

KATY INDUSTRIES INC
Form PRE 14A
April 06, 2001

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

SCHEDULE 14A

Proxy Statement Pursuant To Section 14(A) Of The Securities Exchange Act Of 1934
(Amendment No.)

Filed by the Registrant [X]

Filed by a Party other than the Registrant []

Check the appropriate box:

[X] Preliminary Proxy Statement

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14a-6(e)(2))

[] Definitive Proxy Statement

[] Definitive Additional Materials

[] Soliciting Material Pursuant to (S) 240.14a-12

KATY INDUSTRIES, INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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[X] No fee required.

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- 3) Filing Party:
- 4) Date Filed:

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PRELIMINARY COPY

KATY INDUSTRIES, INC.
6300 S. Syracuse Way, Suite 300,
Englewood, Colorado 80111
(303) 290-9300

To our Stockholders:

We will be holding the Annual Meeting of Stockholders at _____
on May __, 2001 at _____a.m. local time.

At the Annual Meeting we will ask you to consider and vote upon a proposed investment in Katy Industries, Inc. by an affiliate of an investment fund managed by Kohlberg & Co., L.L.C., a private investment firm. Specifically, we need your approval to sell 400,000 shares of convertible preferred stock, \$100 par value per share, to this investor. We also need your approval to amend Katy's Restated Certificate of Incorporation to authorize 600,000 shares of convertible preferred stock. At the Annual Meeting you will also be asked to vote upon the election of nine members of the Board of Directors, including certain nominees designated by Kohlberg's affiliate, and to vote on a proposal to classify the Board into two classes with staggered terms.

The enclosed Notice of Annual Meeting of Stockholders and Proxy Statement provides details of the proposed investment and related information. Your Board has determined that the terms of the investment are fair to and in the best interests of Katy and its stockholders. YOUR BOARD OF DIRECTORS HAS APPROVED AND RECOMMENDS THAT YOU VOTE FOR THE PROPOSALS AT THE ANNUAL MEETING.

The investment is part of a series of transactions that your Board has approved. This series of transactions includes a tender offer by Kohlberg's affiliate to purchase from Katy stockholders up to 2,500,000 shares of Katy's common stock. As explained in this Proxy Statement, the Board of Directors believes that this series of transactions is in the best interests of stockholders.

We have enclosed with this letter a Notice of Annual Meeting, a Proxy Statement, a proxy card and a return envelope. A copy of Katy's annual report on Form 10-K is also enclosed. We urge you to read all of the enclosed materials carefully.

Please sign, date and promptly return the enclosed proxy card in the enclosed, prepaid return envelope. Your shares will be voted at the Annual Meeting in accordance with your proxy instructions.

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On behalf of the Board of Directors and the employees of Katy, we cordially invite all stockholders to attend the Annual Meeting. If you plan to attend the meeting, please mark the appropriate box on the enclosed proxy card.

Sincerely,

Robert M. Baratta
President and Chief Executive Officer

YOUR VOTE IS IMPORTANT

Please Sign, Date and Return Your Proxy Card by May ____, 2001

If you have questions about voting your shares, please contact our proxy solicitor, Innisfree M&A Incorporated, toll-free at 1-888-750-5834.

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KATY INDUSTRIES, INC.
6300 S. Syracuse Way, Suite 300,
Englewood, Colorado 80111
(303) 290-9300

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To the Stockholders of Katy Industries, Inc.:

We are holding an Annual Meeting of Stockholders of Katy on May ____, 2001 at __ a.m., local time. The meeting will be held at _____. At the meeting, you will be asked to vote on the following:

1. A proposal to sell 400,000 shares of Katy's convertible preferred stock, \$100 par value per share, to KKTU Holding Company, L.L.C., an affiliate of an investment fund managed by Kohlberg & Co., L.L.C., a private investment firm.
2. A proposal to approve an amendment to Katy's Restated Certificate of Incorporation to authorize 600,000 shares of convertible preferred stock.
3. A proposal to approve an amendment to Katy's Restated Certificate of Incorporation authorizing the classification of the Board of Directors into two classes with staggered terms.
4. The election of nine members of the Board of Directors to serve for the staggered terms specified in the enclosed Proxy Statement or, if Proposals 1, 2 and 3 are not adopted by the stockholders, the election of nine members of the Board of Directors to serve for a term of one year.
5. The ratification of the selection by the Board of Directors of the firm of Arthur Andersen LLP as independent auditors of Katy for the current year.
6. The transaction of such other business as may properly come before the Annual Meeting or any adjournment thereof.

As part of Proposal 1, we are also asking you to approve at this time the issuance of shares of common stock to the holder of the convertible preferred stock upon conversion of the convertible preferred stock in accordance with the terms of the convertible preferred stock. The effectiveness of each of Proposals 1, 2 and 3 is contingent upon the approval of the others. No action will be taken by Katy on Proposals 1, 2 or 3 unless all three proposals are

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approved.

The Proxy Statement that we are delivering with this Notice contains important information concerning the proposals to be considered at the Annual Meeting. You will be able to vote your shares at the Annual Meeting if you were a stockholder of Katy at the close of business on April 23, 2001.

By order of the Board of Directors:

Arthur R. Miller
Secretary

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Dated: April __, 2001

YOUR VOTE AT THE ANNUAL MEETING IS IMPORTANT.

PLEASE INDICATE YOUR VOTE ON THE ENCLOSED PROXY CARD AND RETURN IT IN THE ENCLOSED ENVELOPE AS SOON AS POSSIBLE, EVEN IF YOU PLAN TO ATTEND THE MEETING.

IF YOU HAVE QUESTIONS ABOUT VOTING YOUR SHARES, PLEASE CONTACT OUR PROXY SOLICITOR, INNISFREE M&A INCORPORATED, TOLL-FREE AT 1-888-750-5834.

IF YOU ATTEND THE MEETING, YOU WILL BE ABLE TO REVOKE YOUR PROXY AND VOTE IN PERSON.

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KATY INDUSTRIES INC.
6300 S. Syracuse Way, Suite 300,
Englewood, Colorado 80111
(303) 290-9300

PROXY STATEMENT FOR ANNUAL MEETING

This Proxy Statement provides information that you should read before you vote on five proposals that will be presented to the stockholders of Katy at an Annual Meeting to be held on May __, 2001 at _____.

For convenience, we first provide a question-and-answer summary of important information. The remainder of this Proxy Statement provides specific information about the Annual Meeting, the proposals on which you will be asked to vote at the Annual Meeting, the investment that is the subject of the first two proposals you will be asked to consider, and other relevant information.

On April __, 2001, we began mailing information to people who, according to our stockholder records, owned shares of Katy's common stock at the close of business on April 23, 2001.

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ANNEX A -- Opinion of Bear, Stearns & Co. Inc. dated March 29, 2001

ANNEX B -- Preferred Stock Purchase and Recapitalization Agreement dated as of March 29, 2001 between KKTU Holding Company, L.L.C. and Katy Industries, Inc.

ANNEX C -- Stock Voting and Tender Agreement dated as of March 29, 2001

ANNEX D -- Proposed Amendment to Katy's Restated Certificate of Incorporation to authorize 600,000 shares of convertible preferred

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stock and to adopt a classified board

ANNEX E -- Charter of the Audit Committee of the Board of Directors of Katy

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SUMMARY

This summary answers basic questions about the proposals. Please read the rest of the Proxy Statement for full information about the proposals.

This Proxy Statement contains forward-looking statements that involve risks and uncertainties. The words "believe," "anticipate," "expect," "estimate," "intend" and similar expressions identify forward-looking statements. Actual results could differ materially from those discussed in the forward-looking statements as a result of certain factors. See "Forward-Looking Statements" on page ____ of the Proxy Statement.

WHAT ARE WE ASKING YOU TO APPROVE?

The first proposal for you to consider is the issuance and sale by Katy of convertible preferred stock, \$100 par value per share, to an affiliate of an investment fund managed by Kohlberg & Co., L.L.C. ("Kohlberg"). (We will use the term "convertible preferred stock" to refer to the convertible preferred stock, \$100 par value, that we are proposing to sell. We will use the term "Purchaser" to refer to the buyer of the convertible preferred stock.) As part of this proposal, we are also asking you to approve at this time the issuance of shares of common stock to the holder of the convertible preferred stock upon conversion of the convertible preferred stock in accordance with the terms of the convertible preferred stock.

Purchaser will purchase, for \$100 per share, 400,000 shares of convertible preferred stock. Each share of convertible preferred stock is convertible into 12.5 shares of Katy common stock, so that the purchase price of convertible preferred stock is equivalent to \$8.00 per share of common stock into which the preferred stock is convertible. 400,000 shares of convertible preferred stock would be convertible into 5,000,000 shares of common stock.

The second proposal for you to consider, which is related to the first proposal, is an amendment to Katy's Restated Certificate of Incorporation to authorize 600,000 shares of convertible preferred stock. Katy does not currently have any shares of preferred stock authorized or issued. If stockholders do not approve this proposal, Katy will not be able to sell the convertible preferred stock to Purchaser.

The third proposal, which is a condition to the completion of the transactions with Kohlberg, is an amendment to Katy's Restated Certificate of Incorporation authorizing the classification of the Board of Directors into two classes with staggered terms.

You are also being asked to elect the members of your Board and to ratify the selection of Arthur Andersen LLP as independent auditors of Katy. If the first three proposals are adopted, the nominees for election to the Board include five nominees designated by Purchaser, plus a new Chief Executive Officer, who was also proposed by Purchaser, and directors will be elected in two classes for staggered terms.

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WHY IS KATY SELLING PREFERRED STOCK TO PURCHASER?

Your Board has approved the sale of convertible preferred stock to Purchaser because such sale would provide Katy with significant increased cash resources and would permit Katy to refinance its existing bank loans, which otherwise would likely become due June 30, 2001, and to partially redeem a third party's preferred interest in a Katy subsidiary. (We will sometimes refer to the sale of convertible preferred stock to Purchaser as the "Preferred Stock Purchase.") The Preferred Stock Purchase would decrease the percentage of Katy's capitalization that consists of debt. The Board has determined that the financial and other terms of the Preferred Stock Purchase are fair to and in the best interests of Katy and its stockholders.

Kohlberg is a private merchant banking firm with offices in New York and California. Founded in 1987, Kohlberg has completed more than 70 acquisitions and recapitalization transactions in a variety of industries. It manages a pool of capital in excess of \$1.5 billion. It has substantial experience in providing companies in which its affiliates invest with financial and managerial advisory services aimed at building value and improving operational, marketing and financial performance.

WHAT ARE THE RELATED TRANSACTIONS?

The Preferred Stock Purchase is part of a series of transactions approved by your Board. This series of transactions includes a tender offer by Purchaser for 2,500,000 shares of Katy's common stock at \$8.00 per share (the "Tender Offer").

As part of the series of transactions, Purchaser has obtained a commitment letter from Bankers Trust Company to provide up to \$150 million of senior secured term and revolving loans to Katy, which will replace Katy's existing senior bank loans. In addition, a condition to the Preferred Stock Purchase and the Tender Offer is the completion of the sale of Katy's subsidiary Hamilton Metals, L.P. for gross proceeds in cash, net of liabilities retained by Katy, of at least \$20,000,000. Katy has entered into a non-binding letter of intent with a potential buyer for a sale of substantially all of the assets of Hamilton on terms that Katy believes will satisfy the condition.

Katy and its subsidiary Contico International, LLC have entered into an agreement with Newcastle Industries, Inc. for Contico to repurchase 165 of Newcastle's 329 preferred units in Contico for a total of \$9.9 million, plus accrued and unpaid priority return and profit participation on those units, if the transactions with Purchaser close. Katy and Newcastle have also agreed to amendments to the Members Agreement relating to Contico and to Contico's Limited Liability Company Agreement which take effect subject to the transactions with Purchaser closing.

