| Net sales  | \$ 54,093     | \$ 55,305                     |
| Cost of sales  | (45,957)      | (44,219)                      |
| -----  |               |                               |
| Gross profit   | 8,136         | 11,086                        |
| Selling, general and<br>administrative expenses  | (8,565)       | (8,180)                       |
| -----  |               |                               |
| Operating (loss) profit  | (429)         | 2,906                         |
| Interest expense   | (278)         | (179)                         |
| Other income (expense), net  | 563           | (396)                         |
| -----  |               |                               |
| (Loss) income before provision for environmental<br>claims, income taxes and minority interest | (144)         | 2,331                         |
| Provision for environmental claims   | (1,762)       | --                            |
| -----  |               |                               |
| (Loss) income before provision for income<br>taxes and minority interest                       | (1,906)       | 2,331                         |
| Benefit (provision) for income taxes   | 586           | (897)                         |
| -----  |               |                               |

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|  |            |          |
|--|------------|----------|
| (Loss) income before minority interest | (1,320)    | 1,434    |
| Minority interest                      | (219)      | (364)    |
| -----                                  |            |          |
| Net (loss) income                      | \$ (1,539) | \$ 1,070 |
| =====                                  |            |          |
| Basic (loss) earnings per share        | \$ (.04)   | \$ .03   |
| =====                                  |            |          |
| Diluted (loss) earnings per share      | \$ (.04)   | \$ .03   |
| =====                                  |            |          |

The accompanying notes are an integral part of these statements.

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RAYTECH CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share data)  
(unaudited)

| For the 26 Weeks Ended  | June 29, 2003 | June 30, 2002<br>(as revised) |
|---|---------------|-------------------------------|
| -----   |               |                               |
| Net sales   | \$ 109,828    | \$108,014                     |
| Cost of sales   | (92,807)      | (86,403)                      |
| -----   |               |                               |
| Gross profit  | 17,021        | 21,611                        |
| Selling, general and<br>administrative expenses   | (16,844)      | (15,774)                      |
| -----   |               |                               |
| Operating profit  | 177           | 5,837                         |
| Interest expense  | (515)         | (456)                         |
| Other income (expense), net   | 578           | (217)                         |
| -----   |               |                               |
| Income before provision for environmental<br>claims, income taxes and minority interest | 240           | 5,164                         |
| Provision for environmental claims  | (1,762)       | --                            |
| -----   |               |                               |
| (Loss) income before provision for income<br>taxes and minority interest                | (1,522)       | 5,164                         |
| Benefit (provision) for income taxes  | 402           | (1,988)                       |
| -----   |               |                               |
| (Loss) income before minority interest  | (1,120)       | 3,176                         |
| Minority interest   | (492)         | (776)                         |
| -----   |               |                               |
| Net (loss) income   | \$ (1,612)    | \$ 2,400                      |
| =====   |               |                               |
| Basic (loss) earnings per share   | \$ (.04)      | \$ .06                        |
| =====   |               |                               |
| Diluted (loss) earnings per share   | \$ (.04)      | \$ .06                        |
| =====   |               |                               |

The accompanying notes are an integral part of these statements.

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RAYTECH CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)  
(unaudited)

| For the 26 Weeks Ended                             | June 29, 2003 | June 30, 2002<br>(as revised) |
|--|---------------|-------------------------------|
| -----  |               |                               |
| Cash flows from operating activities:              |               |                               |
| Net (loss) income                                  | \$ (1,612)    | \$ 2,400                      |
| Depreciation and amortization                      | 9,192         | 8,489                         |
| Other operating activities                         | (5,619)       | (2,819)                       |
| -----  |               |                               |
| Net cash provided by operating activities          | 1,961         | 8,070                         |
| -----  |               |                               |
| Cash flow from investing activities:               |               |                               |
| Capital expenditures                               | (5,547)       | (5,576)                       |
| Proceeds on sales of property, plant and equipment | --            | 196                           |
| -----  |               |                               |
| Net cash used in investing activities              | (5,547)       | (5,380)                       |
| Cash flow from financing activities:               |               |                               |
| Net payments on short-term notes                   | (1,729)       | (859)                         |
| Principal payments on long-term debt               | (1,188)       | (552)                         |
| Proceeds from long-term borrowings                 | 1,146         | 106                           |
| Proceeds from exercise of stock options            | 152           | 243                           |
| -----  |               |                               |
| Net cash used in financing activities              | (1,619)       | (1,062)                       |
| Effect of exchange rate changes on cash            | 217           | 147                           |
| Net change in cash and cash equivalents            | (4,988)       | 1,775                         |
| Cash and cash equivalents at beginning of period   | 19,983        | 14,463                        |
| -----  |               |                               |
| Cash and cash equivalents at end of period         | \$ 14,995     | \$16,238                      |
| =====  |               |                               |

The accompanying notes are an integral part of these statements.

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RAYTECH CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(in thousands)  
(unaudited)

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|                               | Common<br>Stock | Additional<br>Paid in<br>Capital | Accumulated<br>Deficit<br>(as revised) | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>(as revised) |
|-------------------------------|-----------------|----------------------------------|--|---|-----------------------|
| Balance,<br>December 30, 2001 | \$41,528        | \$116,843                        | \$ (5,577)                             | \$ (8,711)                                    | \$ 144,083            |
| Comprehensive income:         |                 |                                  |  |   |                       |
| Net income                    | --              | --                               | 2,400                                  | --  | 2,400                 |
| Changes during<br>the period  | --              | --                               | --                                     | 1,112   | 1,112                 |
| Total comprehensive<br>income | --              | --                               | 2,400                                  | 1,112   | 3,512                 |
| Stock options exercised       | 78              | 165                              |  |   | 243                   |
| Balance,<br>June 30, 2002     | \$41,606        | \$117,008                        | \$ (3,177)                             | \$ (7,599)                                    | \$ 147,838            |
| Balance,<br>December 29, 2002 | \$41,701        | \$117,458                        | \$ (8,402)                             | \$ (8,647)                                    | \$ 142,110            |
| Comprehensive income:         |                 |                                  |  |   |                       |
| Net loss                      | --              | --                               | (1,612)                                | --  | (1,612)               |
| Changes during<br>the period  | --              | --                               | --                                     | 838   | 838                   |
| Total comprehensive<br>income | --              | --                               | (1,612)                                | 838   | (774)                 |
| Stock options exercised       | 36              | 116                              |  |   | 152                   |
| Balance,<br>June 29, 2003     | \$41,737        | \$117,574                        | \$ (10,014)                            | \$ (7,809)                                    | \$ 141,488            |

The accompanying notes are an integral part of these statements.

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RAYTECH CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Note A - Summary of Significant Accounting Policies

For a summary of all other significant accounting policies, refer to Note A to the consolidated financial statements included with the 2002 Form 10-K.

1. Presentation of Condensed Unaudited Consolidated Financial Statements

These condensed unaudited consolidated financial statements have been prepared pursuant to the requirements of Article 10 of Regulation S-X, and in the opinion of management, contain all adjustments necessary to fairly

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present the consolidated financial position of Raytech as of June 29, 2003 and the consolidated results of operations and cash flows for all interim periods presented. All adjustments are of a normal recurring nature. The year-end condensed consolidated balance sheet data was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. The financial statements contained herein should be read in conjunction with the Company's financial statements and related notes filed on Form 10-K for the year ended December 29, 2002. Interim results are not necessarily indicative of the results for the full year.

