# POWERING TOMORROW'S WORLD

*2002 Annual Report*

## COMPANY PROFILE

RAYOVAC CORPORATION IS ONE OF THE WORLD'S LARGEST CONSUMER BATTERY AND LIGHTING PRODUCT COMPANIES. FOUNDED IN 1906, RAYOVAC IS THE LEADING VALUE BRAND OF ALKALINE BATTERIES IN NORTH AMERICA AND LATIN AMERICA, THE TOP SUPPLIER OF RECHARGEABLE BATTERIES IN THE U.S. AND EUROPE, AND THE LARGEST MANUFACTURER AND MARKETER OF HEARING AID BATTERIES IN THE WORLD.

HEADQUARTERED IN MADISON, WISCONSIN, RAYOVAC HAS MORE THAN 4,000 EMPLOYEES AND MARKETS ITS PRODUCTS IN MORE THAN 115 COUNTRIES. THE COMPANY'S STOCK TRADES ON THE NEW YORK STOCK EXCHANGE UNDER SYMBOL ROV.

RAYOVAC MANUFACTURES AND DISTRIBUTES
HIGH-PERFORMANCE PRODUCTS TO
POWER TOMORROW'S WORLD

# Financial and Operating **HIGHLIGHTS**

*In millions, except per-share amounts*

| | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| Total revenue | $441.8 | $504.2 | $630.9 | $616.2 | $572.7 |
| Adjusted gross profit[2] | 172.9 | 199.5 | 259.4 | 255.0 | 238.6 |
| Adjusted operating income[3] | 46.7 | 63.0 | 89.3 | 76.7 | 76.2 |
| Adjusted EBITDA[4] | 59.2 | 76.8 | 108.6 | 96.8 | 94.0 |
| Net income | 14.4 | 24.1 | 38.4 | 11.5 | 29.2 |
| Adjusted net income[5] | 21.4 | 30.4 | 38.4 | 31.1 | 37.5 |
| Diluted net income per common share | $ 0.51 | $ 0.83 | $ 1.32 | $ 0.39 | $ 0.90 |
| Adjusted diluted net income per common share[1] | $ 0.74 | $ 1.04 | $ 1.32 | $ 1.05 | $ 1.16 |

[1] See Table 1, Page 12 for reconciliation to U.S. GAAP financials.

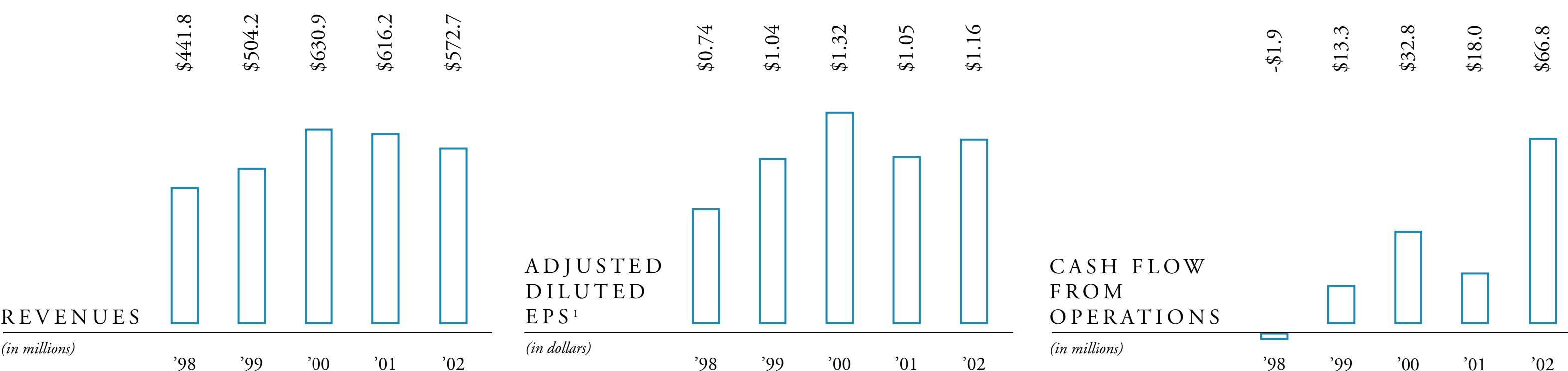
[2] See Table 2, Page 12 for reconciliation to U.S. GAAP financials.

[3] See Table 3, Page 12 for reconciliation to U.S. GAAP financials.

[4] See Table 4, Page 12 for reconciliation to U.S. GAAP financials.

[5] See Table 5, Page 12 for reconciliation to U.S. GAAP financials.

# SUMMARY OF FINANCIAL PERFORMANCE




*[1] See Table 1, Page 12 for reconciliation to U.S. GAAP financials.*

# STRATEGIC VISION

**OUR VISION IS TO BECOME A GLOBAL, TECHNOLOGY-FOCUSED, MARKET-DRIVEN CONSUMER PRODUCTS COMPANY.**

*VARTA's advanced battery products provide exciting benefits to consumers and retailers alike.*

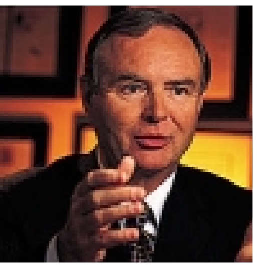
*We provide industry leading NiMH rechargeable battery and charger technology.*

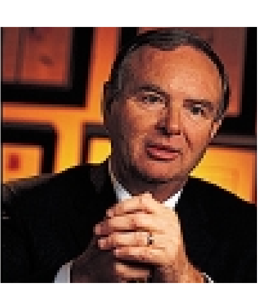
*We've improved the performance of our alkaline batteries by 33 percent since 1998.*

*We're creating our most powerful zinc air batteries.*

# GLOBAL PRESENCE

**OUR VARTA ACQUISITION HAS RESHAPED THE COMPETITIVE LANDSCAPE IN THE GLOBAL BATTERY INDUSTRY, POSITIONING RAYOVAC AS ONE OF THE LARGEST CONSUMER BATTERY AND LIGHTING COMPANIES IN THE WORLD.**