Your Board decided that the transaction with Kohlberg is in the best interests of stockholders for several reasons. While the Preferred Stock Purchase will permit a reduction in Katy's indebtedness and a restructuring of Katy's existing bank loans, the Tender Offer will permit stockholders to choose to receive cash in exchange for a portion of their Katy common stock. The Preferred Stock Purchase and Tender Offer will also bring to Katy's business the managerial assistance and support of Kohlberg.

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WHAT FACTORS SHOULD YOU TAKE INTO ACCOUNT IN CONSIDERING THE PROPOSED PREFERRED STOCK PURCHASE?

Katy's Board unanimously approved the transactions with Kohlberg because it

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believed they would be in the best interests of Katy and its stockholders. (We will use the term "unanimously" in the Proxy Statement to refer to actions by all current members of Katy's Board, except William F. Andrews, a principal of Kohlberg, who did not take part in the discussions relating to the transactions with Kohlberg.) You should consider the factors described at pages _____ below. Positive factors considered by the Board include:

- The Board received an opinion from Bear, Stearns & Co. Inc. that, as of the date of such opinion, the Preferred Stock Purchase and Tender Offer, taken as a whole, were fair from a financial point of view to Katy's stockholders. A copy of the Bear Stearns opinion is attached as Annex A.
- Katy's cash resources and financial strength will be increased as a result of the cash infusion by Purchaser and borrowing availability under the new credit facility with Bankers Trust Company.
- The Tender Offer and Preferred Stock Purchase give stockholders the opportunity to sell shares of Katy in the Tender Offer at a substantial premium to the market price of Katy shares before the transaction with Kohlberg was announced, and also to remain as stockholders in a company that will be financially strengthened by the Purchaser's cash infusion.
- Katy's existing credit agreement must be refinanced by June 30, 2001. If the transactions with Kohlberg are not completed, considering the current market environment, a substantive risk exists that Katy will be unable to obtain further waivers of the defaults under the current credit facility and that Katy will be unable to obtain, on reasonable terms or at all, financing necessary to replace its current credit facility. If Katy is unable to refinance its existing bank loans, the entire amount under the existing credit agreement could be declared due and payable not later than June 30, 2001.

Negative factors considered by the Board include:

- The issuance of the convertible preferred stock will have a dilutive effect on Katy's existing stockholders.
- If the transactions with Purchaser are completed, Purchaser's significant ownership interests could effectively deter a third party from making an offer to acquire Katy.
- Purchaser's nominees, if elected, will constitute a majority of the Board of Directors, five of whom will serve an initial term of two years.

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- Purchaser will nominate the proposed Chief Executive Officer, who is also a nominee for director, and who, if elected as director, will serve for an initial term of one year.
- Purchaser will have the right, so long as it retains any convertible preferred stock, to nominate a majority of the members of the Board of Directors in connection with future elections of directors.
- The holders of the convertible preferred stock will have preferential rights with respect to distributions if Katy is liquidated.
- If the Purchase Agreement is terminated, then, under certain

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circumstances, Katy will be obligated to pay to Purchaser a fee of \$2,000,000 and to reimburse Purchaser's expenses up to \$1,000,000.

The Board believed that, on balance, the possible benefits to Katy stockholders from the positive factors outweighed the possible detriments from the negative factors.

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INFORMATION ABOUT THE ANNUAL MEETING AND VOTING

THE ANNUAL MEETING

The Annual Meeting will be held on May __, 2001 at _____ at ____ a.m. local time.

THIS PROXY SOLICITATION

Katy is sending you this Proxy Statement because Katy's Board of Directors is seeking your proxy to vote your shares at the Annual Meeting. This Proxy Statement includes information that Katy is required to provide to you under the rules of the Securities and Exchange Commission. It is intended to assist you in voting your shares. On April __, 2001, we began mailing information to all people who, according to our stockholder records, owned shares at the close of business on April 23, 2001.

Katy will pay the cost of requesting these proxies. Katy's directors, officers and employees may request proxies in person or by telephone, mail, telecopy or letter. Katy also has retained Innisfree M&A Incorporated to assist in distributing proxy solicitation materials and seeking proxies. Katy will pay Innisfree a fee of approximately \$15,000, plus reasonable out-of-pocket expenses, for this assistance. Katy will reimburse brokers and other nominees their reasonable out-of-pocket expenses for forwarding proxy materials to beneficial owners of stock.

VOTING YOUR SHARES

You are entitled to one vote at the Annual Meeting for each share of Katy's common stock that you owned of record at the close of business on April 23, 2001. The number of shares you own (and may vote) is listed on the enclosed proxy card.

You may vote your shares at the Annual Meeting in person or by proxy. To vote in person, you must attend the Annual Meeting and obtain and submit a ballot. We will give you a ballot at the Annual Meeting. To vote by proxy, you must complete and return the enclosed proxy card. By completing and returning the proxy card, you will be directing the persons designated on the proxy card to vote your shares at the Annual Meeting in accordance with the instructions you give on the proxy card.

Your proxy card will be valid only if you sign, date and return it before the Annual Meeting. IF YOU COMPLETE THE PROXY CARD EXCEPT FOR THE VOTING INSTRUCTIONS, THEN YOUR SHARES WILL BE VOTED FOR THE PROPOSED SALE OF CONVERTIBLE PREFERRED STOCK TO PURCHASER AND FOR EACH OF THE OTHER PROPOSALS. You may revoke your proxy at any time before it is voted by any of the following means:

- Notifying the Secretary of Katy in writing that you wish to revoke your proxy.

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- _ Submitting a proxy dated later than your original proxy.
- _ Attending the Annual Meeting and voting. Merely attending the Annual Meeting will not by itself revoke a proxy; you must vote your shares at the Annual Meeting to revoke the proxy.

IF YOU WERE A HOLDER OF SHARES AT THE CLOSE OF BUSINESS ON APRIL 23, 2001, YOU WILL BE ENTITLED TO VOTE YOUR SHARES WHETHER OR NOT YOU SUBSEQUENTLY TENDER YOUR SHARES IN THE TENDER OFFER DESCRIBED ON PAGES _____ OF THIS PROXY STATEMENT. YOU SHOULD THEREFORE SIGN, DATE AND RETURN THE ENCLOSED PROXY CARD EVEN IF YOU HAVE ALREADY TENDERED, OR INTEND TO TENDER, YOUR SHARES IN THE TENDER OFFER.

The Board of Directors does not expect any matter other than the proposals that are discussed in this Proxy Statement to be presented at the Annual Meeting. However, if any other matter properly comes before the Annual Meeting, your proxies will act on such matter in their discretion.

VOTE REQUIRED FOR APPROVAL

We have agreed with Purchaser that we will ask you to approve the Preferred Stock Purchase. Also, the rules of the New York Stock Exchange (where Katy stock is traded) require stockholders to approve substantial sales of common stock or of securities convertible into common stock.

Proposal 1, regarding the proposed sale of convertible preferred stock to Purchaser, and Proposal 5, regarding the ratification and appointment of Arthur Andersen LLP as the independent auditors of Katy, will be approved if a majority of the votes cast on the proposal are cast in favor of the proposal. Proposals 2 and 3, the proposed amendments to Katy's Restated Certificate of Incorporation to authorize the convertible preferred stock and to classify the Board of Directors, respectively, each require the affirmative vote of the holders of a majority of the voting power of Katy's outstanding capital stock entitled to vote at the Annual Meeting. With respect to Proposal 4, regarding the election of directors, directors will be elected by a plurality of the shares present in person or by proxy and entitled to vote on the election of directors. "Plurality" means that the individuals who receive the largest number of votes cast are elected as directors up to the maximum number of directors to be elected at the Annual Meeting. Consequently, any shares not voted (whether by abstention, broker non-vote or withholding authority) will have no impact on the election of directors.

The effectiveness of each of Proposal 1, Proposal 2 and Proposal 3 is contingent on the approval of the others. Katy will not take any action on Proposal 1, Proposal 2 or Proposal 3 unless stockholders approve all three. Therefore, if you vote against approving either of the two amendments to Katy's Restated Certificate of Incorporation, this will have the same effect as voting against the Preferred Stock Purchase.

Certain Katy stockholders have also entered into a Stock Voting and Tender Agreement dated as of March 29, 2001 (the "Voting Agreement"). The Voting Agreement provides, among other things, that those stockholders will tender, in aggregate, at least 1,500,000 shares to Purchaser in the Tender Offer and will vote, in the aggregate, 2,500,000 shares in favor of Proposals 1, 2, 3 and 4. The 2,500,000 common shares subject to these voting obligations represent, as of March 29, 2001, approximately 29.8% of the shares of Katy capital stock entitled to vote at the Annual Meeting. The Voting Agreement is included as Annex C to

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this Proxy Statement.

On the record date for the Annual Meeting, April 23, 2001, _____ shares of Katy's common stock, \$1.00 par value per share, were issued and outstanding. In addition, a "quorum" must be present at the Annual Meeting. Each share of common stock is entitled to one vote. A quorum will be present if a majority of the outstanding shares of common stock are represented at the Annual Meeting, either in person (by the stockholders) or by proxy. If there is no quorum, a vote cannot occur.

In deciding whether there is a quorum, abstentions and "broker non-votes" will be counted as shares that are represented at the Annual Meeting. (A broker non-vote can occur if you hold your shares with a broker and are asked to instruct your broker how to vote your shares. If you do not tell your broker how to vote, your broker will not be able to vote for or against the proposal. If your broker returns a proxy card for your shares without any voting instructions, your shares will be counted as "broker non-vote" shares.) In deciding whether Proposal 1 or Proposal 5 has been approved, abstentions will count as if they were votes against the proposal, but broker non-votes will not count. Since Proposal 2 and Proposal 3 each requires the affirmative vote of the holders of a majority of the voting power of Katy's outstanding capital stock entitled to vote, broker non-votes will count as if they were votes against such proposals. Neither abstentions nor broker non-votes will count in electing directors.

OTHER MATTERS

Katy's stockholders are not entitled to appraisal rights under Section 262 of the Delaware General Corporation Law, whether or not they vote against the sale of convertible preferred stock to Purchaser.

Arthur Andersen LLP is Katy's independent accountant. Representatives of Arthur Andersen LLP will attend the Annual Meeting. They will have the opportunity to make a statement if they wish, and to respond to appropriate questions.

PROPOSAL 1 - SALE OF CONVERTIBLE PREFERRED STOCK

INTRODUCTION

Katy is asking you to approve a sale of 400,000 shares of convertible preferred stock to KKTU Holding Company, L.L.C. ("Purchaser"), an affiliate of an investment fund managed by Kohlberg, for a price of \$100 per share. Katy is also asking you to

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approve at this time the issuance of shares of common stock to the holder of the convertible preferred stock upon conversion of the convertible preferred stock in accordance with the terms of the convertible preferred stock. On March 29, 2001, Purchaser and Katy signed a Preferred Stock Purchase and Recapitalization Agreement (the "Purchase Agreement") that sets out the terms of the proposed sale of convertible preferred stock. The Purchase Agreement is included as Annex B to this Proxy Statement. You should read the entire Purchase Agreement including the Annexes and Exhibits included with the Purchase Agreement.

Purchaser's purchase of the convertible preferred stock is part of a series of transactions. Concurrently with Katy mailing this Proxy Statement, Purchaser will offer to purchase from Katy stockholders 2,500,000 shares of Katy's common stock, at a price of \$8.00 per share, in a tender offer (the "Tender Offer") provided that, among other things, at least 2,000,000 shares of Katy's common

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stock are tendered. On the closing of the Tender Offer and assuming stockholder approval, Katy will sell 400,000 shares of Katy's convertible preferred stock, \$100 par value per share, to Purchaser for a price of \$100 per share, on the terms and subject to the conditions in the Purchase Agreement. (We will sometimes refer to the sale of the convertible preferred stock to Purchaser as the "Preferred Stock Purchase.")