### 2. Stock-Based Compensation

Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," encourages a fair value based method of accounting for employee stock options and similar equity instruments, which generally would result in the recording of additional compensation expense in the Company's financial statements. The Statement also allows the Company to continue to account for stock-based employee compensation using the intrinsic value for equity instruments using APB Opinion No. 25. The Company has adopted the disclosure-only provisions of SFAS No. 123, as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." Accordingly, no compensation cost has been recognized for the stock option plans in the accompanying financial statements.

SFAS No. 123, as amended by SFAS No. 148, requires the Company to disclose pro forma net income and pro forma earnings per share amounts as if compensation expense was recognized for options granted after 1994. Pro forma net income and the related basic and diluted earnings per share amounts would be as follows:

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Note A, continued

|  | For the 13 Weeks Ended |                               |
|--|------------------------|-------------------------------|
|  | June 29, 2003          | June 30, 2002<br>(as revised) |
|  | -----                  | -----                         |
|  | (Unaudited)            |                               |
| Net (loss) income:   |                        |                               |
| As reported  | \$ (1,539)             | \$ 1,070                      |
| Less: Total stock-based employee<br>compensation expense determined<br>under fair value based method | (671)                  | --                            |
|  | -----                  | -----                         |
| Pro forma net (loss) income  | \$ (2,210)             | \$ 1,070                      |
|  | =====                  | =====                         |
| Basic (loss) earnings per share:   |                        |                               |
| As reported  | \$ (.04)               | \$ .03                        |
| Pro forma  | \$ (.05)               | \$ .03                        |
| Diluted (loss) earnings per share:   |                        |                               |
| As reported  | \$ (.04)               | \$ .03                        |
| Pro forma  | \$ (.05)               | \$ .03                        |

During the thirteen weeks ended June 29, 2003, the Company granted options



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for 1,172,000 shares of common stock with an exercise price of \$5.70 per share. The fair value of these options was estimated at \$2.05 per common share on the date of grant, using the Black-Scholes option pricing model with the following assumptions: expected volatility of 62.30%, dividend yield of 0.00%, risk free interest rate of 2.84% and an expected life of the options of six years. Options to purchase 290,659 shares of common stock at \$4.25 per share and options to purchase 2,773,000 shares of common stock at \$5.70 per share were not included in the computation of diluted earnings per share for the thirteen weeks ended June 29, 2003 because of their anti-dilutive effect due to the Company incurring a net loss for the period.

There was no pro forma impact on net income for the thirteen weeks ended June 30, 2002, as all options outstanding during the period were fully vested in 1999.

|  | For the 26 Weeks Ended |                               |
|--|------------------------|-------------------------------|
|  | June 29, 2003          | June 30, 2002<br>(as revised) |
|  | -----                  | -----                         |
|  | (Unaudited)            |                               |
| Net (loss) income:   |                        |                               |
| As reported  | \$ (1,612)             | \$ 2,400                      |
| Less: Total stock-based employee<br>compensation expense determined<br>under fair value based method | (1,084)                | --                            |
|  | -----                  | -----                         |
| Pro forma net (loss) income  | \$ (2,696)             | \$ 2,400                      |
|  | =====                  | =====                         |
| Basic (loss) earnings per share:   |                        |                               |
| As reported  | \$ (.04)               | \$ .06                        |
| Pro forma  | \$ (.06)               | \$ .06                        |
| Diluted (loss) earnings per share:   |                        |                               |
| As reported  | \$ (.04)               | \$ .06                        |
| Pro forma  | \$ (.06)               | \$ .06                        |

During the twenty-six weeks ended June 29, 2003, the Company granted options for 2,773,000 shares of common stock with an exercise price of

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### Note A, continued

\$5.70 per share. Options to purchase 290,659 shares of common stock at \$4.25 per share and options to purchase 2,773,000 shares of common stock at \$5.70 per share were not included in the computation of diluted earnings per share for the twenty-six weeks ended June 29, 2003 because of their anti-dilutive effect due to the Company incurring a net loss for the period.

There was no pro forma impact on net income for the twenty-six weeks ended June 30, 2002, as all options outstanding during the period were fully vested in 1999.

### 3. Guarantees

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On November 26, 2002, FASB issued Interpretation No. 45 ("FIN 45"), Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Guarantees of Indebtedness of Others. FIN 45 clarifies the requirements of SFAS No. 5, Accounting for Contingencies, relating to a guarantor's accounting for, and disclosure of, the issuance of certain types of guarantees. For certain guarantees issued after December 31, 2002, FIN 45 requires a guarantor to recognize, upon issuance of a guarantee, a liability for the fair value of the obligations it assumes under the guarantee.

The Company provides certain warranties relating to the quality and performance of its products. The primary product of the Company, friction plates, is used in manual and automatic transmissions, transfer cases and wet wheel brake systems for heavy duty equipment. Warranty claims have historically been de minimis due to the quality of the Company's products and the impact of other potential parts interactions in these systems, which may contribute to the root cause of any system failure. The Company does maintain product warranty insurance in the event a warranty issue does arise. The costs in 2003 for product warranty support have been de minimis.

#### 4. Recently Issued Accounting Pronouncements

In April, 2003, the FASB issued Financial Accounting Standard No. 149 (SFAS No. 149) "Amendment of Statement 133 Accounting for Derivative Instruments and Hedging Activities." This Statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under FASB Statement No. 133. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, with all provisions applied prospectively. Amendments relating to implementation issues that were previously cleared by the FASB and were effective for fiscal quarters beginning before June 15, 2003 should continue to be applied in accordance with their respective effective dates. Raytech is evaluating the impact, if any, that this statement may have on future reporting. Management's initial review has determined that the statement is not currently applicable to Raytech.

In May, 2003, the FASB issued Financial Accounting Standard No. 150 (SFAS No. 150), "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equities. This Statement establishes standards regarding the manner in which an issuer classifies and measures certain types of financial instruments having characteristics of both liabilities and equity. SFAS No. 150 is

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#### Note A, continued

effective for financial instruments entered into or modified after May 31, 2003 and for contracts in existence at the start of the first interim period beginning after June 15, 2003. Raytech currently does not have financial instruments with the characteristics described in the standard.