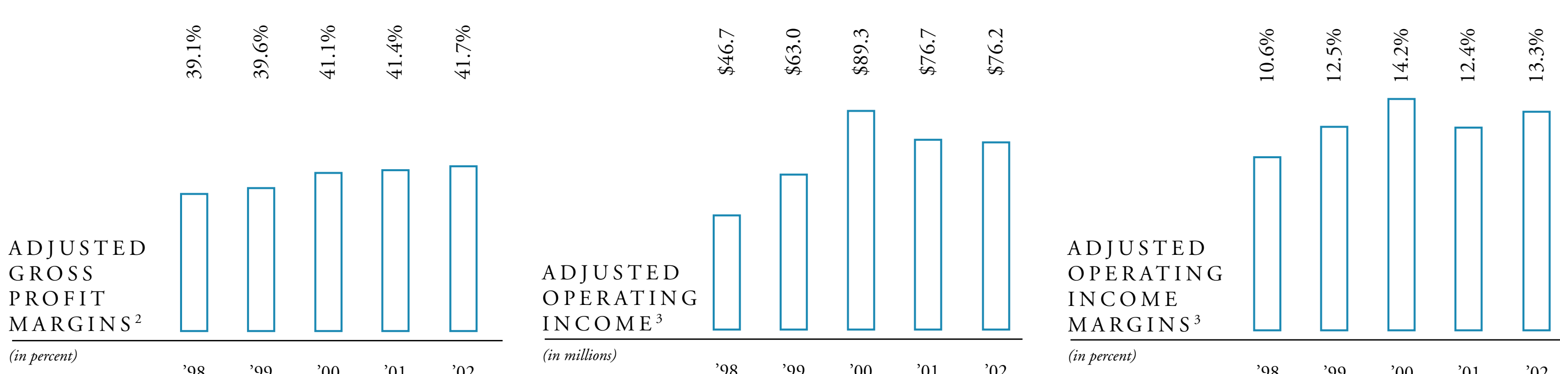


*"Rayovac now has sales and distribution capabilities in 115 countries and relationships with nine of the top 10 global retailers."*

# to our SHAREHOLDERS

For **RAYOVAC CORPORATION**, fiscal 2002 was an exciting and challenging year, and one that will be remembered as a defining period in our growth story. During the year, we announced the most important transaction in our Company's history: the combination of Rayovac's business with the consumer battery unit of Germany-based VARTA AG, a leader in the global battery industry. This groundbreaking agreement, which closed on October 1, 2002, has literally transformed Rayovac, dramatically expanding our global presence, and bringing us significantly closer to our long-held goal of becoming a technology-focused, market-driven, global consumer products company.

# SUMMARY OF FINANCIAL PERFORMANCE



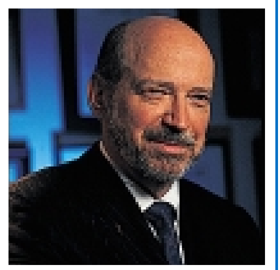
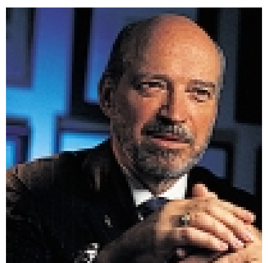
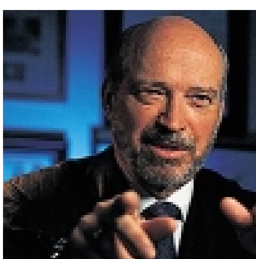

## HIGHLIGHTS

- *Announced acquisition of consumer battery business of VARTA AG, a leader in the global battery industry*
- *Obtained new $625 million bank credit facility to finance the VARTA transaction, and to fuel our growth*
- *Fortified our balance sheet by reducing inventory and receivables, driving improvements in working capital and controlling costs*
- *Increased cash flow from operations to $66.8 million dollars, a $49 million dollar improvement compared with last year*
- *Added to our strong leadership at Board and senior management levels*

[2] *See Table 2, Page 12 for reconciliation to U.S. GAAP financials.*

[3] *See Table 3, Page 12 for reconciliation to U.S. GAAP financials.*

> *"The VARTA acquisition provides Rayovac with the resources we need to capture a greater global market share."*

Indeed, we have already realized the worldwide component of our goal, as the transaction has given Rayovac an expanded footprint that includes sales and distribution capabilities in 115 countries. We now have relationships with nine of the top 10 global retailers: Wal*Mart, Target, Home Depot, Kmart, Sears, Kroger, Ahold, Carrefour, and Tesco. Fifty-four percent of our sales take place outside of North America. Sixty percent of our employees are based in countries other than the U.S. In short, in an age when fast-growing global retailers are seeking partnerships with suppliers that can meet their demands worldwide, Rayovac is positioned to be a partner of choice.

Moreover, the VARTA transaction has affected the entire global consumer battery industry. In one bold move, it has reshaped the competitive landscape by making Rayovac one of the largest consumer battery and lighting products companies in the world. It has also equipped us with the resources we need to capture a greater global market share, including a deeper management team, a strong new global brand, nearly $1 billion in annual sales, a rich product portfolio, a solid customer service platform, and advanced new manufacturing and distribution capabilities to serve the needs of our global retail customers.

Our union with VARTA truly framed fiscal 2002 for Rayovac, making it a watershed year in our Company's history. However, it was not, by any means, our sole accomplishment. We also posted a number of technological and marketing achievements that furthered our industry standing and positioned Rayovac to be an even more powerful enterprise in the years to come.

***Introducing Cutting-Edge Technology***

Over the last two years, we have introduced several innovative technologies that have positioned Rayovac as the undisputed leader in a number of product categories. For example, in 2001, we launched the world's first one-hour Nickel Metal Hydride (NiMH) charger, as well as long-lasting, high-capacity NiMH batteries. These products enabled us to retain more than a 60 percent share of the U.S. rechargeables market and solidified our position as the nation's top-selling rechargeable brand.

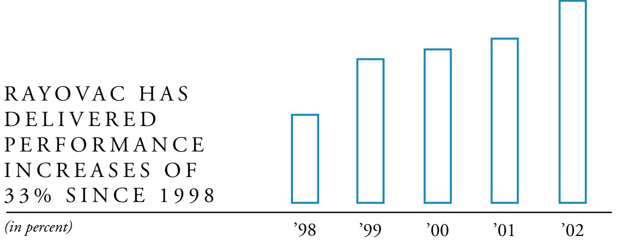
In fiscal 2002, we built on these technological innovations by inventing the revolutionary new In-Cell Charge Control (I-C$^{3}$™) rechargeable NiMH battery system, which is slated for commercial rollout in the fall of 2003. This new battery technology places charging control in the battery instead of in the charger, allowing for dramatically reduced battery charge time and significant performance and convenience improvements over existing rechargeable and single-use battery systems. The I-C$^{3}$ rechargeable battery can be charged in as little as 15 minutes or less, up to 1,000 times. These compelling product attributes uniquely position the I-C$^{3}$ to win a sizable share of the consumer rechargeable battery market. The I-C$^{3}$ system is expected to hold particular appeal for original equipment manufacturers (OEMs) and consumers of high-tech electronic devices, household appliances and products that employ emerging technologies.