As part of the series of transactions, Purchaser has obtained a commitment letter from Bankers Trust Company to provide up to \$150 million of senior secured term and revolving loans to Katy, which will replace Katy's existing bank loans. In addition, the completion of the sale of Hamilton Metals, L.P. ("Hamilton") for cash proceeds, net of liabilities retained by Katy, of \$20,000,000 is a condition to Purchaser's obligation to consummate the Preferred Stock Purchase and the Tender Offer. Katy has entered into a non-binding letter of intent with a potential buyer for a sale of substantially all of the assets of Hamilton on terms that Katy believes will satisfy this condition.

Katy engaged Bear Stearns to provide a fairness opinion in connection with the transactions with Kohlberg. On March 29, 2001, Bear Stearns delivered an opinion to the Board of Directors that, as of the date of such opinion, the Preferred Stock Purchase and the Tender Offer, taken as a whole, were fair, from a financial point of view, to Katy's stockholders. Bear Stearns' written opinion is included as Annex A to this Proxy Statement. The opinion sets forth the assumptions made, matters considered and limitations on the review undertaken in connection with the opinion. The opinion of Bear Stearns does not constitute a recommendation as to how any holder of Katy stock should vote with respect to any matter described herein. You should read the entire opinion carefully. Additional information about the opinion can be found at pages ____.

REQUIRED VOTE

The affirmative vote of the holders of a majority of the outstanding shares of common stock entitled to vote at the Annual Meeting that are present in person or by proxy is required to approve Proposal 1. Approval of Proposal 1 is contingent on approval of Proposal 2 and Proposal 3.

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RECOMMENDATION OF THE BOARD OF DIRECTORS

THE BOARD OF DIRECTORS HAS UNANIMOUSLY APPROVED THE MATTERS SET FORTH IN PROPOSAL 1 AND BELIEVES THAT THEY ARE FAIR TO AND IN THE BEST INTERESTS OF KATY AND ITS STOCKHOLDERS AND RECOMMENDS THAT THE STOCKHOLDERS VOTE "FOR" THE APPROVAL OF PROPOSAL 1.

THE TRANSACTION

Subject to the conditions in the Purchase Agreement, Katy has agreed to issue and sell, and Purchaser has agreed to buy, 400,000 shares of newly-issued convertible preferred stock, \$100 par value per share, for a price of \$100 per share. The gross proceeds from the sale will be \$40 million. 400,000 shares of convertible preferred stock would be convertible into 5,000,000 shares of common stock at an exchange ratio of 12.5 shares of common stock per share of convertible preferred stock.

INFORMATION ABOUT THE PURCHASE AGREEMENT

The important terms of the Purchase Agreement are described below. The Purchase Agreement is included as Annex B to this Proxy Statement. You should read the entire Purchase Agreement including the Annexes and Exhibits included with the Purchase Agreement.

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The Tender Offer

Concurrently with the mailing of this Proxy Statement, Purchaser will offer to purchase from Katy stockholders 2,500,000 shares of Katy's common stock, at a price of \$8.00 per share.

The Tender Offer will initially be open for 20 business days after its commencement date, or until May __, 2001, if such date is later. Purchaser can extend the Tender Offer for up to an additional 20 business days (but not past June 30, 2001). Purchaser must so extend the Tender Offer if Katy requests this, provided the conditions to Purchaser's obligations to close the purchase of shares pursuant to the Tender Offer are satisfied (with some exceptions, including the condition that stockholders have tendered at least 2,000,000 shares of common stock).

Purchaser's obligation to accept for payment and to pay for shares of common stock validly tendered into the Tender Offer is subject to various conditions in the Purchase Agreement. In any event, Purchaser cannot purchase more than 29.9% of Katy's outstanding common stock. Therefore, if stockholders tender more than 2,500,000 shares of common stock, Purchaser will buy shares from them pro rata up to the 2,500,000 maximum.

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The Preferred Stock Issuance

Subject to the conditions in the Purchase Agreement, Katy has agreed to issue and sell, and Purchaser has agreed to buy, 400,000 shares of newly-issued convertible preferred stock, \$100 par value per share, for a price of \$100 per share. 400,000 shares of convertible preferred stock would be convertible into 5,000,000 shares of common stock at an exchange ratio of 12.5 shares of common stock per share of convertible preferred stock (which, based on the \$100 purchase price for a share of convertible preferred stock, is the equivalent of \$8.00 per share of common stock).

The terms and conditions of the convertible preferred stock are set out below in the section entitled "Terms of the Convertible Preferred Stock."

Corporate Governance

Under the Purchase Agreement, Purchaser has the right to nominate five directors for election at the Annual Meeting, subject to election by the holders of common stock present in person or by proxy and voting at the Annual Meeting. The Purchaser's designees have been unanimously approved by the members of the Board currently in office (other than Mr. Andrews, who removed himself from consideration of matters relating to the proposed transaction because of his affiliation with Kohlberg). At any subsequent annual or special meeting of the stockholders of Katy at which an election for members of Katy's Board is held, Purchaser has the right, for so long as it retains any shares of convertible preferred stock, to nominate a number of nominees such that, after the election, the Purchaser's designees constitute a simple majority of the members of Katy's Board, subject to election by vote of the holders of the common shares.

If stockholders approve Proposal 1, Proposal 2 and Proposal 3, the directors elected at the 2001 annual meeting of stockholders will be classified into two classes as follows:

- One class will comprise three current directors who will continue in office (Robert M. Baratta, Daniel B. Carroll and Wallace E. Carroll, Jr.) plus C. Michael Jacobi, the proposed Chief Executive Officer

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nominated by Purchaser. This class will initially be elected for a one year term expiring at the annual meeting of stockholders to be held in 2002.

- The second class will comprise the five Purchaser designees, one of whom is William F. Andrews, a current director. This class will initially be elected for a two year term expiring at the annual meeting of stockholders to be held in 2003.

Beginning with the election of directors to be held at the year 2002 annual meeting, each class of directors would be elected for a two-year term.

Purchaser has agreed that it will not sell more than 20% of the Katy common stock (on a fully diluted basis, including the shares of common stock issuable upon the

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conversion of convertible preferred stock) in any transaction or series of related transactions, unless all holders of Katy common stock except Purchaser and its affiliates (the "Other Holders") have the right to participate in such sale for the same consideration per share of common stock (or common share equivalent) on a pro rata basis. In connection with any merger, consolidation or other business combination involving Katy in which Katy is not the surviving corporation, the Other Holders shall receive the same consideration per share of common stock (or common share equivalent) as Purchaser receives.

All fees paid by Katy to Purchaser (or its affiliates) and any transactions between Katy and Purchaser (or its affiliates) shall be subject to approval of the members of Katy's Board who are not designees of Purchaser or otherwise affiliated with Purchaser (the "Other Directors").

The above governance provisions will be reflected in Katy's by-laws, effective on the closing. Any amendment to Katy's by-laws modifying the terms described above will be subject to approval by a majority of the Other Directors and by a majority of the Other Holders.

Conditions to Accepting Shares Tendered into the Tender Offer and Purchasing the Preferred Stock

Both Purchaser's and Katy's obligations to close the transactions are subject to certain conditions including the absence of a law or judgment that would prevent the transactions from closing and receipt of necessary approvals. A party need not close if the other party has materially breached its representations or warranties, or failed to comply with its obligations, under the Purchase Agreement.

Also, Purchaser need not buy shares of common stock tendered into the Tender Offer nor the convertible preferred stock to be issued by Katy unless certain other conditions in the Purchase Agreement are satisfied. These include:

- there being validly tendered and not withdrawn prior to the expiration of the Tender Offer at least 2,000,000 shares of Katy's common stock;
- the shares of common stock tendered in the Tender Offer, together with the shares of common stock into which Purchaser's convertible preferred stock is convertible, represent a majority of Katy's common stock issuable and outstanding, calculated on a fully diluted basis (excluding outstanding options);

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- the shares of common stock tendered in the Tender Offer, after proration, if any, represent less than 30% of the combined voting power of the outstanding securities of Katy on the date the purchase of tendered shares closes;

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- there being no change in the financial condition, businesses, operations, properties, results of operations, assets or prospects of Katy and its subsidiaries that has a material adverse effect on Katy and its subsidiaries;
- absence of a material adverse change after the commencement of the Tender Offer in financial or credit agreement syndication markets that results in Katy not obtaining funding under the Bankers Trust Company loan commitment letter;
- the stockholders have elected the Purchaser's designees, amended Katy's Restated Certificate of Incorporation to authorize the issue of convertible preferred stock and to adopt a classified Board of Directors, and authorized the sale of the convertible preferred stock to Purchaser;
- Katy's board of directors has not withdrawn or materially modified its recommendation of the transactions or approved a competing transaction;
- Katy has obtained an unqualified audit opinion on its financial statements for the year ended December 31, 2000;
- Katy has consummated the sale of its subsidiary Hamilton for gross proceeds in cash, net of liabilities retained by Katy, of at least \$20,000,000;
- no person or group has, after the date of the Purchase Agreement, acquired beneficial ownership of more than 20% of Katy's common stock;
- there shall not have occurred in the United States, a general suspension of trading in securities markets, a banking moratorium or suspension of payments by banks, a limitation by a governmental authority on the extension of credit by banks or other financial institutions, or a declaration of war or commencement of hostilities;
- Bear Stearns has not withdrawn its fairness opinion;
- Katy has entered into definitive documentation for the credit facilities to be established under the terms and conditions of the proposed refinancing with Bankers Trust Company in a term sheet signed by Bankers Trust Company and Purchaser (including any modification of the refinancing terms approved by Purchaser); and
- certain stockholders of Katy have entered into a stock voting agreement with respect to electing Purchaser designees as directors at stockholder meetings after the 2001 annual stockholder meeting.

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No Solicitation

Katy has agreed that, prior to closing, it will not solicit, initiate or

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encourage inquiries or proposals, or participate in discussions or negotiations, about competing transactions meeting certain criteria. However, Katy can give information to, or enter into discussions or negotiations with, anyone making an unsolicited enquiry and who gives Katy a written proposal if a majority of Katy's directors determines that doing so would be reasonably likely to result in a written proposal to acquire more than 50% of Katy's outstanding equity securities that Katy's Board of Directors determines in good faith (after consultation with an independent, nationally recognized investment bank) to be superior to Katy's stockholders from a financial point of view compared to Purchaser's proposal, and that failure to do so would not be consistent with the directors' fiduciary duties.

Katy's Board of Directors cannot withdraw its approval or recommendation of the transactions, approve or recommend certain types of competing transactions or cause Katy to enter into a letter of intent or acquisition agreement for such competing transactions except to comply with securities laws or stock exchange requirements or if the board determines that not doing so would be inconsistent with the directors' fiduciary duties.

Termination

Katy and Purchaser can terminate the Purchase Agreement at any time by mutual agreement. Either party can terminate the Purchase Agreement if:

- the transactions have not closed by June 30, 2001 (unless this is due to that party's breach);
- a law or judgment prevents the transactions; or
- the other party materially breaches its representations or does not perform its covenants under the Purchase Agreement (and does not or cannot remedy its breach).

Purchaser can terminate the Purchase Agreement if stockholders do not tender at least 2,000,000 shares of common stock into the Tender Offer or if any of the other conditions to purchasing shares tendered into the Tender Offer and purchasing the convertible preferred stock are not satisfied.

Katy can terminate the Purchase Agreement, in furtherance of its directors' fiduciary duties, to enter into an agreement with a third party relating to a superior proposal to acquire more than 50% of Katy's outstanding equity securities. Katy must have given Purchaser three business days' notice of the competing proposal and negotiate with Purchaser during those three business days if Purchaser wishes to do so.