#### Note B - Inventories

Inventories, net, consist of the following:

|               |                   |
|---------------|-------------------|
| June 29, 2003 | December 29, 2002 |
|---------------|-------------------|

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|                 | (Unaudited) |          |
|-----------------|-------------|----------|
|                 | -----       | -----    |
| Raw material    | \$11,944    | \$11,049 |
| Work in process | 7,727       | 8,349    |
| Finished goods  | 13,488      | 14,659   |
|                 | -----       | -----    |
|                 | \$33,159    | \$34,057 |
|                 | =====       | =====    |

Note C - Earnings Per Share

|   | For the<br>13 Weeks Ended<br>June 29, 2003 | For the<br>13 Weeks Ended<br>June 30, 2002<br>(as revised) |
|---|--|--|
|   | -----                                      | -----  |
|   | (Unaudited)                                |  |
| Basic EPS Computation                       |  |  |
| Numerator:                                  |  |  |
| Net (loss) income                           | \$ (1,539)                                 | \$ 1,070   |
| Denominator:                                |  |  |
| Weighted average shares                     | 41,701,554                                 | 41,528,520   |
| Weighted average stock<br>options exercised | 32,148                                     | 33,696   |
|   | -----                                      | -----  |
| Adjusted weighted average shares            | 41,733,702                                 | 41,562,216   |
|   | =====                                      | =====  |
| Basic (loss) earnings per share             | \$ (.04)                                   | \$ .03   |
|   | =====                                      | =====  |
| Diluted EPS Computation                     |  |  |
| Numerator:                                  |  |  |
| Net (loss) income                           | \$ (1,539)                                 | \$ 1,070   |
| Denominator:                                |  |  |
| Weighted average shares                     | 41,701,554                                 | 41,528,520   |
| Weighted average stock<br>options exercised | 32,148                                     | 33,696   |
| Dilutive potential common shares            | --   | 124,901  |
|   | -----                                      | -----  |
| Adjusted weighted average shares            | 41,733,702                                 | 41,687,117   |
|   | =====                                      | =====  |
| Diluted (loss) earnings per share           | \$ (.04)                                   | \$ .03   |
|   | =====                                      | =====  |

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Note C, continued

Options to purchase 290,659 shares of common stock at \$4.25 per share and options to purchase 2,773,000 shares of common stock at \$5.70 per share were not included in the computation of diluted earnings per share for the thirteen weeks ended June 29, 2003 because of their anti-dilutive effect due to the Company incurring a net loss for the period.

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|   | For the<br>26 Weeks Ended<br>June 29, 2003 | For the<br>26 Weeks Ended<br>June 30, 2002<br>(as revised) |
|---|--|--|
|   | -----                                      | -----  |
|   | (Unaudited)                                |  |
| Basic EPS Computation                       |  |  |
| Numerator:                                  |  |  |
| Net (loss) income                           | \$ (1,612)                                 | \$ 2,400   |
| Denominator:                                |  |  |
| Weighted average shares                     | 41,701,554                                 | 41,528,520   |
| Weighted average stock<br>options exercised | 16,074                                     | 16,848   |
|   | -----                                      | -----  |
| Adjusted weighted average shares            | 41,717,628                                 | 41,545,368   |
|   | =====                                      | =====  |
| Basic (loss) earnings per share             | \$ (.04)                                   | \$ .06   |
|   | =====                                      | =====  |
| Diluted EPS Computation                     |  |  |
| Numerator:                                  |  |  |
| Net (loss) income                           | \$ (1,612)                                 | \$ 2,400   |
| Denominator:                                |  |  |
| Weighted average shares                     | 41,701,554                                 | 41,528,520   |
| Weighted average stock<br>options exercised | 16,074                                     | 16,848   |
| Dilutive potential common shares            | --   | 54,155   |
|   | -----                                      | -----  |
| Adjusted weighted average shares            | 41,717,628                                 | 41,599,523   |
|   | =====                                      | =====  |
| Diluted (loss) earnings per share           | \$ (.04)                                   | \$ .06   |
|   | =====                                      | =====  |

Options to purchase 290,659 shares of common stock at \$4.25 per share and options to purchase 2,773,000 shares of common stock at \$5.70 per share were not included in the computation of diluted earnings per share for the twenty-six weeks ended June 29, 2003 because of their anti-dilutive effect due to the Company incurring a net loss for the period.

In February 2002, lawyers claiming to represent the Committee of Equity Holders filed a motion in U.S. Bankruptcy Court to compel Raytech to either issue up to approximately 700,000 additional shares to the pre-reorganization holders of shares in Raytech or their successors, or to proportionately reduce the shareholdings of the general unsecured creditor shareholders under the Plan of Reorganization. The ultimate outcome of this matter is unknown; however, it is possible that its resolution could cause the Company to issue additional shares to the original shareholder group, or to retire shares held by the general unsecured creditor shareholder group. This might directly impact the earnings per share calculations of the Company. The Company has filed a motion for summary judgment asking the Court to dismiss the action, and the Court has denied that motion.

Note D - Segment Reporting

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based on management structure, product type and distribution channel, as described below.

The Wet Friction segment produces specialty engineered products for heat resistant, inertia control, energy absorption and transmission applications used in an oil immersed environment. The Company markets its products to automobile and heavy duty original equipment manufacturers ("OEM"), as well as to farm machinery, mining, truck and bus manufacturers.

The Dry Friction segment produces engineered friction products, which are not used in an oil immersed environment, and are primarily used in original equipment automobile and truck manual transmissions. The clutch facings produced by this segment are marketed to companies who assemble the manual transmission systems used in automobiles and trucks.

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

Information relating to operations by industry segment follows:

### OPERATING SEGMENTS

|                                 | For the<br>13 Weeks Ended<br>June 29, 2003 | For the<br>13 Weeks Ended<br>June 30, 2002<br>(as revised) |
|---------------------------------|--|--|
|                                 | -----                                      | -----  |
|                                 | (Unaudited)                                |  |
| NET SALES                       |  |  |
| Wet Friction                    | \$ 33,740                                  | \$ 37,303  |
| Aftermarket                     | 11,290                                     | 12,106   |
| Dry Friction                    | 11,401                                     | 8,437  |
| Intersegment elimination (1)    | (2,338)                                    | (2,541)  |
|                                 | -----                                      | -----  |
| Net sales to external customers | \$ 54,093                                  | \$ 55,305  |
|                                 | =====                                      | =====  |
| OPERATING (LOSS) PROFIT (2)     |  |  |
| Wet Friction                    | \$ (1,233)                                 | \$ 2,144   |
| Aftermarket                     | 2,013                                      | 2,268  |
| Dry Friction                    | 1,504                                      | 193  |
| Corporate                       | (2,428)                                    | (2,274)  |
|                                 | -----                                      | -----  |
| Consolidated                    | \$ (144)                                   | \$ 2,331   |
|                                 | =====                                      | =====  |

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Note D, continued

|  | For the<br>26 Weeks Ended | For the<br>26 Weeks Ended |
|--|---------------------------|---------------------------|
|--|---------------------------|---------------------------|

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|                                 | June 29, 2003 | June 30, 2002<br>(as revised) |
|---------------------------------|---------------|-------------------------------|
|                                 | -----         | -----                         |
|                                 | (Unaudited)   |                               |
| NET SALES                       |               |                               |
| Wet Friction                    | \$ 68,412     | \$ 71,651                     |
| Aftermarket                     | 22,779        | 24,590                        |
| Dry Friction                    | 23,110        | 16,590                        |
| Intersegment elimination (1)    | (4,473)       | (4,817)                       |
|                                 | -----         | -----                         |
| Net sales to external customers | \$ 109,828    | \$ 108,014                    |
|                                 | =====         | =====                         |
| OPERATING (LOSS) PROFIT (2)     |               |                               |
| Wet Friction                    | \$ (2,427)    | \$ 3,657                      |
| Aftermarket                     | 4,243         | 4,826                         |
| Dry Friction                    | 2,869         | 948                           |
| Corporate                       | (4,445)       | (4,267)                       |
|                                 | -----         | -----                         |
| Consolidated                    | \$ 240        | \$ 5,164                      |
|                                 | =====         | =====                         |

- (1) The Company records intersegment sales at an amount negotiated between the segments. All intersegment sales are eliminated in consolidation.
- (2) The Company's management reviews the performance of its reportable segments on an operating profit basis, consisting of (loss) income before provision for environmental claims, income taxes and minority interest.