AN IMPROVED COMBINATION OF POWER AND PERFORMANCE

# MAXIMUM PROFILE

WE'VE UNVEILED A BOLD NEW LOGO THAT HELPS US TO STAND OUT FROM OUR COMPETITORS AT RETAIL AND BUILDS CONSUMER AWARENESS OF RAYOVAC'S NEW AND IMPROVED ALKALINE PRODUCT, MAXIMUM **PLUS**™.

# TAKING RAYOVAC TO A NEW LEVEL




- *Introduced the Maximum Plus™ high-performance alkaline battery, our longest lasting alkaline battery ever*
- *Increased our alkaline battery life by 33 percent over our 1998 alkaline product*
- *Launched a bold new Rayovac logo and package design across all battery products*

Another major technology achievement for Rayovac in 2002 was our launch of the new Maximum Plus™ alkaline battery. Maximum Plus incorporates our latest advances in battery chemistry and internal cell construction, and is the longest lasting Rayovac alkaline product yet. Maximum Plus lasts an average of 11 percent longer than our prior generation of alkaline products across all sizes, and 33 percent longer than the alkaline batteries we produced in 1998. The introduction of Maximum Plus, withits improved performance, brings Rayovac's value proposition to a new level.

Rayovac has long been known for the excellence of our advertising, branding, package design and point-of-purchase presentation. We continued this tradition in 2002 by launching a bold new Rayovac logo that communicates the power and performance of our brand. We have incorporated this new high-tech neon blue, black and silver logo into the Company's packaging, displays and battery cells, thereby sharpening our profile at the point of purchase. Our new "look" was developed by a leading design firm after extensive consumer research, and it was preferred by battery consumers three to one over our previous graphic design. More importantly, nine of 10 consumers said they would consider purchasing the new product, a key success indicator in a high-impulse category like batteries.

*Spurring New Growth*

Distribution expansion is a key priority for Rayovac, and during 2002 we continued our efforts in this arena. As a result, we scored a number of important new U.S. distribution gains with such quality retailers as Best Buy, Speedway, Stop & Shop, Snyder Drug/Drug Emporium and Giant Food Stores.

We also obtained a new $625 million bank credit facility in October 2002, the proceeds of which were used to replace existing debt, finance the VARTA transaction and provide for the increased working capital needs of our new, larger company. The additional funding will enable our Company to continue to grow in the future.

Finally, we undertook measures to ensure that our Company has the right leadership in place to direct our future growth. We added two outstanding senior executives to our Board as independent Directors: Barbara S. Thomas and William P. Carmichael, each of whom has extensive senior management experience with leading consumer products companies. We also welcomed the return of Rayovac Executive Vice President and Chief Financial Officer Randall J. Steward, who rejoined the Company after a brief absence to attend to important family matters.

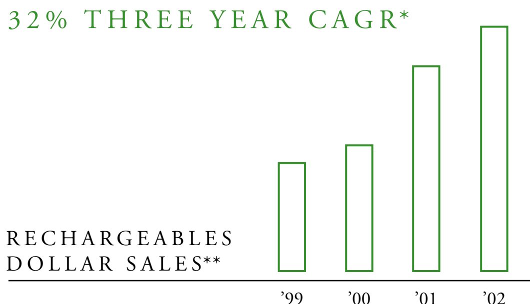
***Maximum Plus™ incorporates our latest advances in battery chemistry and internal cell construction to deliver Rayovac's highest performance, longest lasting alkaline battery.***

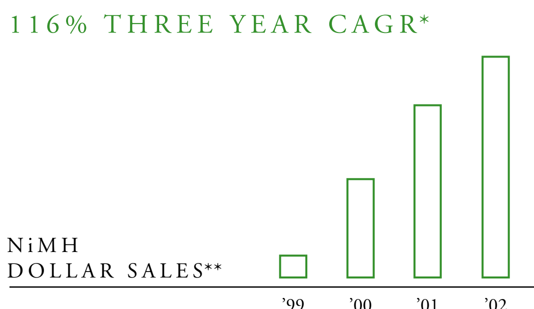
POWERFUL SOLUTIONS FOR
POPULAR CONSUMER PRODUCTS

# TECHNOLOGY FOCUS

WE'VE COMPLEMENTED OUR ADVERTISING, MARKETING, BRANDING, PACKAGE DESIGN AND POINT-OF-PURCHASE CAPABILITIES WITH INNOVATIVE TECHNOLOGY INITIATIVES THAT HAVE POSITIONED US AS THE INDUSTRY LEADER IN SEVERAL PRODUCT CATEGORIES.

# RECHARGEABLES ARE DRIVING GROWTH IN BATTERY CATEGORY




- *Rechargeable batteries are the fastest growing segment of the overall battery market*
- *Nickel Metal Hydride (NiMH) batteries are the most popular rechargeables*
- *High-tech digital cameras are spurring the growth of NiMH rechargeable batteries*
- *Rayovac is the number-one-selling rechargeable brand in the U.S.*

** Compound Annual Growth Rate*
***A.C. Nielsen*

*Overcoming Challenges*

While we would be proud of our fiscal year 2002 achievements in any environment, we're particularly pleased that we delivered them during what was the most challenging period that our industry has faced in recent years. Heated competition in the U.S. battery industry characterized by intense promotional pricing resulted in virtually no alkaline category dollar growth for the second consecutive year—a first in the industry's history. The sluggish U.S. economy influenced the retail environment and caused retailers to be cautious about inventory levels. Slowing sales of small electronic devices that are important to battery market growth also impacted the category. Kmart, the nation's second largest retailer and a key Rayovac customer, fell victim to the tough economic times and filed for Chapter 11 bankruptcy protection. In Latin America, another important Rayovac market, weak economic conditions, political turmoil and currency devaluations all contributed to a depressed consumer products market and significant year-over-year declines in the battery category.

We responded swiftly and effectively to these challenges, meeting the industry issues head-on. In spite of the difficult economic environment and intense competition, we maintained our overall market share in our key markets. In the U.S., we added new customers in alternate channels to help offset the negative impact of the economic environment. And in Latin America, we took aggressive measures to retain our market share while reducing our cost structure.

*Delivering Solid Performance*

While our operating performance in fiscal 2002 enabled us to deliver better earnings than in 2001, the stress of the year's market pressures still impacted our financial results. Sales declined seven percent to $572.7 million, compared with $616.2 million in the last fiscal year. Diluted earnings per share increased to $0.90 from $0.39 last year at this time. Adjusted diluted earnings per share was $1.16, an increase from the $1.05 reported for the same period a year ago.[1] Though these financial results are not consistent with Rayovac's long-term goals, we are still gratified that we were able to deliver such solid performance under trying short-term market conditions.