Termination Fees

Katy must reimburse Purchaser for its documented expenses, up to \$1,000,000, if the Purchase Agreement is terminated because:

- the transactions have not closed by June 30, 2001;
- a law or judgment prevents the transactions;
- the stockholders do not tender at least 2,000,000 shares of common stock into the Tender Offer;
- any of the other conditions to Purchaser closing the transactions are not satisfied;

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- Katy has materially breached its representations or not performed its covenants under the Purchase Agreement (and did not or could not remedy its breach); or
- in furtherance of the directors' fiduciary duties, Katy wishes to enter into an agreement with a third party relating to a superior proposal for a third person to acquire more than 50% of Katy's outstanding equity securities.

Also, Katy must pay Purchaser a fee of \$2 million if:

- another person proposes to Katy or its stockholders, or publicly proposes, a competing transaction under which that person would buy a business constituting at least 40% of Katy's consolidated net revenues, net income or assets, buy at least 40% of Katy's common stock or enter into a merger, recapitalization or similar transaction involving Katy;
- the Purchase Agreement is terminated after that because:
 - . the stockholders do not tender at least 2,000,000 shares of common stock into the Tender Offer;
 - . any of the other conditions to Purchaser completing the transactions are not satisfied (except for a law or judgment preventing the transactions; an adverse change in the financing or credit agreement syndication markets that results in Katy not obtaining financing; a general suspension of trading in securities markets (or various other disruptions to financial markets); or merely that the Purchase Agreement has been terminated);

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- . Katy has materially breached its representations or not performed its covenants under the Purchase Agreement (and did not or could not remedy its breach); or
- . in furtherance of the directors' fiduciary duties, Katy wishes to enter into an agreement with a third party relating to a superior proposal for a third person to acquire more than 50% of Katy's outstanding equity securities.
- Katy enters into the competing transaction within 12 months of the termination of the Purchase Agreement, and closes that competing transaction within 18 months of the Purchase Agreement terminating.

Transaction and Monitoring Fee

Katy's Board of Directors has approved Katy paying a transaction fee of \$3 million to Kohlberg if the transactions with Kohlberg are completed. Therefore, if the stockholders pass Proposals 1, 2, 3 and 4 and the transactions are completed, Katy will pay Kohlberg this \$3 million fee.

Kohlberg has informed Katy that Kohlberg intends to propose an annual monitoring fee of \$500,000 for investment banking and advisory services on an ongoing basis and in lieu of director fees for the Kohlberg designees.

VOTING AGREEMENT

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Purchaser and certain members of the Wallace E. Carroll, Jr. family, trusts for the benefit of family members, and entities associated with the Carroll family (the "Agreement Shareholders") have entered into a Stock Voting and Tender Agreement ("Voting Agreement") under which the Agreement Shareholders have agreed to vote 2,500,000 shares, in the aggregate, in favor of, among other things: the election of the directors nominated by Katy's Board of Directors; the authorization and adoption of amendments to Katy's Amended Certificate of Incorporation authorizing 600,000 shares of convertible preferred stock and authorizing the classification of the Board of Directors into two classes with staggered terms; the issuance of convertible preferred stock; and the issuance of shares of common stock on the conversion of the convertible preferred stock. Agreement Shareholders have also agreed to vote 2,500,000 shares, in the aggregate, against any actions intended, or that could reasonably be expected, to impede or delay the transactions.

The Agreement Shareholders also agree to tender into the Tender Offer, in aggregate, not less than 1,500,000 shares of common stock.

The Agreement Shareholders have agreed that, before the closing of the transactions, they will not solicit, initiate or encourage inquiries or proposals, or participate in discussions or negotiations, about competing transactions meeting certain

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criteria (although an Agreement Shareholder can, in his or her capacity as a Katy director or officer, take any action permitted under the Purchase Agreement).

The 2,500,000 shares subject to being voted in accordance with the Voting Agreement represent approximately 29.8% of Katy's common stock as of March 29, 2001.

A copy of the Voting Agreement is attached as Annex C to this Proxy Statement. You should read the entire Voting Agreement.

TERMS OF THE CONVERTIBLE PREFERRED STOCK

The complete text of the proposed amendment to Keystone's Restated Certificate of Incorporation, which establishes the convertible preferred stock, is included in this Proxy Statement as Annex D. You should read Annex D in its entirety.

The certificate of amendment establishing the convertible preferred stock authorizes 600,000 shares of convertible preferred stock, par value \$100 per share. The convertible preferred stock will rank senior (with respect to liquidation payments) to the common stock and any future preferred stock of Katy.

Conversion Rights

Each share of convertible preferred stock is convertible, at the holder's option, into 12.5 shares of common stock at any time after the earliest of:

- the fifth anniversary of the closing of the transactions;
- Katy's Board of Directors approving a merger, consolidation or other business combination involving Katy (except where Katy is the surviving entity and there is no change in control of Katy), or a sale or other disposition of all or substantially all of Katy's assets;

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- steps being taken to liquidate, dissolve or wind up Katy; and
- a solicitation of proxies, for a stockholder meeting or stockholder consent, in respect of the election of directors, against the election of a person nominated by the holders of the convertible preferred stock or for the removal of any person nominated by the holders of the convertible preferred stock for election as a director.

Registration Rights

In most cases where Katy registers shares of common stock under a registration statement, holders of convertible preferred stock will have "piggy back" rights to include in that registration their shares of common stock issued on conversion of convertible preferred stock. Holders of shares of common stock issued upon conversion of

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convertible preferred stock can also require Katy to file a registration statement on up to three occasions.

Liquidation Preference

On liquidation, holders of convertible preferred stock are entitled to be paid the par value (\$100) for each share of convertible preferred stock before holders of common stock receive a distribution.

Redemption

Shares of convertible preferred stock are redeemable in whole, at Katy's option, after the 20th anniversary of the closing date of the transactions, at the par value of \$100 per share.

No Dividends

Convertible preferred stock carry no rights to dividends.

No Voting Rights

Holders of convertible preferred stock do not have the right to vote on any matter to be voted on by stockholders or classes of stockholders, except where this is required by law.

No Preemptive Rights

Holders of convertible preferred stock have no preemptive rights with respect to any shares of Katy's capital stock.

Special Rights

Katy must obtain the approval of the holders of at least a majority of the then outstanding shares of convertible preferred stock before undertaking certain actions including:

- authorizing or issuing equity securities with equal or superior rights to the convertible preferred stock on liquidation, dissolution or winding up;
- amending Katy's Amended Certificate of Incorporation or by-laws in any way or entering into a merger, consolidation, reorganization, recapitalization or sale of all or substantially all of its assets, in

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any case which adversely affects the rights of holders of convertible preferred stock; and

- engaging in a transaction impairing the rights of holders of convertible preferred stock.

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USE OF PROCEEDS

Purchaser will acquire 400,000 shares of convertible preferred stock at a price of \$100 per share. The gross proceeds from the sale will be \$40 million. Katy will use these funds, together with the proceeds of the new secured loan facility and the net proceeds of the sale of Hamilton, to refinance its existing bank debt, to partially redeem a third party's preferred interest in a Katy subsidiary and to pay approximately \$8,000,000 towards the transaction costs of the transactions with Kohlberg. The costs of the transactions with Kohlberg include expenses such as financing fees (in connection with the refinancing), professional fees, printing costs and the transaction fee payable to Kohlberg.

INFORMATION ABOUT THE RELATED TRANSACTIONS

The Tender Offer

Purchaser has agreed that, concurrently with the mailing of this Proxy Statement, Purchaser will distribute to stockholders a Tender Offer Statement on Schedule TO ("Tender Offer Statement"). Concurrently, Katy will distribute to stockholders a Solicitation/Recommendation Statement on Schedule 14D-9 ("Solicitation/Recommendation Statement"). The Tender Offer Statement and Solicitation/Recommendation Statement contain additional information about the Tender Offer. The section of this Proxy Statement titled "Where to Get Additional Information" explains how to get copies of the Tender Offer Statement and the Solicitation/Recommendation Statement.

In the Tender Offer, Purchaser will offer to purchase 2,500,000 shares of common stock at a price of \$8.00 per share. Purchaser has agreed to commence the Tender Offer concurrently with the mailing of this Proxy Statement and that the Tender Offer will expire on the 20th business day after the Tender Offer is commenced or, if later, on May __, 2001, unless Purchaser extends the expiration date (but in no event past June 30, 2001). The Purchaser will be required to extend the expiration date, at the request of Katy, if the conditions (other than the minimum condition and specified other conditions) have been satisfied.

The Board approved the Tender Offer to give stockholders the opportunity to receive cash for a portion of their investment in Katy. The Tender Offer price of \$8.00 per share represented a substantial premium over the trading price of Katy common stock immediately before the announcement of the Preferred Stock Purchase and Tender Offer.

Purchaser will not be required to purchase shares of common stock in the Tender Offer unless the following conditions, and other customary conditions, are satisfied:

- there being validly tendered and not withdrawn prior to the expiration of the Tender Offer at least 2,000,000 shares of Katy's common stock;
- the shares of common stock tendered into the Tender Offer, together with the shares of common stock into which Purchaser's convertible

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preferred stock is convertible, represent a majority of Katy's common stock issuable and outstanding, calculated on a fully diluted basis (excluding outstanding options);

- the shares of common stock tendered in the Tender Offer, after proration, if any, represent less than 30% of the combined voting power of the outstanding securities of Katy on the date the purchase of tendered shares closes;
- there being no change in the financial condition, businesses, operations, properties, results of operations, assets or prospects of Katy and its subsidiaries that has a material adverse effect on Katy and its subsidiaries;
- absence of a material adverse change in financial or credit agreement syndication markets after the commencement of the Tender Offer that results in Katy not obtaining funding under the Bankers Trust Company loan commitment letter;
- the stockholders have elected the Purchaser's designees, amended Katy's Restated Certificate of Incorporation to authorize the issue of convertible preferred stock and to adopt a classified Board of Directors, and authorized the issuance of the convertible preferred stock to Purchaser;
- Katy's Board of Directors has not withdrawn or materially modified its recommendation of the transactions or approved a competing transaction;
- Katy has obtained an unqualified audit opinion with respect to its financial statements for the year ended December 31, 2000;
- Katy has consummated the sale of its subsidiary Hamilton for gross proceeds in cash, net of liabilities retained by Katy, of at least \$20,000,000;
- no person or group has, after the date of the Purchase Agreement, acquired beneficial ownership of more than 20% of Katy's common stock;
- there shall not have occurred in the United States, a general suspension of trading in securities markets, a banking moratorium or suspension of payments by banks, a limitation by a governmental authority on the extension of credit by banks or other financial institutions, or a declaration of war or commencement of hostilities;
- Bear Stearns has not withdrawn its fairness opinion;
- Katy has entered into definitive documentation for the credit facilities to be established under the terms and conditions of the proposed refinancing with Bankers Trust Company in a term sheet signed by Bankers Trust

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Company and Purchaser (including any modification of the refinancing terms approved by Purchaser); and

- certain stockholders of Katy have entered into a stock voting agreement with respect to electing Purchaser designees as directors at

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stockholder meetings after the 2001 annual stockholder meeting.

Bankers Trust Credit Facility

Bankers Trust Company has entered into a commitment letter with Purchaser to provide Katy with up to \$150,000,000 of senior secured term and revolving loan facilities, consisting of a term loan of up to \$40,000,000 and a revolving loan of up to \$110,000,000 upon consummation of the Preferred Stock Purchase and the Tender Offer. The commitment letter provides that Bankers Trust Company may change the terms and conditions, pricing and structure of the facility if it is advisable to ensure successful syndication of the facilities, provided that the total amount of the facilities remains unchanged.