Note E - Income Taxes

The effective rate for the thirteen-week period ended June 29, 2003 is a benefit of 30.7% compared to an expense of 38.5% for the same period in the prior year. The difference is attributable to changes in the mix of earnings and losses in the domestic and foreign entities and the effect of permanent differences. The effective tax rate for the twenty-six week period ended June 29, 2003 is a benefit of 26.4% compared to an expense of 38.5% for the same period in the prior year. The effective rate for the twenty-six-week period ended June 29, 2003 reflects the Company's anticipated annualized rate and differs from the Federal statutory rate for several reasons. The rate for the current period reflects a statutory federal rate adjusted for state and foreign taxes and contributions made to the Raymark pension plans. Payments to the Raymark pension plans create a permanent difference due to this tax benefit inuring to the Raytech Personal Injury Trust in accordance with the Tax Benefits Assignment and Assumption Agreement. In addition, the Company did not recognize any tax benefits associated with the operating losses incurred by the Company's U.K. operations due to doubts about their future recoverability.

Pursuant to the Tax Benefits Assignment and Assumption Agreement (the "Agreement"), all tax benefits received by the Company due to the reorganization are to be passed onto the PI Trust as received. At June 29, 2003, the Company has tax loss carryforwards of \$74.8 million and tax credit carryforwards of \$1.2 million. The net operating loss carryforwards are allocated between Raytech Corporation and the PI Trust in the amounts of \$2.8 million and \$72.0 million, respectively. The tax credit

Note E, continued

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carryforwards all belong to the PI Trust. Additionally, future payments to the

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PI Trust and others will create additional tax deductions, which will inure to the benefit of the PI Trust in accordance with the Agreement. These include deductions for payments to the PI Trust of tax benefits associated with the utilization of the operating losses allocated to the PI Trust, and contributions made to the Raymark pension plans. If Raytech Corporation generates additional losses in future periods, exclusive of losses attributable to the payments discussed above, those losses will be retained by the Company. The method of allocation in utilizing current and future operating losses, if any, between the PI Trust and Raytech Corporation has not been determined at this time. Additional tax recoveries expected to be received in future periods are shown as deferred tax assets and a deferred payable to the PI Trust which amounted to \$42.4 million at June 29, 2003.

At June 29, 2003, the Company has recorded a tax receivable in the amount of \$1.8 million, net of Federal income tax, due from state governments for returns filed in 2002. The Company has received \$3.0 million, net of Federal tax and interest, in the thirteen-week period ended June 29, 2003 as a partial recovery of these state taxes. In accordance with the Agreement, this amount inures to the benefit of the PI Trust. The State of Indiana has completed its audit of Raytech for the years 1992 through 2001. As a result of the audit, Raytech was denied refunds claimed for Indiana Gross Income tax paid in the years 1992 through 1997 of \$1.0 million and certain interest on amounts refunded. Raytech has filed a protest with respect to these items with the Indiana Department of Revenue, and a hearing is expected later this year. Pursuant to the Agreement, any tax refunds received will be payable, net of tax, to the PI Trust.

The Company is under an IRS audit for 1996 through 2001. Any tax assessment, up to the amount of the refunds received, arising from this audit or any other years in the carryback period, are, pursuant to the Agreement, the responsibility of the PI Trust and will therefore reduce the deferred tax asset associated with, and liability payable to, the PI Trust.

The Company owns 57% of the stock of Allomatic Products Company ("APC"). The Company has not recorded a deferred tax liability for the undistributed earnings of APC since management expects that those earnings will be distributed to the Company in a tax-free transaction. However, the deferred tax liability on the undistributed earnings of APC would be approximately \$1.3 million at June 29, 2003, if all of APC's earnings were to be distributed through dividends.

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### Note F - Goodwill and Other Intangible Assets

|                                | June 29, 2003               |                             | December 29, 2002           |                             |
|--------------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|                                | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization |
|                                | -----                       | -----                       | -----                       | -----                       |
|                                | (Unaudited)                 |                             |                             |                             |
| Finite life intangible assets: |                             |                             |                             |                             |
| Unpatented technology          | \$ 16,262                   | \$4,366                     | \$ 16,262                   | \$ 3,396                    |
| Distribution base              | 5,716                       | 643                         | 5,716                       | 500                         |
|                                | -----                       | -----                       | -----                       | -----                       |

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|                                    |           |         |           |          |
|------------------------------------|-----------|---------|-----------|----------|
| Sub-total                          | 21,978    | \$5,009 | 21,978    | \$ 3,896 |
|                                    | -----     | -----   | -----     | -----    |
| Indefinite life intangible assets: |           |         |           |          |
| Trademarks                         | 17,713    |         | 17,713    |          |
|                                    | -----     |         | -----     |          |
| Goodwill                           | 34,767    |         | 34,767    |          |
|                                    | -----     |         | -----     |          |
| Intangible assets, net             | \$ 69,449 |         | \$ 70,562 |          |
|                                    | =====     |         | =====     |          |

The weighted-average amortization periods for the unpatented technology and the distribution base are 8.6 and 20.0 years, respectively. Amortization expense for the thirteen weeks ended June 29, 2003 amounted to \$557. Amortization expense for the twenty-six weeks ended June 29, 2003 amounted to \$1,113.

Estimated annual amortization expense is as follows:

For the year ending:

|      |          |
|------|----------|
| 2003 | \$ 2,226 |
| 2004 | 2,226    |
| 2005 | 2,226    |
| 2006 | 2,226    |
| 2007 | 1,926    |

Trademarks and goodwill will not be amortized but will be reviewed for impairment annually. The Company's three operating segments have been defined as reporting units for purposes of testing goodwill for impairment. The amount of goodwill has been assigned to each of the Company's segments. During the thirteen weeks ended June 29, 2003, the Company performed its annual impairment review of the reporting units in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," as of March 31, 2003. The effort, which was performed with assistance from a third party valuation firm, indicated that no impairment adjustment was necessary. Accordingly, there were no changes in the carrying amount of trademarks or goodwill during the twenty-six weeks ended June 29, 2003.

Note G - Litigation

The Company is subject to certain legal matters that have arisen in the ordinary course of business, and management does not expect these matters will have a material adverse effect on the Company. In addition, the Company is involved in the following litigation.

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Note G, continued

In April 1996, the Indiana Department of Environmental Management ("IDEM") advised Raybestos Products Company ("RPC"), a wholly-owned subsidiary of the Company, that it may have contributed to the release of lead and PCB's (polychlorinated biphenyls) found in a drainage ditch (the "Site") near its Indiana facility. In June 1996, IDEM named RPC as a potentially responsible



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party ("PRP"). RPC notified its insurers of the IDEM action and one insurer responded by filing a complaint in January 1997 in the U.S. District Court, Southern District of Indiana, captioned Reliance Insurance Company vs. RPC seeking a declaratory judgment that any liability of RPC is excluded from its policy with RPC. In January 2000, the District Court granted summary judgment to RPC, indicating that the insurer has a duty to defend and indemnify losses stemming from the IDEM claim. However, in June 2001, Reliance Insurance Company was placed in rehabilitation in Pennsylvania. The Company has filed a claim for such defense and indemnity cost reimbursement in the rehabilitation proceedings but has not yet received any decision on its claim. Three additional insurers have been added to the Reliance case as ordered by the District Court.