We also fortified our balance sheet during fiscal 2002. We achieved substantial improvements in working capital, reducing inventory by $7 million and accounts receivable by $32 million. At the same time, we continued to exercise the stringent cost management disciplines that are an essential part of Rayovac's management culture. As a result, we boosted our cash flow from operations to $66.8 million, a $49 million increase year over year.

[1] See Table 1, Page 12 for reconciliation to U.S. GAAP financials.

***The patent pending I-C³ rechargeable NiMH battery can be charged in 15 minutes or less in our I-C³ charger, providing consumers with unparalleled convenience and compelling cost savings.***

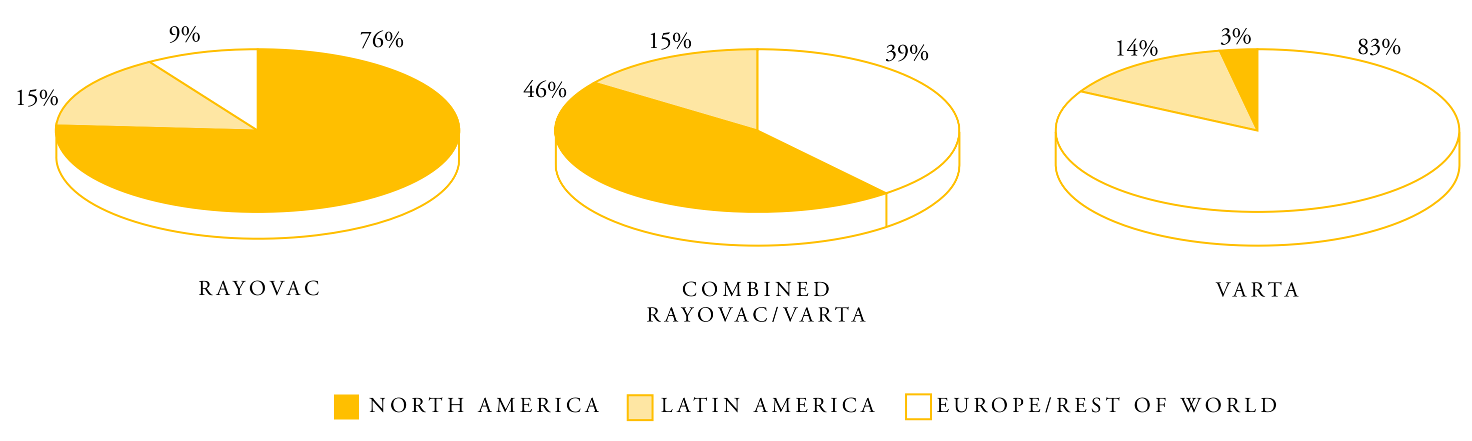
VARTA
CONSUMER BATTERIES

## LEADERS IN THE EUROPEAN AND LATIN AMERICAN BATTERY MARKETS

# NEW OPPORTUNITIES

**OUR ACQUISITION OF VARTA, A HIGHLY REGARDED AND WELL-RECOGNIZED EUROPEAN BRAND, HAS ESTABLISHED A STRONG PLATFORM FOR OUR GROWTH IN EUROPE AND LEVERAGES FAVORABLE EUROPEAN MARKET DYNAMICS TO INCREASE OUR REVENUES AND GROW OUR PROFIT MARGINS.**

# COMPANY-TRANSFORMING TRANSACTION




- *Creates a powerful global consumer battery competitor*
- *Builds a base of manufacturing and distribution capabilities*
- *Yields a combined revenue base of nearly $1 billion*

*Forging a Perfect Union*

As we look to 2003, we are sharply focused on maximizing the value of the VARTA acquisition. At the same time, we are keenly aware that the success of our union is predicated on the need for our two companies to become one. Based on the many similarities between the two organizations—including our corporate styles, the way we go to market, the value we offer to retailers and the complementary capabilities of our management teams—we are confident that we share a common platform for growth. More importantly, we have similar attitudes toward our customers, service, cost control, product quality and innovation. And we share a profound commitment to excellence, a culture of innovation and a performance-driven, entrepreneurial spirit. For these reasons, we believe that our new alliance poses tremendous advantages as we look to the future.



As we integrate the two organizations, we will employ the best qualities of each in terms of people and business processes, and we will seek ways to operate every aspect of our business more efficiently, from manufacturing to marketing, from finance to distribution. As a global company, we will be able to leverage new opportunities to gain operating efficiencies. To ensure that we capture these efficiencies, we will undertake the largest restructuring in our history. Though we anticipate that this effort will result in a charge to earnings, we expect that it will also yield $35–$40 million in savings by the end of fiscal 2005.



We will also consolidate Rayovac's and VARTA's existing European and Latin American businesses, thereby creating a strong market platform that was nearly unimaginable a few years ago. In 1998, Rayovac was primarily a U.S. battery company; as we begin 2003, we are a global company with the majority of our sales outside of the U.S. We are also the leading battery company in Germany, Europe's largest battery market, as well as the number-two battery brand in Europe. We are exceptionally well positioned to take advantage of the multiple opportunities we see in Europe to drive revenues, grow profit margins and increase shareholder value. And with an even stronger position in Latin America, we are also poised to outperform the category in that region once local economies improve.

True to Rayovac's culture, we are very excited about these prospects—and highly confident that we will make the most of them. Capitalizing on new opportunities has long been part of Rayovac's business strategy and culture. Our corporate style is informal, team oriented and entrepreneurial. Our organization is flat and unfettered by corporate bureaucracy. And our decision makers work seamlessly, with a sharp focus on results. These factors, combined with the strength of our balance sheet, strongly position us to leverage the opportunities that will arise as we maximize the power of our synergistic union with VARTA.