The term loan is proposed to have a final maturity of five years, with mandatory amortization quarterly in annual amounts totaling \$8,000,000. The revolving credit facility would mature in five years. Both facilities would be secured by a grant of security interests in all of the assets of Katy and its subsidiaries, including a pledge of inter-company notes and subsidiary stock (66% in the case of foreign subsidiaries) and by a pledge of all the stock of Katy owned by Purchaser. The loans would bear interest at rates equal to the base rate plus 1.5% or the Euro-Dollar rate plus 2.5% per annum, or at the base rate plus 3.5% in the event of a default. Loans under the revolving credit facility would be subject to a maximum availability determined by reference to a borrowing base consisting of 65% of eligible inventory, not to exceed \$75,000,000, and 85% of eligible accounts receivable. Availability of loans under the term loan would be subject to a maximum availability determined by reference to a borrowing base equal to 90% of orderly liquidation value of eligible machinery and equipment plus 60% of appraised fair market value of eligible real property. The facilities would be subject to mandatory prepayment and reduction of commitments equal to 100% of the net proceeds from asset sales, and net proceeds of equity offerings and certain debt issuances and 75% of excess annual cash flow. The facilities would be made under loan agreements containing customary representations and warranties, covenants and events of default, to be negotiated.

Bankers Trust Company's obligations to fund the commitment is subject to a number of conditions, including, without limitation, negotiation of definitive documentation satisfactory to Bankers Trust, the consummation of the Preferred Stock Purchase and the Tender Offer on terms satisfactory to Bankers Trust, receipt of financial statements and projections substantially consistent with projected financial results for subsequent periods, no material adverse change in Katy having occurred since December 31, 1999, no material disruption of the syndication markets for credit facilities and no material adverse change in the financial, banking or capital markets having occurred, in

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either case that would have an adverse effect on such syndication market, as determined by Bankers Trust Company in its sole discretion.

Bankers Trust Company would receive a financing fee of \$3,750,000 for providing the facilities and certain other fees for administering the facilities and providing letters of credit under it. The commitment expires on June 30, 2001 unless the transactions are consummated by June 30, 2001.

Partial Redemption of Preferred Interest in Contico International

Katy and its subsidiary Contico International, L.L.C. have entered into an agreement with Newcastle Industries, Inc for Contico to repurchase 165 of Newcastle's 329 preferred units in Contico for a total of \$9.9 million, plus the accrued and unpaid priority return and profit participation on those units, if

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the transactions with Purchaser close. Newcastle has agreed that the transactions with Purchaser do not trigger Newcastle's put option (that is, Newcastle's right to require Katy to buy its preferred units) under the Members Agreement exercisable on a change of control.

Katy and Newcastle have also agreed to amendments to Contico's Limited Liability Company Agreement and the Members Agreement to take effect subject to the transactions with Purchaser closing. These include:

- Newcastle can exercise its put option during the period beginning on the earlier of the fifth anniversary of the closing of the transactions with Purchaser and the date Katy repays all outstanding indebtedness for borrowed money Katy incurs in connection with those transactions;
- Newcastle has a new put option exercisable if Katy redeems or repurchases preferred stock (or any securities into which it is convertible) or declares a dividend or makes another distribution in respect of its capital stock;
- Katy can require holders of preferred units to sell to Katy all or some of their units (although Katy must buy at least 82 units when it exercises this right);
- on the exercise of a put option, Katy must pay Newcastle in cash, rather than in Katy stock; and
- Contico is to keep available adequate reserves with respect to working capital, taxes, future capital expenditures and mandatory distributions.

BACKGROUND OF THE TRANSACTION

In September 2000, Katy recognized that it would fall out of compliance with certain financial ratio covenants under its existing bank credit agreement and commenced negotiations with its bank group with respect to a waiver. On September 28, 2000, the bank group agreed to waive the covenant defaults through October 27, 2000, to provide

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time to arrive at an amendment to the credit agreement satisfactory to Katy and the bank group. Underlying the waiver and the proposed amendment was an understanding that Katy would consider strategic alternatives, including the potential sale of Katy or one or more of its material subsidiaries. Unless the banks' waiver was extended beyond October 27, 2000, Katy would have been in default under the credit agreement, and the banks could have accelerated the debt and demanded immediate payment from Katy.

In early October 2000, the Board of Directors retained Debevoise & Plimpton, as legal counsel, to assist in negotiations with Katy's lenders and with the consideration and negotiation of strategic alternatives.

On October 3, 2000, the Board of Directors determined that Katy should begin exploring possible strategic alternatives, including alternatives to remaining an independent company. The Board of Directors authorized senior management of Katy to contact potential strategic and financial partners and to provide confidential Katy information to such persons. In addition, the Board of Directors requested senior management of Katy to continue to analyze Katy's financial position in order to determine whether a stand-alone alternative, with or without the sale of subsidiaries of Katy, was feasible in the context of the

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financial covenants in the existing credit agreement.

After the October 3 Board of Directors meeting, management of Katy completed preparation of an information package (the "Information Package") concerning Katy which contained historical financial information, segment information, the information memorandum sent to the Katy's bank group in connection with the proposed amendment to the credit agreement and certain forecasts.

In early October 2000, Katy contacted a number of potential strategic and financial partners inquiring as to their interest in acquiring Katy. Kohlberg was introduced to Katy by William F. Andrews, a director of Katy, who at that time informed Katy that he was a principal of Kohlberg and received a consulting fee from that company and also served as a director of several companies affiliated with Kohlberg. The Information Package was transmitted to those parties that expressed preliminary interest in Katy, once such parties executed confidentiality agreements with Katy. In total, management contacted 16 potential buyers, including 11 strategic buyers - that is, companies engaged in similar businesses - and 5 financial buyers. Of the parties contacted, 5 strategic buyers and 3 financial buyers expressed preliminary interest and executed confidentiality agreements. These interested recipients included Kohlberg, which signed a confidentiality agreement on October 11, 2000.

On or about October 12, 2000, representatives of Kohlberg met with John R. Prann, Jr., then the Chief Executive Officer and a director of Katy, and with other representatives of senior management at Katy's head office at Englewood, Colorado.

At a meeting of the Board of Directors on October 13, Mr. Prann reported that Kohlberg was interested in acquiring Katy in a transaction in which trusts associated with members of the Carroll family would exchange a portion of their

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shareholdings in Katy for shares of an affiliate that would acquire the publicly held common shares at a price of \$14.50.

In the second half of October, Kohlberg and two of its prospective financing sources met with representatives of Katy for additional business due diligence discussions.

In late October, of the potential purchasers that had initially expressed interest, only two potential strategic buyers, Public Company 1 and Public Company 2, remained interested in considering a transaction to purchase all or part of Katy.

After negotiations throughout October with Katy's existing lenders on an amendment to the existing credit agreement, on October 27, 2000, an amendment to the credit agreement was signed. As a part of the amendment, compliance with certain covenants required by the credit agreement was waived as of September 30, 2000, and new ratio levels for certain covenants were established for measurement at December 31, 2000. Also as part of the amendment, Katy agreed to grant the lenders under the credit agreement a security interest in all of Katy's and its subsidiaries' material assets on March 31, 2001, if certain events did not occur before February 28, 2001. Under the terms of the amendment, a security interest was not required if (1) on or before February 28, 2001, a letter of intent (satisfactory to the bank group) existed for the sale of (i) Katy as a whole or (ii) one or more of its material subsidiaries if (in the case of clause (ii)) Katy demonstrates that following such sale Katy would be in compliance with a specified leverage ratio, or (2) Katy was in compliance with

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certain covenants at pre-amendment ratio levels.

Based on publicly available information and additional information about Katy that Kohlberg received from Katy, on October 26, 2000, including Katy's estimates for earnings before interest, taxes, depreciation and amortization ("EBITDA") for the fourth quarter and the full year 2000, Kohlberg submitted a draft preliminary indication of interest to acquire Katy for a purchase price of up to \$14.50 per Share in cash. At the request of Katy, Kohlberg submitted a revised preliminary indication of interest on October 27, 2000, to provide for a firm purchase price of \$14.50 per Share in cash. This signed indication of interest was accompanied by a letter from one of Kohlberg's prospective financing sources indicating that it was confident that it could arrange the financing needed to complete the transaction. The Kohlberg proposal contemplated the entry into a letter of intent with an exclusivity period and an expense reimbursement, together with, in the event that negotiations with certain strategic partners are exempted from the exclusivity covenant, a termination fee.

The Board of Directors considered the Kohlberg draft letter of intent with respect to its proposal at a meeting on October 27, 2000. The proposal was for the acquisition of all of Katy's outstanding shares. Part of the outstanding shares owned by the Carroll trusts would be exchanged for shares of a Kohlberg affiliate, which would acquire the balance of the outstanding shares for cash at the price of \$14.50 per share. Also at this meeting, the Board of Directors authorized the retention of Bear Stearns to

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render a fairness opinion with respect to a transaction with Kohlberg if requested to do so.

On October 31, 2000, the Board of Directors met with representatives of Bear Stearns and Debevoise & Plimpton to consider the expressions of interest that had been received, to be updated on discussions with the other potential buyers still involved in the process and to consider the steps to be taken. At the start of the meeting, Mr. Christopher Lacovara, a principal of Kohlberg, was present and discussed and answered questions regarding Kohlberg's expression of interest. At the October 31, 2000 meeting, William Andrews, one of the directors, reminded the Board of Directors that he was a principal of Kohlberg, was a director of several of their portfolio companies, had assisted them in making a number of acquisitions and received a retainer for his services. In light of Kohlberg's interest in sponsoring an acquisition of Katy, Mr. Andrews excused himself from the meeting and stated that he would not participate in future board meetings as long as a possible transaction with Kohlberg was under consideration.

At the October 31 meeting, after Mr. Andrews excused himself, the Board of Directors also reviewed other alternatives. While Public Company 1 had signed a confidentiality agreement, it had not submitted an expression of interest. One financial sponsor ("Financial Sponsor 1") which had done only limited due diligence had submitted an expression of interest for an acquisition at a broad indicated price range (\$12 to \$15.50 per share), in a transaction in which the Carroll trusts and management would have the option of retaining a meaningful equity interest in Katy. The expression of interest was unaccompanied by expressions of interest from financing sources and contemplated a period of exclusivity and a break-up fee.

On November 2, 2000, Kohlberg delivered a draft letter of intent to Katy, which included a purchase price of \$14.50 per Share. Representatives of Katy and of Kohlberg negotiated the terms of the draft Letter of Intent between November 2 and November 6, 2000.

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On November 6, 2000, representatives of the Financial Sponsor 1, having been informed earlier of the state of negotiations with Kohlberg, had indicated that the timeline for a transaction was too rapid for it and that it had decided not to proceed at that time.

On November 6, 2000, the Board of Directors was advised of the decision of Financial Sponsor 1 not to proceed and that Public Company 1 had decided not to make a proposal at that time. Public Company 2 had scheduled some due diligence discussions with Katy. Another potential strategic buyer was interested only in Katy's abrasives businesses. After review of the improvements in the letter of intent since the initial draft received from Kohlberg, the Board of Directors (without the participation of Arthur Miller, a trustee of the Carroll family trusts, or of Wallace Carroll or Amelia Carroll) authorized the execution of the letter of intent (the "First Letter of Intent"), which was executed that day.

The First Letter of Intent provided for an acquisition of all of Katy's common stock. The Carroll family trusts would be permitted to exchange all or part of their shares

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of Katy common stock for shares of a newly formed Kohlberg affiliate, which would acquire the other shares of common stock at a purchase price of \$14.50 per Share in cash. The First Letter of Intent contemplated a 30 day period during which Kohlberg would complete its due diligence and financing arrangements. The First Letter of Intent provided for a 45 day exclusive negotiation period with Kohlberg, but specifically exempted ongoing discussions between Katy and two named strategic buyers and also permitted discussions with unsolicited other bidders if the Board of Directors determined, after consultation with its legal and financial advisors, that failure to participate in such discussions would be inconsistent with the directors' fiduciary duties. The First Letter of Intent provided for an expense reimbursement not to exceed \$250,000 and a termination fee of \$1.5 million upon the consummation of a competing transaction, if during the term of the First Letter of Intent Katy did not enter into a definitive agreement despite Kohlberg's willingness to do so at the price and substantially on the terms contained in the First Letter of Intent.