The U.S. Environmental Protection Agency ("EPA") became involved in the Site in December 2000 and issued a Unilateral Administrative Order under CERCLA ("Order") demanding removal of contaminated soils from the Site. RPC has substantially completed the investigation and remediation required under the Order. The Company has estimated that the cost to comply with the Order will be approximately \$16.2 million of which \$10.5 million has been spent through June 29, 2003. The remaining balance of \$5.7 million is included in accrued liabilities. It is at least reasonably possible that the assessment of estimated costs to comply with the Order may be modified as the project progresses and that there may be additional assessments from the EPA. On May 6, 2003, EPA indicated that RPC is potentially liable for PCB contamination downstream of the Site area that is the subject of the Order. EPA has not issued an order to RPC regarding this downstream area. However, the Company has engaged in negotiations with the EPA concerning such possible additional remediation. Regardless of the outcome of these negotiations, the Company might be required to do additional remediation at the Site.

Before EPA became involved in the Site, IDEM and RPC had entered into an Agreed Order providing for a risk-based remediation of the contamination different from the EPA's Order. After IDEM withdrew from the Agreed Order, an Indiana State Superior Court ruled that IDEM's purported withdrawal from the Agreed Order was illegal and ordered IDEM to reinstate the Agreed Order and IDEM complied. In July 2002, RPC filed an action against IDEM for breach of contract claiming damages based on the difference between the costs of cleanup under the EPA Order and the IDEM Agreed Order. The outcome of this litigation is not known.

In February 2002, lawyers claiming to represent the Committee of Equity Holders filed a motion in U.S. Bankruptcy Court to compel Raytech to either issue up to approximately 700,000 additional shares to the pre-reorganization holders of shares in Raytech or their successors or to proportionately reduce the shareholdings of the general unsecured creditor shareholders under the Plan of Reorganization. The ultimate outcome of this matter is unknown; however, it is possible that its resolution could cause the Company to issue additional shares to the original shareholder group, or to retire shares held by the general unsecured creditor shareholder group. This might directly impact the earnings per share calculations of the Company. The Company has

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Note G, continued

filed a motion for summary judgment asking the Court to dismiss the action and the court has denied that motion.

On January 8, 2002, the Michigan Department of Environmental Quality ("MDEQ") sent the Company a letter alleging responsibility for trichloroethylene ("TCE") contamination at a Ferndale, Michigan, industrial site that Advanced Friction Materials Company ("AFM") leased from 1974 to 1985. The Company

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acquired AFM in 1998. The Company is cooperating with the MDEQ in evaluating the subsurface of the site to obtain data concerning the alleged contamination. The Company's liability at this site is indeterminable at this time.

### Note H - Restricted Cash

Restricted cash relates to the following:

|                      | June 29, 2003<br>-----<br>(Unaudited) | December 29, 2002<br>----- |
|----------------------|---------------------------------------|----------------------------|
| Payable to the Trust | \$1,998                               | \$ --                      |
| Letters of credit    | 1,620                                 | 1,617                      |
| Other                | 410                                   | 410                        |
|                      | -----                                 | -----                      |
|                      | \$4,028                               | \$2,027                    |
|                      | =====                                 | =====                      |

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

### Note I - Revision of Interim Financial Statements

The accompanying condensed unaudited consolidated statements of operations for the thirteen and twenty-six weeks ended June 30, 2002, and the condensed unaudited consolidated statements of cash flows and of changes in shareholders' equity, as well as the accompanying notes, have been revised from those previously reported to reflect lower depreciation expense and the related tax effects.

The Company determined subsequent to the filing of the Form 10-Q for the quarter ended September 29, 2002, that depreciation expense had been overstated in both the second quarter filing, at June 30, 2002, by \$475 and in the third quarter filing, at September 29, 2002, by \$368. The quarterly reporting herein reflects the corrected amounts for the thirteen and twenty-six weeks ended June 30, 2002.

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### Note I, continued

The effect of this revision is as follows:

|   | For the 13 Weeks Ended<br>June 30, 2002<br>----- |                        | For the 26 Weeks Ended<br>June 30, 2002<br>----- |                        |
|---|--|------------------------|--|------------------------|
|   | As Previously<br>Reported<br>-----               | As<br>Revised<br>----- | As Previously<br>Reported<br>-----               | As<br>Revised<br>----- |
|   | (Unaudited)                                      |                        |  |                        |
| Net sales   | \$ 55,305  | \$ 55,305              | \$108,014  | \$108,014              |
| Gross profit  | 10,611   | 11,086                 | 21,136   | 21,611                 |
| Income before income taxes<br>and minority interest | 1,856  | 2,331                  | 4,689  | 5,164                  |

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|                            |         |         |         |         |
|----------------------------|---------|---------|---------|---------|
| Net income                 | 778     | 1,070   | 2,108   | 2,400   |
| Basic earnings per share   | .02     | .03     | .05     | .06     |
| Diluted earnings per share | .02     | .03     | .05     | .06     |
| Accumulated deficit        | (3,469) | (3,177) | (3,469) | (3,177) |

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

In preparing the discussion and analysis required by the Federal Securities Laws, it is presumed that users of the interim financial information have read or have access to the discussion and analysis for the preceding fiscal year.

As further discussed in Note I to the condensed unaudited consolidated financial statements, amounts relating to the thirteen and twenty-six weeks ended June 30, 2002 have been revised from those previously reported to reflect lower depreciation expenses and the related tax effects.

#### Safe Harbor Statement

Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995: Statements under the "Liquidity, Capital Resources and Future Liquidity" heading and other statements herein that relate to future operating periods are subject to important risks and uncertainties that could cause actual results to differ materially. Forward-looking statements relating to the Company's businesses involve certain factors that are subject to change, including the many interrelated factors that affect consumer confidence, including worldwide demand for automotive and heavy duty products, general economic conditions, the environment, actions of competitors in the various industries in which the Company competes; production difficulties, including capacity and supply constraints; dealer practices; labor relations; interest and currency exchange rates; technological difficulties; accounting standards, and other risks and uncertainties. Further information, including factors that potentially could materially affect the Company's financial results, is included in the Company's filings with the Securities and Exchange Commission.

#### Significant Accounting Policies

Preparation of the Company's financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Management believes the most complex and sensitive judgments, because of their significance to the consolidated financial statements, result primarily from the need to make estimates about the effects of matters that are inherently uncertain. Management's Discussion and Analysis and Note 1 to the Consolidated Financial Statements in the Company's Form 10-K for fiscal 2002 describe the significant accounting estimates and policies used by management in the preparation of the consolidated financial statements. Actual results in these areas could differ from management's estimates. There have been no changes in the Company's critical accounting estimates during the twenty-six-week period ended June 29, 2003.