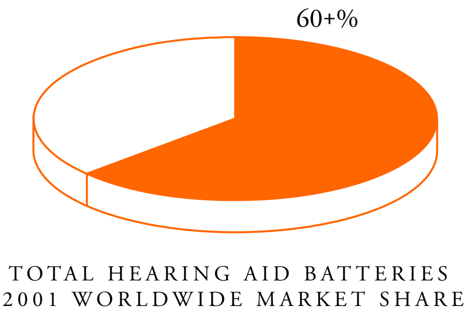
***VARTA offers a full range of consumer batteries including, advanced alkaline, rechargeable, zinc carbon and photo.***

## RAISING THE VOLUME FOR THE HEARING IMPAIRED

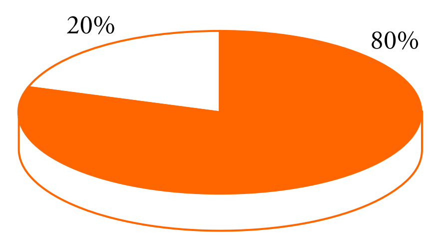
# DRIVING INNOVATION

**WE'RE EXPANDING OUR INDUSTRY-LEADING ZINC AIR TECHNOLOGY CAPABILITIES TO CREATE A NEW GENERATION OF BATTERIES THAT WILL BE OUR MOST POWERFUL.**

# EXPANDED RETAIL DISTRIBUTION




TOTAL HEARING AID BATTERIES
2001 WORLDWIDE MARKET SHARE




TOTAL HEARING AID BATTERIES
2001 NORTH AMERICA PROFESSIONAL MARKET SHARE

ALL OTHER RAYOVAC

- *Rayovac has more than 60 percent of the worldwide hearing aid battery market share*
- *Rayovac hearing aid batteries comprise 80 percent of the batteries sold in the North America Professional channel*

*Source: A.C. Nielsen, Management Estimates*

*Pursuing a Bright Future*

As we concluded the fiscal year, some of the market forces that buffeted our industry in fiscal 2002 showed signs of continuing into 2003. A near-term economic recovery in North America is uncertain, and the stock market continues to bounce erratically on news of terrorism, turmoil in the Middle East and corporate scandals. Latin American economies, closely tagged to the health of their huge northern trading partner, continue to struggle.

In spite of these challenging economic conditions, Rayovac's management team continues to pursue our primary mission: to create and deliver our industry's most powerful solutions to consumers, customers, employees and shareholders. In the coming months, we will strive to build our alkaline battery core business, introduce product improvements and expand market share. We expect to solidify our rechargeables leadership by launching the I-C$^3$ system, by broadening distribution and retail sales of our rechargeable product line. We will also build upon this year's success of our lighting products business that rebounded as a result of new innovative designs and distribution wins. We will pursue these initiatives, as always, with a sharp focus on driving revenue growth and expanding margins.

We will also strive to be the premier ***value player*** in our industry for both consumers and retailers on a global basis. For consumers, this means that Rayovac will strive to provide high-quality products that deliver powerful performance, at a value price, day in and day out. For retailers, this means Rayovac will provide industry-leading category management skills and processes designed to maximize their revenues and profits. We are deeply committed to delivering on these promises to consumers and retailers around the world, both today and in the future.

As we forge ahead into fiscal 2003, Rayovac's world is larger, more exciting and more promising than it was just 12 months ago. We're thrilled about our future and the opportunities that it holds for continued growth and success. As we pursue these goals, we thank you—our valued shareholders—for being a key part of our evolving world and an important participant in our future.

**David A. Jones**
*Chairman and Chief Executive Officer*

**Kent J. Hussey**
*President and Chief Operating Officer*

***Rayovac's zinc air hearing aid batteries deliver powerful performance and excellent sound quality—the perfect solution for high-demand hearing aids.***

## RECONCILIATION TO GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

Rayovac Corporation and Subsidiaries

The Company believes adjusting for unusual items in the Company's results provides useful information regarding the Company's ability to service its indebtedness and facilitates investors' and analysts' ability to evaluate the Company's operations excluding these unusual items. However, the following factors should be considered in evaluating such measures: EBITDA and other related adjusted financial measures (i) should not be considered in isolation, (ii) are not measures of performance calculated in accordance with generally accepted accounting principles ("GAAP"), (iii) should not be construed as alternatives or substitutes for income from operations, net income or cash flows from operating activities in analyzing the Company's operating performance, financial position or cash flows (in each case, as determined in accordance with GAAP) and (iv) should not be used as indicators of the Company's operating performance or measures of its liquidity. Additionally, because all companies do not calculate EBITDA and related adjusted financial measures in a uniform fashion, the calculations presented herein may not be comparable to other similarly titled measures of other companies.

*All information in millions, except per-share amounts*

Table 1—Adjusted Diluted Net Income Per Share

| Impact of Unusual Items within the Statement of Operations: | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| Diluted Net Income Per Share (5) | $ 0.51 | $ 0.83 | $ 1.32 | $ 0.39 | $ 0.90 |
| Unusual Items | | | | | |
| Unusual items within gross profit and operating expenses, net of tax (2), (3) | 0.16 | 0.21 | — | 0.48 | 0.26 |
| Extraordinary items, net of tax (6) | 0.07 | — | — | 0.18 | — |
| Adjusted diluted net income per share | $ 0.74 | $ 1.04 | $ 1.32 | $ 1.05 | $ 1.16 |

Table 2—Adjusted Gross Profit

| Impact of Unusual Items within the Statement of Operations: | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| Gross profit (1) | $172.9 | $198.2 | $259.4 | $232.9 | $237.4 |
| Unusual Items | | | | | |
| Special charges within gross profit (2) | — | 1.3 | — | 22.1 | 1.2 |
| Adjusted gross profit | $172.9 | $199.5 | $259.4 | $255.0 | $238.6 |

Table 3—Adjusted Operating Income

| Impact of Unusual Items within the Statement of Operations: | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| Operating income | $ 40.5 | $ 53.6 | $ 89.3 | $ 54.4 | $ 63.0 |
| Unusual Items | | | | | |
| Special charges within gross profit (2) | — | 1.3 | — | 22.1 | 1.2 |
| Special charges within operating expenses (2) | 6.2 | 8.1 | — | 0.2 | — |
| Bankruptcy filing of a key customer (3) | — | — | — | — | 12.0 |
| Adjusted operating income | $ 46.7 | $ 63.0 | $ 89.3 | $ 76.7 | $ 76.2 |

Table 4—Adjusted EBITDA

| Impact of Unusual Items within the Statement of Operations: | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| EBITDA (4) | $ 53.0 | $ 67.4 | $108.6 | $ 74.5 | $ 80.8 |
| Unusual Items | | | | | |
| Special charges within gross profit (2) | — | 1.3 | — | 22.1 | 1.2 |
| Special charges within operating expenses (2) | 6.2 | 8.1 | — | 0.2 | — |
| Bankruptcy filing of a key customer (3) | — | — | — | — | 12.0 |
| Adjusted EBITDA | $ 59.2 | $ 76.8 | $108.6 | $ 96.8 | $ 94.0 |

Table 5—Adjusted Net Income

| Impact of Unusual Items within the Statement of Operations: | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| Net income | $ 14.4 | $ 24.1 | $ 38.4 | $ 11.5 | $ 29.2 |
| Unusual Items | | | | | |
| Unusual items within gross profit and operating expenses, net of tax (2), (3) | 5.0 | 6.3 | — | 14.2 | 8.3 |
| Extraordinary items, net of tax (6) | 2.0 | — | — | 5.4 | — |
| Adjusted net income | $ 21.4 | $ 30.4 | $ 38.4 | $ 31.1 | $ 37.5 |

(1) Footnote 2(v) in the Notes to Consolidated Financial Statements.