Also on November 6, 2000, Katy issued a press release announcing that it was exploring its strategic alternatives, including the possible sale of Katy, and that it was in discussions with a potential purchaser relating to a transaction involving the purchase of Katy at a premium to its then current price.

In mid-November 2000, representatives of Kohlberg and one of its prospective financing sources toured the facilities and met with management of several Katy subsidiaries. During this period, Kohlberg reviewed transaction financing alternatives with five commercial banks and two mezzanine lenders.

In late November 2000, management of Katy informed Kohlberg that it was revising downward its EBITDA forecast for the fourth quarter and for the year 2000 and provided Kohlberg with its revised forecast.

Kohlberg thereafter revised its financial analysis based on the new information provided by management. Kohlberg also continued discussions with selected financing institutions to discuss financing for the transaction. During this period, most of the commercial banks and both of the mezzanine lenders declined to participate in the financing. Starting in late 2000, an alternative financing source, an asset-backed lender (Bankers Trust Company), commenced its due diligence efforts.

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Following the completion of this revised analysis, Kohlberg informed Katy that, primarily because of the decline in expected fourth quarter results, it would not be able to complete a transaction at the price outlined in the First Letter of Intent. On November 28, 2000, Kohlberg circulated a proposed amendment to the First Letter of Intent, but without a specified price per Share, for a transaction with Katy. Mr. Lacovara informed Katy that the offer price would likely be between \$9 and \$10 a share. The Board of Directors on November 30, 2000 decided not to extend the exclusivity period, but to keep working towards a transaction with Kohlberg. The First Letter of Intent was terminated by Katy in early December 2000.

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On December 14, 2000, Mr. Lacovara telephoned Mr. Prann and confirmed that Kohlberg had concluded that Katy's operating results and the results of Kohlberg's review of Katy did not support the valuation provided in the First Letter of Intent. Mr. Lacovara expressed interest in acquiring Katy for a purchase price of \$8.25 per Share in cash.

That day, Mr. Lacovara delivered to Katy a first draft of a merger agreement, and the Board of Directors met with representatives of Debevoise & Plimpton and Bear Stearns. The Board of Directors considered the status of discussions with Kohlberg, and also reviewed Katy's alternatives. There had been discussions with another financial sponsor, which had indicated that because of the current state of the financing markets it would not be able to bid higher than the then trading price for Katy stock (then about \$7.63 a share). That financial buyer later decided it did not wish to proceed further. Katy had not heard back from Public Company 2, which had undertaken some preliminary due diligence with Katy after the November 6 meeting. The Board of Directors also considered the alternative of continuing as an independent company. The Board had real questions as to Katy's ability to restructure its debt, and whether, if Katy sold businesses, the earnings of the remaining businesses would be consistent with Katy remaining a public company.

Because the Kohlberg proposal provided for the possibility of allowing (but not requiring) the Carroll family trusts to exchange their shares of Katy for common stock of a newly formed Kohlberg affiliate that would be the acquisition vehicle, the Board of Directors at the December 14 meeting formed a Special Committee of directors who were not connected with the Carroll family trusts to negotiate with Kohlberg. The members of the Special Committee were Charles W. Sahlman, Jacob Saliba and Daniel B. Carroll. The Special Committee was authorized to consider whether the Kohlberg proposal was in the best interests of Katy stockholders who were not part of the buying group, to negotiate with Kohlberg, and to consider and negotiate any alternatives it believed to be available. It was also authorized to give instructions to Bear Stearns and to Debevoise & Plimpton.

On December 20, 2000, Kohlberg submitted to Katy a draft of a second letter of intent (the "Second Letter of Intent"), which included a purchase price of \$8.25 per Share, a renewed exclusivity period, and provision for expense reimbursement and a termination fee. Kohlberg requested that this Second Letter of Intent be executed prior to the commencement of negotiations on the definitive merger agreement.

On December 21, 2000, the Special Committee, Bear Stearns and Debevoise & Plimpton discussed with Mr. Lacovara Kohlberg's insistence on the Second Letter of Intent, the various factors considered by Kohlberg in arriving at the price reduction, and the state of Kohlberg's financing negotiations. Mr. Lacovara indicated that Kohlberg had received an oral expression of interest from an asset-based financing source, Bankers Trust Company, in financing the

transaction.

Before the Second Letter of Intent was executed, a member of the Special Committee and subsequently a senior officer of Katy had contacted representatives of

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Public Company 1, and had been advised that Public Company 1 might well never submit a proposal and in any event would not consider doing so unless a transaction with another party were to be announced. The Special Committee and the Board of Directors also considered the alternative of Katy continuing on a stand-alone basis, with or without sales of businesses.

Following further negotiation of terms, and preliminary exchanges of comments on a draft merger agreement provided by Kohlberg's counsel, on January 2, 2001, Kohlberg and Katy signed the Second Letter of Intent. The Second Letter of Intent, as executed, provided for a renewed exclusivity period until the letter was terminated. Either party could terminate the Second Letter of Intent if, among other things, the definitive agreement was not signed by January 15, 2001. The Second Letter of Intent also provided for an expense reimbursement not to exceed \$500,000 and, to the extent that Kohlberg was able to sign a definitive merger agreement at \$8.25, a termination fee of \$1.5 million payable upon the consummation of a competing transaction.

By letter dated January 8, 2001, Bear Stearns was formally engaged to render an opinion as to the fairness of the proposed transaction.

After counsel for the Special Committee gave its comments on a revised draft merger agreement, representatives of Debevoise & Plimpton met on January 12, 2001 with Mr. Lacovara and representatives of Hunton & Williams to discuss the outstanding issues associated with the draft merger agreement. At that meeting, the Kohlberg representatives requested a one week extension of the specified dates in the Second Letter of Intent.

In the evening of January 15, Mr. Lacovara telephoned Mr. Prann and counsel to the Special Committee to inform them that Kohlberg had concerns with the liquidity position of Katy post-closing and that Kohlberg was considering an additional equity investment in the transaction. Mr. Lacovara indicated that the Kohlberg partnership would be meeting on January 17, 2001 to determine whether to contribute an additional \$15 million of equity, and that without that contribution, Mr. Lacovara did not feel comfortable that Kohlberg could pursue the transaction.

Given the uncertainty raised by Mr. Lacovara's update, on January 16, 2001, the Board of Directors determined to postpone a decision on the proposed amendment to the Second Letter of Intent.

On January 17, 2001, Mr. Lacovara informed Katy that the Kohlberg partners had voted against the proposed additional \$15 million equity investment and that, as a result, Kohlberg would be unable to continue working on the transaction unless an alternative solution to the liquidity concern was found. On each of January 18, 2001 and January 19, 2001, the Special Committee and representatives of Debevoise & Plimpton met with Mr. Lacovara to discuss Kohlberg's concerns and to discuss possible solutions, including the possibility of increasing the level of proposed subordinated debt financing, negotiating a deferral of payments, which would be owed upon a change of control, to the holder of preferred units in Contico, and proceeding with sales of subsidiaries of Katy. On January

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19, the Special Committee authorized Mr. Prann to proceed with discussions in respect of the proposed sale of Hamilton, and authorized representatives of Kohlberg to contact directly the holder of the Contico preferred units.

In late January 2001, representatives of the Special Committee and of Kohlberg negotiated the terms of the proposed amendment to the Second Letter of Intent. Changes requested by representatives of the Special Committee included exclusions from the exclusivity covenant for discussions with (i) Public Company 1, (ii) potential purchasers of Contico's retail division, (iii) potential purchasers of Hamilton and (iv) unsolicited bidders.

In January 2001, Katy began discussion with several potential buyers of Hamilton.

In the second half of January 2001, Kohlberg representatives, seeking additional post-closing liquidity for Katy, discussed with the holder of the Contico preferred units the possible deferral of amounts otherwise payable to the holder following the closing.

On January 31, 2001, Kohlberg and Katy executed an amended letter of intent (the "Third Letter of Intent"). The Third Letter of Intent contemplated that the Carroll family trusts would convert 727,273 of their shares for shares of a newly formed Kohlberg affiliate, which would acquire the other shares of Katy common stock at a price of \$8.25 per share. The amended letter of intent contained the requested carve-outs on exclusivity during the term of the agreement, and provided for a termination fee of \$1.5 million, if Kohlberg was able to sign the merger agreement by February 5, 2001, payable upon the consummation of a competing transaction.

On February 2, 2001, representatives of Kohlberg met with members of Katy's senior management to provide an overview of the proposed transaction, to review the proposed business plan and to discuss the proposed equity program.

In mid-February 2001, Mr. Lacovara informed counsel to Katy of additional obstacles to the proposed transaction to acquire Katy, which consisted of the need to obtain an additional \$15 million in financing because of the reduction in the amount Kohlberg's proposed asset-based lender (Bankers Trust Company) was prepared to lend based on appraisals of the assets, the poor fourth quarter results, the negative earnings outlook for the first quarter of 2001 and the generally poor economic conditions. Based on these four factors, Kohlberg thought it would be difficult to complete the transaction contemplated by the Third Letter of Intent.

As a result of the above, Mr. Lacovara proposed as an alternative to the proposed acquisition transaction with Katy ("Plan A"), a recapitalization ("Plan B") under which Kohlberg would buy new equity from Katy with proceeds used to reduce existing debt to a level which could be financed by Bankers Trust Company and would buy a portion of the existing shares. This proposal eventually formed the basis for the Preferred Stock Purchase and Tender Offer.

On February 17, 2001, Mr. Lacovara sent to Katy Kohlberg's analysis of the components of both Plan A and Plan B. On February 18, 2001, Mr. Lacovara reviewed

the terms of each of Plan A and Plan B with the Special Committee, and reported on the status of efforts to find the additional financing for Plan A.

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On February 21, 2001, Kohlberg sent a draft of a revised letter of intent (the "Fourth Letter of Intent") reflecting Kohlberg's Plan B. The Fourth Letter of Intent contained a proposed price of \$7.50 per share. On February 24, Katy responded to Kohlberg, indicating that Katy was interested in exploring Plan B as set forth in the Fourth Letter of Intent, but at a higher price, and provided comments on the Fourth Letter of Intent to Kohlberg.

During February 2001, after the Third Letter of Intent was signed, Katy carried on discussions with Public Company 1 and with a potential strategic buyer of Contico's retail division. In February 2001, Public Company 1 said it was not interested in an acquisition of Katy as a whole, but was interested in Contico. Discussions with both potential buyers broke off by the end of February 2001. While Public Company 1 indicated that it continued to be interested in buying Contico, it concluded that it could not follow through on such a transaction until the second half of 2001. The other company informed Katy that it was not interested in exploring further the possible purchase of part of Contico.

In the latter half of February, Kohlberg informed Katy representatives that it could not complete Plan A because of the negative EBITDA trends, the expected debt financing shortfall and the possibility that without adequate liquidity coverage lenders might not provide financing at closing.

On March 2, 2001, after additional negotiation, Kohlberg and Katy executed the Fourth Letter of Intent. The Fourth Letter of Intent, as executed, incorporated many of the changes requested by Katy, including an increase in the purchase price from \$7.50 to \$8.00 per share. The obligation to enter into a definitive agreement was conditioned on, among other things, the execution of a letter of intent relating to the divestiture of Hamilton and the negotiation of a term sheet for the refinancing of Katy's existing bank loans. The Fourth Letter of Intent provided for expense reimbursement to Kohlberg of up to \$750,000. The Fourth Letter of Intent formed the basis for the Purchase Agreement and the Preferred Stock Purchase and Tender Offer.