#### Results of Operations and Liquidity and Capital Resources

Raytech Corporation recorded a net loss of \$1.5 million for the thirteen-week-period ended June 29, 2003 or \$.04 loss per basic and diluted share compared to net income of \$1.1 million or \$.03 per basic and diluted share in the same period in the prior year. The reduction in earnings was due to lower gross profit and an environmental charge of \$1.8 million for the period. The

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Company recorded a net loss for the twenty-six-week period ended June 29, 2003 of \$1.6 million or \$.04 loss per basic and diluted share compared to net income of \$2.4 million or \$.06 per basic and diluted share, a decrease of \$4.0 million period-over-period. The decrease is due to lower gross profit and an environmental charge taken in the

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second quarter of 2003. The details for the quarter and the twenty-six-week period are presented below.

### Net Sales

Raytech recorded net sales of \$54.1 million for the thirteen-week period ended June 29, 2003 compared to \$55.3 million for the same period in the prior year, a decrease of \$1.2 million. The Company recorded net sales of \$109.8 million for the twenty-six-week period ended June 29, 2003 compared to \$108.0 million for the same period in the prior year, an increase of \$1.8 million. An analysis of the change in sales for the thirteen-week and twenty-six-week periods compared to prior period amounts are presented below.

The Wet Friction segment recorded sales of \$33.7 million for the thirteen-week period ended June 29, 2003 compared to \$37.3 million for the same period in the prior year, a decrease of \$3.6 million period-over-period. The decrease is divided equally between lower sales to the automotive OEM component of the segment and lower sales to the heavy duty component of the segment. The reduced sales to the automotive OEM's is due to lower demand in the overall automotive market due to the poor U.S. economy, which is reflected in the 3.6% year-to-date decline in North American car and truck production in 2003. The lower sales to the heavy duty component of the segment reflect lower sales to the agricultural market due to lower demand and lower sales to the construction market due to lower demand and increased competition. The net sales for the twenty-six-week period ended June 29, 2003 of \$68.4 million compares to \$71.7 million for the same period in the prior year, a decrease in sales of \$3.3 million. Most of the decrease is attributable to lower sales for the period in the heavy duty component of this segment. The automotive OEM component of the segment recorded higher sales for the six-month period of \$.2 million compared to the same period in the prior year.

The Aftermarket segment recorded net sales of \$11.3 million for the thirteen-week period ended June 29, 2003 compared to \$12.1 million for the same period in the prior year, a decrease of \$.8 million. The reduced sales for the quarter continues to reflect the slower aftermarket for Raytech's products from the customer base, predominately warehouse distribution, due to the slower economy and improved OEM quality of original equipment parts. Specifically, sales in the transmission filter component of this segment are slower due to reduced replacement schedules suggested by the OEM manufacturers. The net sales for the twenty-six-week period ended June 29, 2003 of \$22.8 million compare to \$24.6 million for the same period in the prior year, a decrease of \$1.8 million period-over-period. The sales for the six-month period reflect the same issues outlined above for the quarter ended June 29, 2003.

The Dry Friction segment recorded net sales of \$11.4 million for the thirteen-week period ended June 29, 2003 compared to \$8.4 million for the same period in the prior year, an increase of \$3.0 million period-over-period. The sales increase reflects the continued expansion through the operation in China, which increased sales \$1.0 million over 2002 results for the same period as demand for product from the facility continues to increase. The net sales through the German operation improved \$2.2 million in the thirteen-week period ended June 29, 2003 over net sales in the same period in the prior year. The increase in sales through the German operation reflects a volume increase of \$.6

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million and a translation gain of \$1.6 million due to the effects of the exchange change in the Euro to the U.S. dollar. The Dry Friction segment recorded net sales of \$23.1 million for the twenty-six-week period ended June 29, 2003 compared to \$16.6 million for the same period in the prior year, an increase of \$6.5 million. The increased sales for the six-month period reflects improved sales of \$1.7 million through the operation in China and \$5.1 million in increased sales through the German operation. The improved sales in China reflect a volume increase due to increased demand for our

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product. The increase in sales through the German operation reflects a volume increase of \$1.8 million and a translation gain of \$3.3 million due to the change in exchange rates period-over-period of the Euro to the U.S. dollar.

### Gross Profit

Raytech recorded gross profit for the thirteen-week period ended June 29, 2003 of \$8.1 million, a gross profit percentage of 15.0% compared to \$11.1 million in the same period in the prior year, a gross profit percentage of 20.0%, a decline of 5 percentage points period-over-period. The decline in margin reflects lower margins in the Wet Friction segment of the business, which reported a gross margin of 9.1% for the thirteen-week period ended June 29, 2003 compared to 17.1% for the same period in the prior year, a decline of 8 percentage points. The decline is due to higher costs associated with the continued implementation of a new production line in the automotive OEM component of this segment. Certain capital investments have been made to improve the efficiency of the production, and improved profitability is expected over the next quarters. In addition, certain labor, materials and overhead cost reduction programs are in place aimed at improving profitability in light of the lower sales in this segment. The Aftermarket and Dry Friction segments recorded gross profit percentages of 28.9% and 27.6%, respectively, which are substantially the same as the prior year. Raytech recorded a gross profit of \$17.0 million for the twenty-six-week period ended June 29, 2003 compared to \$21.6 million for the same period in the prior year, a decrease of \$4.6 million period-over-period. The gross profit percentage for the twenty-six-week period of 15.5% compared to a gross profit percentage of 20.0% for the same period in 2002, a decrease of 4.5 percentage points. The decrease for the six-month period reflects the issues detailed above for the thirteen-week period, which is reflected in the Wet Friction segment gross profit of 9.1% for the period compared to 16.5% for the same twenty-six-week period in 2002, a decrease of 7.4 percentage points. The Aftermarket segment recorded a gross profit percentage of 29.1% for the twenty-six-week period ended June 29, 2003, which was substantially the same as the same period in the prior year while the Dry Friction segment recorded a gross profit percentage of 28.5%, an increase over the same period in the prior year of 3.2 percentage points primarily to increased sales period-over-period.

### Selling, General and Administrative

The selling, general and administrative expenses for the thirteen-week-period ended June 29, 2003 were \$8.6 million compared to \$8.2 million for the same period in the prior year, an increase of \$.4 million period-over-period. The increased SG&A for the period reflects higher selling and administrative costs in the Dry Friction segment of \$.4 million in support of the increased sales for that segment. The SG&A costs for the twenty-six-week period ended June 29, 2003 were \$16.8 million compared to \$15.8 million in the same period in the prior year, an increase of \$1.0 million. In addition to the explanation noted above for the second quarter, the increased SG&A reflects certain severance and new hire costs as well as increased research and development costs in 2003 over the 2002 costs for the same period.

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### Interest

Interest expense for the thirteen-week period ended June 29, 2003 of \$.3 million compares to \$.2 million for the same period in the prior year, an increase of \$.1 million. The interest expense for the twenty-six-week period ended June 29, 2003 of \$.5 million compares to \$.5 million for the same period in the prior year, an increase of less than \$.1 million. The increased interest expense for the

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thirteen-week- and twenty-six-week period reflects higher average outstanding debt of \$.4 million and \$2.0 million, respectively.

### Operating Profits

The following discussion of operating results by industry segment relates to information contained in Note D - Segment Reporting to the Unaudited Condensed Consolidated Financial Statements. Operating profit is income before provision for environmental claims, income taxes and minority interest.