(2) The Company recorded special charges within gross profit and operating expenses during fiscal 1998, 1999, 2001, and 2002 reflecting: (i) the rationalization of uneconomic manufacturing, packaging, and distribution processes, (ii) the realignment of manufacturing capacities, and (iii) restructuring of the Company's administrative functions. Please see footnote 15 in the Notes to Consolidated Financial Statements and the Management Discussion and Analysis for more information.

(3) In fiscal 2002, the Company recognized a bad debt reserve of $12.0 million, net of recoveries, attributable to the bankruptcy filing of a key customer.

(4) EBITDA represents income from operations plus other (income) expense, net, plus depreciation and amortization (excluding amortization of debt issuance costs). Unless otherwise noted, EBITDA includes expenses related to all identified unusual items in the fiscal years ended September 30, 1998, 1999, 2000, 2001 and 2002.

(5) In fiscal 2002, the Company adopted the provisions of FAS 142 which requires that goodwill and intangible assets with indefinite useful lives no longer be amortized. See also Footnote 2(v) and Footnote 5 in the Notes to Consolidated Financial Statements and the Management Discussion and Analysis for more information.

(6) The Company recorded extraordinary expenses in fiscal 1998 and fiscal 2001 relating to the premium on the repurchase of or redemption of the Company's senior term notes and related write-off of debt issuance costs. See Footnote 6 in the Notes to Consolidated Financial Statements and the Management Discussion and Analysis for more information.

## Forward Looking Statements

Certain of the information contained in this Annual Report is not historical and may include "forward looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements may be identified by such forward looking language as "expects," "anticipates," "intends," "believes," "will," "estimate," "should," "may" or other similar terms. In reviewing such information, you should note that such statements are based upon current expectations of future events and projections; our actual results may differ materially from those set forth in such forward looking statements.

Important factors that could cause our actual results to differ materially from those contained in this Annual Report include, without limitation, (1) competitive promotional activity or spending by competitors or price reductions by competitors, (2) the introduction of new product features or technological developments by competitors and/or the development of new competitors or competitive brands, (3) the loss of, or a significant reduction in, sales to a significant retail customer, (4) difficulties or delays in the integration of VARTA's operations, (5) our ability to develop and successfully introduce new products and protect our intellectual property, (6) our ability to successfully implement, achieve and sustain manufacturing and distribution cost efficiencies and improvements, and fully realize anticipated cost savings, (7) the impact of unusual items resulting from the implementation of new business strategies, acquisitions and divestitures or current and proposed restructuring activities, (8) the cost and effect of unanticipated legal, tax or regulatory proceedings or new laws or regulations (including environmental regulations), (9) changes in accounting policies applicable to our business, (10) interest rate, exchange rate and raw material price fluctuations, (11) the effects of general economic conditions, including inflation, labor costs and stock market volatility, or changes in trade, monetary or fiscal policies in the countries where we do business, and (12) the effects of political or economic conditions or unrest in Latin America and other international markets.



Some of the above-mentioned factors are described in further detail in the section entitled "Risk Factors" beginning on page S-10 of our Prospectus Supplement (to Prospectus dated June 20, 2001) filed pursuant to Rule 424(b)(5) with the Securities and Exchange Commission on June 21, 2001. Other factors and assumptions not identified above were also involved in the derivation of the forward looking statements contained in this Annual Report. If such other factors impact our results or if such assumptions are not correct or do not come to fruition, our actual results may differ materially from those projected. We assume no obligation to update these forward looking statements to reflect actual results or changes in factors or assumptions affecting such forward looking statements.

The following is management's discussion of the financial results, liquidity, and other key items related to the Company's performance. This section should be read in conjunction with the "Summary of Financial Performance", "Financial and Operating Highlights", and our Consolidated Financial Statements and related notes in the "Financial Statements" section of this report. Certain prior year amounts have been reclassified to conform to current year presentation. All references to 2000, 2001, 2002, and 2003 refer to fiscal year periods ended September 30, 2000, 2001, 2002, and 2003, respectively.

## INTRODUCTION

Rayovac Corporation is one of the oldest battery companies in the United States, founded in 1906 as the French Battery Company. Rayovac's product portfolio includes alkaline, rechargeable, and heavy duty batteries, hearing aid batteries, lighting products, and other specialty batteries.

Our financial performance is influenced by a number of factors including: general economic conditions and trends in consumer markets; our overall product line mix, including sales prices and gross margins which vary by product line; and our general competitive position, especially as impacted by our competitors' promotional activities and pricing strategies. These influencing factors played significant roles in our financial results during 2000, 2001 and 2002.

We manage our business based upon three geographic regions. The regions are as follows: North America, which includes the United States and Canada; Latin America, which includes Mexico, Central America, South America and the Caribbean; and Europe/Rest of World ("Europe/ROW"), which includes the United Kingdom, continental Europe and all other countries in which we do business.

Set forth below are other significant developments that have impacted our results and may continue to affect our performance.

### Continued Manufacturing Cost Reduction Initiatives

We continually assess our worldwide manufacturing capacity and product costs in light of existing and forecasted market demand. With our continued focus on cost reduction and rationalization, we believe we can continue to drive down our cost of goods manufactured with continued focus on cost reduction initiatives.

In furtherance of this goal, we closed our Wonewoc, Wisconsin plant during 2001 and now source lighting products previously made at this plant from third-party suppliers. With this closure, we now outsource all of our lighting products.

Similarly, we closed our zinc carbon battery plants in Tegucigalpa, Honduras, and Santo Domingo, Dominican Republic in 2001 and 2002, respectively. We closed the Mexico City, Mexico plant in October 2002. With the closure of the Mexico City, Mexico plant, and prior to the acquisition discussed below, the Guatemala City, Guatemala plant is our only remaining zinc carbon manufacturing plant. The consolidation of our zinc carbon capacity within Latin America is consistent with the global market trend away from zinc carbon toward alkaline batteries.

In October 2002, we announced the closure of operations at our Madison, Wisconsin packaging center and Middleton, Wisconsin distribution center and combination of the two operations into a new leased complex being built in Dixon, Illinois. Transition to the new facility is expected by June 2003.

### Meeting Consumer Needs through Technology and Development

We continue to focus our efforts on meeting consumer needs for portable power and lighting products through new product development and technology innovations. We have announced improvements and new developments in our rechargeable, alkaline, hearing aid, and lighting products product lines.