On March 2, Katy issued a press release announcing that it was engaged in discussions with a potential purchaser of a substantial equity position in Katy. The press release noted that the discussions contemplated a purchase of a substantial minority stake in Katy. The press release also noted that the discussions referred to in Katy's press release of November 6, 2000 had been suspended by these discussions with the same potential purchaser.

In March 2001, Kohlberg and Katy engaged in discussions with Katy's existing lenders and with Bankers Trust Company and other potential financing sources concerning refinancing Katy's existing credit facilities.

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On March 7, 2001, Katy entered into a non-binding letter of intent with respect to the sale of substantially all of the assets of Hamilton.

On March 7, 2001, representatives of Hunton & Williams delivered to Debevoise & Plimpton an initial draft of the Purchase Agreement. The draft Purchase Agreement was based, in large part, on the merger agreement that had previously been negotiated by Kohlberg and Katy in connection with Plan A. On March 8, 2001, representatives of Debevoise & Plimpton, on behalf of Katy, delivered to Hunton & Williams comments on the initial draft of the Purchase Agreement.

On March 9, 2001, representatives of Katy discussed the Purchase Agreement with representatives of Kohlberg and on March 12, 2001, counsel to Kohlberg distributed a revised draft of the Purchase Agreement.

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On March 12, 2001, Katy and Kohlberg extended from March 9 to March 26 the date after which either party could terminate the Fourth Letter of Intent if a definitive purchase agreement had not been executed by that date.

On March 13, 2001, counsel to Kohlberg distributed a first draft of the Voting Agreement, based in large part on the stock voting and tender agreement previously negotiated between Kohlberg and Katy in connection with Plan A.

During the period from March 12, 2001 through March 28, 2001 representatives of Katy and its legal advisers finalized the terms of the Purchase Agreement with representatives of Kohlberg and its legal advisers. Representatives of the Agreement Shareholders also negotiated the terms of the Voting Agreement with representatives of Kohlberg.

On March 17, 2001, the Board of Directors met with representatives of Bear Stearns and Debevoise & Plimpton to review the status of discussions with respect to the Purchase Agreement. On March 20, 2001, a revised draft of the Purchase Agreement was prepared and distributed to the Board of Directors. A proposed commitment letter from Bankers Trust Company to a Kohlberg affiliate to refinance the existing loans of Katy on a secured basis was also distributed to the Board of Directors.

On March 22, 2001, after meeting with representatives of Katy's senior management for an update of information about Katy's operating results and prospects, including the prospects of obtaining stand-alone financing without an equity infusion, the Board of Directors and representatives of Bear Stearns and Debevoise & Plimpton met to consider the terms of the Purchase Agreement, as negotiated, and the transactions contemplated in the Purchase Agreement. Bear Stearns presented its financial analyses to the Board of Directors. Representatives of Debevoise & Plimpton reviewed the duties of the Board of Directors and summarized the Purchase Agreement and the improvements, from the perspective of Katy's stockholders, in the terms of the Purchase Agreement negotiated since receiving the initial draft.

On March 25, 26, and 29, the Board of Directors met again with representatives of Bear Stearns and Debevoise & Plimpton. At the March 29 meeting, Bear Stearns

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delivered to the Board of Directors its oral opinion, later confirmed in writing, to the effect that, as of that date, and subject to the matters stated in the opinion, the Preferred Stock Purchase and Tender Offer, taken as a whole, were fair to the stockholders of Katy from a financial point of view. Following further discussion and deliberation, the Board of Directors of Katy, by the unanimous vote of all directors present (Mr. Andrews was not present because of his relationship with Kohlberg): (i) approved the Purchase Agreement, the Preferred Stock Purchase and Tender Offer and the other transactions contemplated by the Purchase Agreement, (ii) determined that the terms of the Preferred Stock Purchase and Tender Offer were fair to and in the best interests of Katy's stockholders, (iii) approved amendments to Katy's Restated Certificate of Incorporation to authorize 600,000 shares of convertible preferred stock and to establish a classified Board of Directors and recommended they be submitted to the stockholders for approval, (iv) approved Purchaser's five designees, and Mr. Jacobi, who Purchaser has proposed be appointed Chief Executive Officer, as nominees for director of Katy, subject to election by the stockholders and (v) adopted an amendment to Katy's by-laws fixing at nine the number of directors constituting the whole Board of Directors.

Authorized representatives of Katy and Purchaser executed and delivered the

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Purchase Agreement, and Purchaser and the Agreement Shareholders executed and delivered the Voting Agreement, as of March 29, 2001. On March 30, 2001, the execution of the Purchase Agreement was publicly announced through a press release issued by Katy.

FACTORS CONSIDERED BY THE BOARD OF DIRECTORS

The Board of Directors has approved the Purchase Agreement, the Preferred Stock Purchase and the Tender Offer and recommends that stockholders approve the Preferred Stock Purchase.

The material factors that the Board of Directors considered in connection with the Purchase Agreement, the Preferred Stock Purchase and the Tender Offer are described below. Except as noted below, the Board considered the following factors to be positive factors supporting its determination that the Preferred Stock Purchase and Tender Offer are fair to, and in the best interests of, the stockholders. The material positive factors the Board considered were:

- (1) Katy's cash resources and financial strength will increase as a result of Purchaser's cash infusion and from borrowing availability under the new credit facility with Bankers Trust Company, which would not have been provided unless Katy entered into the Purchase Agreement and the transactions contemplated by the Purchase Agreement.
- (2) The Preferred Stock Purchase will decrease the percentage of Katy's capitalization that consists of debt.
- (3) The Tender Offer and Preferred Stock Purchase will give stockholders the opportunity to sell Katy shares at a substantial premium to the market price of Katy shares before the transactions with Purchaser were

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announced, and also to remain as stockholders in a company that will be financially strengthened by Purchaser's cash infusion.

- (4) Bear Stearns' oral opinion and supporting analysis, delivered to the Board of Directors at the March 29, 2001 meeting and later confirmed in writing, was that, as of the date of such opinion, the Preferred Stock Purchase and the Tender Offer, taken as a whole, were fair from a financial point of view to Katy's stockholders.
- (5) Before committing itself to the transactions, Katy had solicited indications of interest in acquiring Katy from a substantial number of potential buyers (strategic and financial) and held discussions with potential lenders about refinancing its indebtedness, and the Board of Directors believed that the transactions with Purchaser were the only readily available transactions that would give Katy the cash it needs to fund its ongoing operations and offer a reasonable opportunity for Katy to achieve its strategic objectives.
- (6) Despite seeking indications of interest for a sale of Katy, a number of potential acquirers visiting Katy or receiving information packages, and Katy's public announcements on November 6 and March 2, only Kohlberg submitted a written proposal after November 6, 2000.
- (7) The initial discussions with Purchaser contemplated a range of alternatives, including a sale of the entire company at \$8.25 per share, and the structure of the transaction ultimately agreed upon in negotiation allows Katy stockholders to retain a stake in Katy, giving

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them upside potential.

(8) It is expected that, unless the transactions with Kohlberg are completed, Katy on June 30, 2001 will be in violation of financial covenants of the present credit agreement. If the transactions with Kohlberg are not completed, considering the current market environment, a substantial risk exists that Katy will be unable to obtain further waivers of the defaults under the current credit agreement and that Katy will be unable to obtain, on reasonable terms or at all, financing necessary to replace its current credit agreement. If Katy is unable to refinance its existing bank loans, the entire amount under the existing credit agreement could be declared due and payable not later than June 30, 2001.

(9) Under the terms of the Purchase Agreement:

- Katy is permitted to give information to and negotiate with third parties in response to an unsolicited acquisition proposal if a majority of the Board of Directors determines (after

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consultation with counsel), that failure to do so would not be consistent with the directors' fiduciary duties;

- the Board of Directors can terminate the Purchase Agreement if Katy receives a superior proposal and the Board of Directors determines in good faith (after consulting with outside legal counsel) that not terminating the Purchase Agreement and entering into a new agreement to effect the superior proposal would be inconsistent with its fiduciary duties; and

- while Katy, in order to accept a superior proposal, must reimburse Purchaser up to \$1,000,000 of its expenses, and, on completing the competing proposal, pay Purchaser a termination fee of \$2,000,000, and these fees and expense reimbursement would increase the cost to a third party interested in acquiring Katy, they would not prevent a third party from making a superior proposal or acquiring Katy.

(10) The Board expected that Katy and its stockholders would benefit from Kohlberg's managerial assistance and support. Kohlberg has substantial experience in providing companies in which its affiliates invest with financial and managerial advisory services aimed at building value and improving operational, marketing and financial performance.

The Board also considered the following negative factors in making its determination. You should consider these in deciding whether to vote for the Preferred Stock Purchase:

(11) The issuance of the convertible preferred stock will dilute the holdings of Katy's existing stockholders. Following the closing of the transactions with Purchaser under the Purchase Agreement, existing stockholders will hold a lesser proportion of common equity (calculated on a fully diluted basis).

(12) Purchaser's significant stock ownership in Katy, its rights to nominate directors and to convert its convertible preferred stock, and the classified Board of Directors, could effectively deter a third party from making an offer to acquire Katy, which might involve a premium stock price or other benefits for stockholders, and could

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otherwise prevent changes in control or management of Katy.

- (13) The purchase of shares tendered into the Tender Offer will reduce the number of shares of Katy common stock that are publicly held, which could increase volatility in the price of Katy's stock and adversely affect liquidity in Katy's stock.
- (14) Purchaser's nominees will constitute a majority of the Board of Directors, five of whom will serve an initial term of two years (see "Corporate Governance" on page ___ of the Proxy Statement),

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preventing major actions not supported by the Purchaser-nominated directors.

- (15) Purchaser has proposed a new Chief Executive Officer, who is also a nominee for director, and who, if elected, as director will serve for an initial term of one year.
- (16) Purchaser will have the right, so long as it retains any convertible preferred stock, to nominate a majority of the members of the Board of Directors in connection with future election of directors.
- (17) The holders of the convertible preferred stock will have preferential rights on distributions if Katy is liquidated, which means that holder of common stock will not receive any distribution on liquidation until the holders of the convertible preferred stock receive their liquidation preference.
- (18) If the Purchase Agreement is terminated then, under certain circumstances, Katy must reimburse Purchaser's expenses (up to \$1,000,000) and pay Purchaser a \$2,000,000 termination fee. For example, Purchaser will be entitled to reimbursement for expenses if stockholders do not approve the sale of convertible preferred stock to Purchaser, and to the termination fee under certain circumstances if, within 12 months after the Purchase Agreement terminates, Katy enters into another transaction for the sale of all or a major part of Katy's voting securities or assets and that other transaction is completed within 18 months of the Purchase Agreement terminating.

The Board of Directors believed that, on balance, the possible benefits to Katy stockholders from the positive factors outweighed the possible detriments from the negative factors summarized above.

In view of the variety of factors considered, the Board of Directors found it impracticable to, and did not, quantify, rank or otherwise assign relative weights to the above factors considered or determine that any factor was of particular importance in reaching its determination. Rather, the Board of Directors views this position and its recommendation as being based upon its judgment, in light of the totality of the information presented and considered, of the overall effect of the Preferred Stock Purchase and Tender Offer on the stockholders compared to any reasonably available alternative transaction.

OPINION OF BEAR STEARNS

Overview

At the March 29, 2001 meeting of Katy's Board of Directors, Bear Stearns presented the analysis of its opinion and then delivered its oral opinion, subsequently confirmed in writing, that, as of March 29, 2001, and based upon

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and subject to the assumptions, qualifications and limitations set forth in its opinion, the Tender Offer and the Preferred Stock Purchase, taken as a whole, were fair, from a financial point of view, to the stockholders of Katy.