Raytech Corporation recorded an operating loss of \$.1 million for the thirteen-week period ended June 29, 2003 compared to operating income of \$2.3 million for the same period in the prior year, a reduction of \$2.4 million. The reduced operating profit is due substantially to the lower gross profit of \$3.0 million and higher SG&A costs of \$.4 million. The operating profit for the twenty-six-week period ended June 30, 2003 of \$.2 million compares to an operating profit of \$5.2 million for the same period in the prior year, a decrease of \$5.0 million. The decrease in operating profits reflects a decline in gross profit of \$4.6 million and an increase in SG&A for the twenty-six-week period of \$1.0 million. The details of the changes in SG&A are outlined above in the SG&A section of this MD&A analysis. The changes in operating profits are detailed below by business segment.

The Wet Friction segment recorded an operating loss of \$1.2 million for the thirteen-week period ended June 29, 2003 compared to an operating profit of \$2.1 million for the same period in the prior year, a decrease of \$3.3 million period-over-period. The operating loss for the twenty-six-week period ended June 29, 2003 of \$2.4 million compares to operating profit for the same period in the prior year of \$3.7 million, a decline in operating profit of \$6.1 million compared to the twenty-six-week results for 2002. The primary reason for the reduced operating profit in this segment is the reduced gross profits for both the thirteen-week- and twenty-six-week periods in 2003 of \$3.3 million and \$5.6 million, respectively. A full discussion of the causes for the decline in gross profit is detailed under the gross profit heading presented earlier in this MD&A section. The SG&A costs for the segment increased \$.2 million for the thirteen-week period ended June 29, 2003 compared to the same period in the prior year. The increase is due primarily to increased selling expense for samples. The SG&A costs increased \$.6 million for the 26-week period due primarily to increased research and development costs and certain employee costs for severance and new hires.

The operating profit for the Aftermarket segment for the thirteen-week period ended June 29, 2003 of \$2.0 million compared to operating profit of \$2.3 million for the same period in the prior year, a decrease of \$.3 million. The decrease is due to the lower sales for the period of \$.8 million, which was the primary reason gross profit was reduced \$.4 million. The reduced gross profit was offset by lower SG&A costs for the period of \$.1 million. The operating profit for the twenty-six-week period ended June 29, 2003 of \$4.2 million compares to operating profit for the same period in the prior year of \$4.8

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million, a decrease of \$.6 million period-over-period. The decreased operating profit reflects the impact of lower sales for the period of \$1.8 million on the gross profit for the period. The gross profit declined \$.4 million in the six-month period in 2003 compared to the same period in the prior year. SG&A and other costs reflected a reduction of \$.1 million compared to the 2002 results.

The Dry Friction segment recorded operating profit of \$1.5 million for the thirteen-week period ended June 29, 2003 compared to \$.2 million for the same period in 2002, an increase in operating profit of \$1.3 million. The increased operating profit was driven by the improved sales of \$3.0 million over the second quarter results of 2002. The improved sales increased the gross profit by \$.8

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million for the period. The segment recorded operating profit of \$2.9 million for the twenty-six-week period ended June 29, 2003 compared to \$.9 million for the same period in the prior year. The increased operating profit of \$2.0 million reflects an increased gross profit of \$2.4 million due to increased sales in the segment of \$6.5 million for the twenty-six-week period. Increased selling costs of \$.4 million offset certain improvements in gross profit.

### Provision for Environmental Claims

The Company recorded a charge in the second quarter of 2003 of \$1.8 million for expected final remediation and administrative costs associated with compliance with the EPA Unilateral Administrative Order, which is discussed in Note G of this report. The work required under the Order has been completed at this time and a final report, which documents the compliance actions, is being prepared for submission to the EPA. During the thirteen-week period ended June 29, 2003, the cost of contaminated soil removal increased over the previously accrued amount \$1.6 million due to changes in the tonnage required to be removed in order to comply with the Order compared to the estimate. In addition, the EPA has estimated the administrative charge for the agency's oversight of the execution of the Order will be approximately \$.4 million. The final determination of this cost will occur subsequent to the EPA receiving the final report from the environmental engineering firm. Also, during the quarter, the Company settled a disputed billing amount, which arose in the first stage of the project from the construction company hired to do the initial cleanup. The resolution of the dispute resulted in a reduction of \$.2 million of amounts previously recorded by the Company. The construction company was replaced prior to the completion of the first stage.

Although the Company has, to the best of its knowledge, complied fully with the Order issued by the EPA, there exists the potential for additional remediation. Further, the Company may be required to remediate additional contiguous parcels of property not subject to the Order, subject to potential future actions taken by the EPA. See Note G for a discussion of this potential additional commitment.

### Income Taxes

See Note E - Income Taxes to the condensed unaudited consolidated financial statements included in Item I of this Part I.

### Liquidity, Capital Resources and Future Liquidity

The Company's cash and cash equivalents at June 29, 2003 totaled \$15.0 million compared to \$20.0 million at December 29, 2002, a decrease of \$5.0 million. Capital expenditures for the twenty-six-week period totaled \$5.5 million which is consistent with planned expenditures and approximates capital

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spending for the same period in the prior year. Net cash provided by operating activities was \$2.0 million for the twenty-six-week period ended June 29, 2003, compared to cash provided by operating activities of \$8.1 million in the prior year period. Cash outflows for other operating activities were \$5.6 million during the current year period, which was primarily comprised of the following: a \$4.6 million increase in accounts receivable, and a \$2.0 million increase in restricted cash, partially offset by a \$.9 million decrease in inventory.

The debt and available lines of credit at June 29, 2003 and December 29, 2002 consist of the following:

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|                    | (in thousands)            |             |           |                   |             |           |
|--------------------|---------------------------|-------------|-----------|-------------------|-------------|-----------|
|                    | June 29, 2003 (Unaudited) |             |           | December 29, 2002 |             |           |
|                    | Current                   | Non-Current | Total     | Current           | Non-Current | Total     |
| Domestic bank debt | \$ 9,275                  | \$ 23       | \$ 9,298  | \$ 11,306         | \$ --       | \$ 11,306 |
| Foreign bank debt  | 4,151                     | 4,466       | 8,617     | 3,609             | 4,095       | 7,704     |
| Total bank debt    | 13,426                    | 4,489       | 17,915    | 14,915            | 4,095       | 19,010    |
| Leases             | 156                       | 156         | 312       | 176               | 198         | 374       |
| <br>               |                           |             |           |                   |             |           |
| Total borrowings   | \$ 13,582                 | \$ 4,645    | \$ 18,227 | \$ 15,091         | \$ 4,293    | \$ 19,384 |

Available lines of credit:

|          | 2003     | 2002     |
|----------|----------|----------|
| Domestic | \$ 5,885 | \$ 5,006 |
| Foreign  | 2,632    | 3,829    |
| <br>     |          |          |
| Total    | \$ 8,517 | \$ 8,835 |

Refer to the Management's Discussion and Analysis section and to Note M to the consolidated financial statements, both included within the Company's 2002 Form 10-K, for information regarding the Company's obligations and commitments by year. These obligations and commitments consist of long-term debt, capital leases and rental agreements. During the thirteen-week period ended June 29, 2003, the Dry Friction segment renegotiated its borrowing agreement in China, lowering the interest rate 3.9 percentage points on the borrowings of \$1.5 million. In addition, the German subsidiary reduced its borrowing rate on \$1.0 million in borrowings by 2.1 percentage points during the period.