During 2001, we introduced a one-hour charger for nickel metal hydride (NiMH) batteries, and began selling higher performing NiMH batteries. In 2002, we announced the development of a revolutionary rechargeable NiMH battery system capable of recharging batteries in as little as 15 minutes and which we anticipate will be available in the retail market during 2003. These technological advancements are expected to provide consumers with portable, rechargeable power as the use of digital cameras and other high drain devices continues to grow.

In 2002, we launched our new, more powerful Maximum Plus™ alkaline batteries, with bold new graphics. Also during 2001 and 2002, we increased the performance of our hearing aid batteries, and launched innovative packaging allowing consumers to more easily dispense the hearing aid batteries. Finally, we rejuvenated our lighting products product line through a series of new product launches designed to reach unique markets within the mass and retail channels.

We believe that our products are well poised to meet the portable power and lighting needs for consumers. We will continue to focus on identifying new technologies necessary to meet consumer and retailer needs within the marketplace.

### Competitive Landscape

The alkaline battery business is highly competitive on a global scale. Within North America, there are three primary branded providers of alkaline batteries. The alkaline marketplace has seen changes in recent years related to product line segmentation, with attempts to segment the category into high-performance, regular and value positions, combined with the introduction of private label batteries at certain retailers. In addition, market participants continue to engage in high levels of promotional activities to gain market share.

Within Latin America, poor economic conditions have dramatically impacted battery sales especially within the heavy duty product line. Heavy duty batteries continue to be the largest share of the battery market in Latin America. In North America, the majority of consumers purchase alkaline batteries.

The rechargeable business has experienced dramatic changes over the past three years. Primary rechargeable alkaline sales have declined over this period with a shift towards rechargeable batteries, such as NiMH, which are higher performing in high drain devices. Our development of a one-hour charger and an innovative 15-minute rechargeable battery technology help us maintain the number one market position within the rechargeable category in the United States with approximately 60% market share, as estimated by management.

Within the hearing aid battery category, we continue to hold the number one global market position based on management estimates. We believe that our close relationship with hearing aid manufacturers and other customers, as well as our product performance improvements and packaging innovations position us for continued success in this category.

## Recent Developments

On October 1, 2002, we acquired the consumer battery business of VARTA AG (VARTA). The combination of the Rayovac and VARTA brands makes us a much stronger global competitor selling in more than 100 countries worldwide. We believe that the combination of these two businesses provides us with a strong platform for market growth, improved customer service, and technology advancements for consumers. We are now one of the largest consumer battery companies in the world with the number one market position in Germany, the largest European battery market, number two overall market position in Europe, a stronger number one position in Latin America, excluding Brazil, as well as the leading value brand in North America (all market shares based on management estimates on a unit basis).



On October 10, 2002, we announced a series of initiatives to position the combined company for future growth opportunities and to optimize the global resources of the combined VARTA and Rayovac organizations. These initiatives include the elimination of duplicate costs in the VARTA and Rayovac organizations and are expected to provide significant benefit to the combined organization. We expect that all geographies will benefit from these initiatives.

## Seasonal Product Sales

Rayovac's quarterly results are impacted by our seasonal sales. Sales during the first and fourth fiscal quarters of the year are generally higher than other quarters due to the impact of the December holiday season. The seasonality of our sales during the last three fiscal years is as follows:

| | Percent of Annual Sales | | |
|---|---|---|---|
| Fiscal Quarter Ended | 2000 | 2001 | 2002 |
| December | 30% | 27% | 28% |
| March | 20 | 22 | 21 |
| June | 22 | 24 | 24 |
| September | 28 | 27 | 27 |

*Fiscal Year Ended September 30, 2002 Compared to Fiscal Year Ended September 30, 2001*

### Highlights of consolidated operating results

***Net Sales.*** Our net sales decreased $43.5 million, or 7.1%, to $572.7 million in fiscal 2002 from $616.2 million the previous year. Increases in hearing aid battery and lighting product sales were unable to offset declines in heavy duty and alkaline sales.

***Net Income.*** Our net income for fiscal 2002 increased $17.7 million, or 153.9%, to $29.2 million from $11.5 million the previous year. The increase reflects a reduction in interest expense attributable to the retirement of $65.0 million in Senior Subordinated Notes following the June 2001 stock offering, plus a $56.1 million reduction in debt during fiscal 2002 due to strong cash flow from operations. In addition, fiscal 2001 results reflect a $22.3 million pretax restructuring charge, and a $5.4 million extraordinary loss, net of tax. These improvements were partially offset by a bad debt reserve of $7.5 million, net of tax, recognized in fiscal 2002 related to the bankruptcy filing of a key customer.

***Segment Results.*** We evaluate segment profitability based on income from operations before special charges and corporate expenses, which includes corporate purchasing expense, general and administrative expense and research and development expense. All depreciation and amortization included in income from operations is related to a segment. Total segment assets are set forth in Note 12 of Notes to Consolidated Financial Statements filed herewith.

North America

| | 2001 | 2002 |
|---|---|---|
| Revenue from external customers | $448.8 | $435.6 |
| Segment profit | 80.8 | 85.5 |
| Segment profit as a % of net sales | 18.0% | 19.6% |

Our revenue from external customers decreased $13.2 million, or 2.9%, to $435.6 million in fiscal 2002 from $448.8 million the previous year. Heavy duty sales decreases of $12.3 million, or 33.8%, reflect the trend in the industry toward alkaline and the discontinuation of certain products at selected stores of a major retailer. Alkaline sales decreases of $4.8 million, or 1.8%, were attributable to the decline in sales to a key customer in bankruptcy, a cautious retail inventory environment and continued promotional activity, and our inability to anniversary sales to an OEM customer in the previous year. Increases in lighting products of $4.3 million, or 7.6%, resulted from new product launches and distribution gains.

Our profitability increased $4.7 million, or 5.8%, to $85.5 million in fiscal 2002 from $80.8 million the previous year. This increase was primarily attributable to cost containment programs that lowered operating expenses, and improved gross profit margins reflecting the benefits of the 2001 plant closures and other cost improvement initiatives. This was partially offset by a $12.0 million bad debt reserve, net of recoveries, resulting from the bankruptcy filing of a key customer.

Latin America

| | 2001 | 2002 |
|---|---|---|
| Revenue from external customers | $118.7 | $84.7 |
| Segment profit | 16.9 | 5.3 |
| Segment profit as a % of net sales | 14.2% | 6.3% |

Our revenue from external customers decreased $34.0 million, or 28.6%, to $84.7 million in fiscal 2002 from $118.7 million the previous year due primarily to decreased sales of zinc carbon batteries. Net sales were impacted by unfavorable economic conditions, curtailment of shipments to certain distributors and wholesalers who were delinquent on payments, political uncertainties in Argentina and Venezuela, and the unfavorable impacts of currency devaluation which contributed approximately $9.3 million of the sales decline versus fiscal 2001.