THE FULL TEXT OF THE FAIRNESS OPINION DATED MARCH 29, 2001, WHICH SETS FORTH, AMONG OTHER THINGS, THE ASSUMPTIONS MADE, PROCEDURES FOLLOWED, MATTERS CONSIDERED AND QUALIFICATIONS AND LIMITATIONS ON THE SCOPE OF THE REVIEW UNDERTAKEN BY BEAR STEARNS IN RENDERING ITS FAIRNESS OPINION, IS ATTACHED AS ANNEX

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A TO THIS DOCUMENT. STOCKHOLDERS ARE URGED TO, AND SHOULD, READ THE FAIRNESS OPINION CAREFULLY AND IN ITS ENTIRETY. THE FAIRNESS OPINION WAS DELIVERED TO THE KATY BOARD OF DIRECTORS FOR ITS USE IN CONNECTION WITH ITS CONSIDERATION OF THE TENDER OFFER AND PREFERRED STOCK PURCHASE AND ADDRESSES ONLY, AS OF THE DATE OF THE FAIRNESS OPINION, THE FAIRNESS OF THE TENDER OFFER AND THE PREFERRED STOCK PURCHASE, TAKEN AS A WHOLE, FROM A FINANCIAL POINT OF VIEW, TO THE STOCKHOLDERS OF KATY. THE FAIRNESS OPINION IS NOT INTENDED TO BE, AND DOES NOT CONSTITUTE, A RECOMMENDATION TO THE BOARD OF DIRECTORS OF KATY OR TO ANY STOCKHOLDER OF KATY AS TO HOW TO VOTE THEIR SHARES OF COMMON STOCK OF KATY OR WHETHER OR NOT TO TENDER THEIR SHARES OF COMMON STOCK OF KATY. THE FAIRNESS OPINION DOES NOT ADDRESS THE UNDERLYING BUSINESS DECISION OF THE BOARD OF DIRECTORS OF KATY TO RECOMMEND THE TENDER OFFER AND PREFERRED STOCK PURCHASE TO THE STOCKHOLDERS OF KATY OR THE UNDERLYING BUSINESS DECISION OF KATY TO ENTER INTO THE PURCHASE AGREEMENT, THE RELATIVE MERITS OF THE TENDER OFFER AND PREFERRED STOCK PURCHASE AS COMPARED TO ANY ALTERNATIVE BUSINESS STRATEGIES THAT MIGHT EXIST FOR KATY OR THE EFFECTS OF ANY OTHER TRANSACTION IN WHICH KATY MIGHT ENGAGE. THE SUMMARY OF THE FAIRNESS OPINION SET FORTH IN THIS DOCUMENT IS QUALIFIED BY REFERENCE TO THE FULL TEXT OF THE FAIRNESS OPINION.

The terms of the Tender Offer and the Preferred Stock Purchase and the form of the consideration were determined by arm's-length negotiations between Katy and Kohlberg and were not based on any recommendation by Bear Stearns. Katy did not provide specific instructions or impose any limitations on Bear Stearns with respect to the investigations made or the procedures followed by Bear Stearns in rendering its opinion.

Bear Stearns Opinion

In connection with rendering its opinion, Bear Stearns, among other things:

- . reviewed a draft of the Purchase Agreement dated March 28, 2001;
- . reviewed a draft of the Voting Agreement dated March 28, 2001;
- . reviewed a commitment letter from Kohlberg Investors IV, L.P. to Purchaser dated March 27, 2001, relating to the Tender Offer and the Preferred Stock Purchase;
- . reviewed the commitment letter from Bankers Trust Company to Purchaser dated March 27, 2001 ("Commitment Letter");
- . reviewed Katy's Annual Reports to Shareholders and Annual Reports on Form 10-K for the years ended December 31, 1998 and 1999, its Quarterly

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Report on Form 10-Q for the periods ended March 31, 2000, June 30,

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2000 and September 30, 2000, its preliminary results for the year ended December 31, 2000, its Proxy Statement on Schedule 14A dated March 31, 2000, its Report on Form 8-K dated January 15, 1999 and its Report on Form 8-K/A dated March 22, 1999;

- . reviewed the Amended and Restated Credit Agreement dated as of December 11, 1998, among Katy, Bank of America National Trust and Savings Association, as Administrative Agent and Issuing Bank, La Salle National Bank, as Managing Agent, and the other financial institutions party thereto;
- . reviewed certain operating and financial information, including projections for the seven years ended December 31, 2007, provided to Bear Stearns by management relating to Katy's business and prospects;
- . met with certain members of Katy's senior management to discuss Katy's business, operations, historical and projected financial results and future prospects;
- . reviewed the historical prices, trading multiples and trading volumes of the common shares of Katy;
- . reviewed publicly available financial data, stock market performance data and trading multiples of companies which Bear Stearns deemed generally comparable to Katy;
- . reviewed the terms of selected precedent merger and acquisition transactions of, and investment transactions involving, companies which Bear Stearns deemed generally comparable to Katy or situations which Bear Stearns deemed generally comparable to the Tender Offer and the Preferred Stock Purchase, taken as a whole;
- . performed discounted cash flow analyses based on the projections for Katy furnished to Bear Stearns by the management of Katy;
- . reviewed the pro forma financial results, financial condition and capitalization of Katy giving effect to the Tender Offer and the Preferred Stock Purchase, taken as a whole, and the refinancing contemplated by the Commitment Letter; and
- . conducted such other studies, analyses, inquiries and investigations as Bear Stearns deemed appropriate.

Bear Stearns has relied upon and assumed, without independent verification, the accuracy and completeness of the financial and other information, including without limitation the projections, provided to it by Katy. With respect to Katy's projected financial results, Bear Stearns has assumed that they have been reasonably prepared on

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bases reflecting the best currently available estimates and judgments of the senior management of Katy as to the expected future performance of Katy. Bear Stearns does not assume any responsibility for the independent verification of any such information or of the projections provided to it, and it has further relied upon the assurances of the senior management of Katy that they are unaware of any facts that would make the information or projections provided to Bear Stearns incomplete or misleading.

In arriving at its opinion, Bear Stearns has taken into account, with Katy's consent, the risks inherent in Katy's current business plans, including

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the view of the senior management of Katy that in the current capital markets environment there exists a risk that Katy would be unable in the future to obtain continued waivers of the defaults under its current credit facility and that Katy would be unable to obtain, on reasonable terms, financing necessary to replace its current credit facility. Bear Stearns has also considered that, according to the senior management of Katy, (i) no other potential investor or acquiror has made any investment or acquisition proposal to Katy since November 6, 2000 (the date of the public announcement by Katy that it was exploring its strategic alternatives, including the possible sale of Katy, and that it was in discussions with a potential purchaser relating to a possible purchase of Katy) or since March 2, 2001 (the date of the public announcement by Katy that it was engaged in discussions with a potential purchaser of a substantial equity position in Katy) and (ii) the prospects for obtaining access to additional financing in the public or private capital markets are limited.

In arriving at its opinion, Bear Stearns has not performed or obtained any independent appraisal of the assets or liabilities (contingent or otherwise) of Katy, nor has Bear Stearns been furnished with any such appraisals. In connection with its engagement, Bear Stearns was not requested to, and it did not, solicit third party indications of interest involving an investment in, a recapitalization of, or acquisition of all or part of, Katy. Bear Stearns assumed that the Tender Offer and the Preferred Stock Purchase and the refinancing contemplated by the Commitment Letter will be consummated in a timely manner and in accordance with the terms of the Purchase Agreement and the Commitment Letter without any limitations, restrictions, conditions, amendments or modifications that collectively would have a material effect on Katy.

Bear Stearns did not express any opinion as to the price or range of prices at which the shares of common stock of Katy may trade subsequent to the announcement of the Tender Offer and the Preferred Stock Purchase and the refinancing contemplated by the Commitment Letter or as to the price or range of prices at which the shares of common stock of Katy may trade subsequent to the consummation of the Tender Offer and the Preferred Stock Purchase and the refinancing contemplated by the Commitment Letter.

Summary of Analysis

The following is a brief summary of the material valuation and financial and comparative analyses considered by Bear Stearns in connection with the rendering of its opinion. This summary does not purport to be a complete description of the analyses

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underlying the Bear Stearns opinion and is qualified in its entirety by reference to the full text of its opinion.

In performing its analysis, Bear Stearns made numerous assumptions with respect to industry performance, general business, economic, market and financial conditions and other matters, many of which are beyond the control of Bear Stearns, Katy and Kohlberg. Any estimates contained in the analysis performed by Bear Stearns are not necessarily indicative of actual values or future results, which may be significantly more or less favorable than suggested by such analysis. In addition, as described above, the Bear Stearns opinion was one among several factors taken into consideration by the Katy Board of Directors in making its determination to approve the Tender Offer and Preferred Stock Purchase.

Historical Stock Price Performance of Katy. Bear Stearns reviewed the trading volume and price history of Katy's common stock on the New York Stock Exchange for the period from March 28, 2000 through March 28, 2001 and for the

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period from March 28, 1996 through March 28, 2001. Bear Stearns also reviewed the relationship between movements in the closing prices of Katy's common stock, the S&P 500 Index and an index of other selected industrial companies (see Comparable Company Analysis below) for the period from March 28, 2000 through March 28, 2001 and for the period from March 28, 1996 through March 28, 2001. Bear Stearns noted that Katy's common stock had underperformed the S&P 500 Index for the period from March 28, 2000 through March 28, 2001 and for the period from March 28, 1996 through March 28, 2001. Additionally, Bear Stearns noted that Katy's common stock had underperformed the index of other selected industrial companies for the period from March 28, 2000 through March 28, 2001 and for the period from March 28, 1996 through March 28, 2001.

Comparative Analysis of Tender Offer and Preferred Stock Purchase Versus Status Quo. Bear Stearns compared the per share value of the Tender Offer and Preferred Stock Purchase, taken as a whole, to the per share value of Katy's outstanding common stock as of March 28, 2001. To estimate the value per share of the Tender Offer and Preferred Stock Purchase, Bear Stearns analyzed (i) the cash to be distributed in the Tender Offer and (ii) the pro forma value per share of Katy's common stock after giving effect to the Tender Offer and Preferred Stock Purchase and transaction-related fees and expenses and the sale of Hamilton.

Assuming full participation in the Tender Offer, Bear Stearns calculated the value of the cash to be distributed in the Tender Offer to 29.8% of Katy's common stock to be approximately \$2.38 per share. The pro forma value per share of Katy's common stock, after giving effect to the Tender Offer and Preferred Stock Purchase and transaction related fees and expenses and the sale of Hamilton, was calculated by using a range of multiples of enterprise value/latest twelve month ("LTM") earnings before interest, taxes, depreciation and amortization, referred to as EBITDA. Bear Stearns selected a range of enterprise value/LTM EBITDA multiples of 5.25x to 6.25x based on its review of the following: (i) an analysis of Katy's historical enterprise value/LTM EBITDA multiples, (ii) an analysis of certain publicly traded companies deemed by Bear Stearns to be generally comparable to Katy (see Comparable Company Analysis below) and (iii) a theoretical discounted cash flow analysis, adjusted for the Tender Offer and

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Preferred Stock Purchase and transaction-related fees and expenses and the sale of Hamilton. This analysis resulted in an implied reference range for the pro forma equity value of Katy's remaining common stock of approximately \$4.33 per share to \$6.38 per share.

Bear Stearns added the cash value per share to be distributed in the Tender Offer to the range of implied pro forma equity values per share to arrive at a range of implied values per share for the Tender Offer and Preferred Stock Purchase, taken as a whole, of approximately \$6.71 per share to \$8.76