The current domestic loan agreement has a covenant requiring the borrowing companies to maintain a rolling twelve-month earnings before interest, taxes, depreciation and amortization (EBITDA). The Company was in compliance



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with this covenant at June 29, 2003.

The domestic borrowing facility matures in September 2003. The Company is reviewing borrowing alternatives and intends to enter into a new lending arrangement by September 2003.

The Company is complying with a Federal Order issued by the U.S. Environmental Protection Agency ("EPA") at its manufacturing facility in Crawfordsville, Indiana. See Note G - Litigation. The Company spent \$3.3 million during the twenty-six weeks ended June 29, 2003 and has a remaining accrual of \$5.7 million for completion of the project, which is included in other accrued liabilities. The Company recorded an additional accrual amount of \$1.8 million for the thirteen-week period ended June 29, 2003 and management estimates the remaining accrual is expected to be sufficient for compliance with the order. Refer to "Provision for Environmental Claims" on page 23 for further discussion.

The Company assumed the liability for the Raymark pension plans as part of the Chapter 11 reorganization. Funding for the plans in 2003 is expected to be approximately \$7.6 million of which \$2.4 million was funded during the twenty-six-week period of 2003.

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

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Management believes that existing cash balances, the Company's ability to replace the current lending facility and cash flow from operations during 2003 will be sufficient to meet all of the Company's obligations arising in the normal course of business, including anticipated capital investments.

### Financial Risks

THE COMPANY MAINTAINS LINES OF CREDIT WITH UNITED STATES AND FOREIGN BANKS, AS WELL AS OTHER CREDITORS. THE COMPANY IS NATURALLY EXPOSED TO VARIOUS INTEREST RATE RISK AND FOREIGN CURRENCY RISK IN ITS NORMAL COURSE OF BUSINESS.

THE COMPANY EFFECTIVELY MANAGES ITS ACCOUNTS RECEIVABLE AS EVIDENCED BY THE AVERAGE DAYS SALES IN TRADE RECEIVABLES OF 52 DAYS. THIS ALLOWS FOR MINIMUM BORROWINGS IN SUPPORTING INVENTORY AND TRADE RECEIVABLES. MANAGEMENT DOES NOT ANTICIPATE A SIGNIFICANT CHANGE IN FISCAL POLICY IN ANY OF ITS BORROWING MARKETS IN 2003 GIVEN CURRENT ECONOMIC CONDITIONS. FURTHER, THE COMPANY CAN REDUCE THE SHORT-TERM IMPACT OF INTEREST RATE FLUCTUATION THROUGH DEFERRAL OF CAPITAL INVESTMENT SHOULD THE NEED ARISE.

THE LOCAL CURRENCIES OF THE COMPANY'S FOREIGN SUBSIDIARIES HAVE BEEN DESIGNATED AS THEIR FUNCTIONAL CURRENCIES. ACCORDINGLY, FINANCIAL STATEMENTS OF FOREIGN OPERATIONS ARE TRANSLATED USING THE EXCHANGE RATE AT THE BALANCE SHEET DATE FOR ASSETS AND LIABILITIES, HISTORICAL EXCHANGE RATES FOR ELEMENTS OF STOCKHOLDER'S EQUITY AND AN AVERAGE EXCHANGE RATE IN EFFECT DURING THE PERIOD FOR REVENUES AND EXPENSES. WHERE POSSIBLE, THE COMPANY ATTEMPTS TO MITIGATE FOREIGN CURRENCY TRANSLATION EFFECTS BY BORROWING IN LOCAL CURRENCIES TO FUND OPERATIONS. THE COMPANY DOES NOT BELIEVE THAT THE FLUCTUATION IN FOREIGN CURRENCY WILL HAVE A MATERIAL ADVERSE EFFECT ON THE COMPANY'S OVERALL FINANCIAL CONDITION. ADDITIONALLY, THE COMPANY DOES NOT ENTER INTO AGREEMENTS TO MANAGE ANY CURRENCY TRANSACTION RISKS DUE TO THE IMMATERIAL AMOUNT OF TRANSACTIONS OF THIS TYPE. THE IMPACT OF THE TRANSLATION BETWEEN THE EURO AND THE U.S. DOLLAR ARE DETAILED IN THE NET SALES SECTION OF ITEM 2 OF THE MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. SEE NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES IN THE NOTES TO CONDENSED

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CONSOLIDATED FINANCIAL STATEMENTS FOR A DISCUSSION OF NEW ACCOUNTING PRONOUNCEMENTS DURING THE PERIOD.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See Item 2.

### ITEM 4. CONTROLS AND PROCEDURES

- (a) Based on evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures, which evaluation was made under the supervision and with the participation of management, including the Company's principal executive officer and principal financial officer, the Company's principal executive officer and principal financial officer have each concluded that such disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in reports that it files under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

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- (b) There has been no change during the thirteen weeks ended June 29, 2003 in the Company's internal controls over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

### PART II. OTHER INFORMATION

#### Item 1. Legal Proceedings

See Note G - Litigation.

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

The Annual Shareholders' Meeting of Raytech was held June 19, 2003. The matters submitted to stockholder vote and the vote count on the matters were as follows:

- Proposal to elect nine Directors for one-year terms and until their respective successors are elected

|                  | For<br>---          | Withheld<br>----- |
|------------------|---------------------|-------------------|
| Albert A. Canosa | 37,547,028<br>----- | 92,028<br>-----   |
| Robert F. Carter | 37,480,751<br>----- | 158,305<br>-----  |
| Archie R. Dykes  | 37,539,328<br>----- | 99,728<br>-----   |
| David N. Forman  | 37,539,787<br>----- | 99,269<br>-----   |

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|                  |            |         |
|------------------|------------|---------|
| John H. Laeri    | 37,505,927 | 133,129 |
| Stanley J. Levy  | 37,480,011 | 159,045 |
| Richard A. Lippe | 37,480,138 | 158,918 |
| Gene Locks       | 37,480,138 | 158,918 |
| John J. Robbins  | 37,480,597 | 158,459 |

2. Proposal to ratify the appointment of PricewaterhouseCoopers LLP as auditors for 2003

For 37,570,224 Against 67,359 Abstain 1,473

3. Proposal to amend Raytech's Certificate of Incorporation

For 37,602,344 Against 32,832 Abstain 3,880

For purposes of determining whether a proposal has received a majority vote, abstentions were included in the vote totals with the result that an abstention had the same effect as a negative vote. Under applicable Delaware law, "non-votes" were not included in the vote totals of proposals voted and, therefore, had no effect on the vote on that proposal. A "non-vote" would occur when a broker holding shares for a beneficial owner voted on one proposal but did not vote on another proposal because the broker did not have discretionary voting power and had not received instructions from the beneficial owner.

Pursuant to the vote of shareholders, proposals 1, 2 and 3 were adopted and effective on June 19, 2003.

The Director whose term of office as Director will continue from a term of three years beginning with an effective date of April 18, 2001 is:

Kevin S. Flannery

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

31-1 Section 302 Certification of the Chief Financial Officer  
31-2 Section 302 Certification of the Chief Executive Officer

(b) Reports on 8-K

None

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SIGNATURE

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

RAYTECH CORPORATION

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By: /s/ JOHN B. DEVLIN

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

Date: August 13, 2003

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