In spite of the sales decline, the segment remained profitable, with profit of $5.3 million in fiscal 2002. However, this was a decrease of $11.6 million, or 68.6%, from the previous year. This decrease was primarily attributable to the impact of the sales decline, partially offset by lower advertising expenses and a reduction in other operating expenses in the region. As of October 1, 2001, the Company adopted Financial Accounting Standards Board Statement No. 142 which resulted in a reduction of amortization expense of $3.0 million for the year. Segment profit margins decreased primarily due to an unfavorable customer mix compounded by relatively fixed operating expenses spread over lower sales.

Europe/ROW

| | 2001 | 2002 |
|---|---|---|
| Revenue from external customers | $48.7 | $52.5 |
| Segment profit | 4.1 | 5.1 |
| Segment profit as a % of net sales | 8.4% | 9.7% |

Our revenue from external customers increased $3.8 million, or 7.8%, to $52.5 million in fiscal 2002 from $48.7 million the previous year, primarily reflecting increased sales of alkaline and hearing aid batteries, and favorable impacts of foreign currency movements.

Our profitability increased $1.0 million, or 24.4%, due primarily to sales gains and a reduction in operating expenses due to cost containment programs and the adoption of Statement No. 142, which resulted in lower amortization expense.



***Corporate Expenses.*** Our corporate expenses increased $6.6 million, or 26.3%, to $31.7 million in fiscal 2002 from $25.1 million the previous year. The increase was primarily due to higher legal expenses, technology spending, and management incentives.

***Special Charges.*** In 2002, we recorded net special charges of $1.2 million related to: (i) the closure of our manufacturing facility in Santo Domingo, Dominican Republic, (ii) certain rationalization efforts in our Mexico City, Mexico manufacturing facility, and (iii) the reversal of $1.3 million of expenses related to the December 2000 restructuring announcement which were not realized. Special charges of $22.3 million were recorded in 2001.

***Income from Operations.*** Our income from operations increased $8.6 million, or 15.8%, to $63.0 million in fiscal 2002 from $54.4 million the previous year. This increase was primarily due to reduction in special charges of $21.1 million offset by a $12.0 million bad debt reserve, net of recoveries, resulting from the bankruptcy filing of a key customer.

***Interest Expense.*** Interest expense decreased $11.2 million, or 41.2%, to $16.0 million in fiscal 2002 from $27.2 million in the previous year primarily due to the retirement of $65.0 million in Senior Subordinated Notes in June 2001 using proceeds from our primary offering and the repayment of $56.1 million in debt from our strong cash flow from operations.

***Income Tax Expense.*** Our effective tax rate for fiscal 2002 was 36.0% compared to 35.4% for fiscal 2001. The higher rate for fiscal 2002 primarily reflects a change in geographic profitability away from lower tax jurisdictions, primarily within Latin America, and proportionately higher income in the United States.

***Extraordinary Item.*** In fiscal 2001, we recorded extraordinary expense of $5.4 million, net of tax, resulting from the premium on the repurchase of $65.0 million of Senior Subordinated Notes and the related write-off of unamortized debt issuance costs.

*Fiscal Year Ended September 30, 2001 Compared to Fiscal Year Ended September 30, 2000*

## Highlights of consolidated operating results

***Net Sales.*** Our net sales decreased $14.7 million, or 2.3%, to $616.2 million in fiscal 2001 from $630.9 million the previous year. Increases in alkaline and hearing aid battery sales were offset by decreased specialty battery sales and lighting products sales.

***Net Income.*** Our net income for fiscal 2001 decreased $26.9 million, or 70.0%, to $11.5 million from $38.4 million the previous year. The decrease reflects the impact of a $22.3 million pretax restructuring charge, a $5.4 million extraordinary loss, net of tax, and sales softness in North America and Europe/ROW.

### North America

| | 2000 | 2001 |
|---|---|---|
| Revenue from external customers | $468.2 | $448.8 |
| Segment profit | 95.3 | 80.8 |
| Segment profit as a % of net sales | 20.4% | 18.0% |

Our revenue from external customers decreased $19.4 million, or 4.1%, to $448.8 million in fiscal 2001 from $468.2 million the previous year due primarily to increased sales of alkaline batteries and hearing aid batteries offset by decreased sales of lighting products and specialty batteries.

Alkaline sales increases of $15.1 million, or 5.9%, were driven by distribution gains, product line expansion, and strong sales in the mass merchandiser and OEM trade channels partially offset by the impacts of Y2K on sales volumes and lower promotional activity at certain food retailers this year. Hearing aid battery sales increases of $4.7 million, or 13.0%, were driven by strength in the professional channel and expanded retail distribution in fiscal 2001. Lighting product sales decreases of $14.9 million, or 20.9%, were driven by weakness in the lights and lantern battery category reflecting the lingering impact of the Y2K phenomenon and our inability to anniversary a strong hurricane season in the previous year. Specialty battery sales decreases versus last year primarily reflect softness in camcorder and lithium battery sales reflecting general softness in lithium battery demand from OEM customers in the PC, telecommunications, and electronics industries and the transition to a camcorder battery licensing agreement.

Our profitability decreased $14.5 million, or 15.2%, to $80.8 million in fiscal 2001 from $95.3 million the previous year. This decrease was primarily attributable to sales volume decreases and operating expense increases partially offset by improved gross profit margins. The operating expense increases were primarily driven by increased distribution costs reflecting fuel surcharges, higher shipping and handling costs and bad debt write-offs due to customer bankruptcies. The improvement in gross profit margins was primarily the result of previously announced cost rationalization initiatives and a favorable shift in product mix away from lower margin lithium, camcorder, and lighting products to more profitable alkaline and hearing aid batteries.

### Latin America

| | 2000 | 2001 |
|---|---|---|
| Revenue from external customers | $112.2 | $118.7 |
| Segment profit | 20.3 | 16.9 |
| Segment profit as a % of net sales | 18.1% | 14.2% |

Our revenue from external customers increased $6.5 million, or 5.8%, to $118.7 million in fiscal 2001 from $112.2 million the previous year due primarily to increased sales of alkaline batteries partially offset by lower sales of zinc carbon batteries and unfavorable impacts of currency devaluation of $1.7 million.

The alkaline sales growth in Latin America primarily reflects new distribution in mass merchandiser chains compounded by the expansion into the Southern region of South America. Heavy duty sales were affected by a slowing economic environment and the impact of currency devaluation.

Our profitability decreased $3.4 million, or 16.8%, to $16.9 million in fiscal 2001 from $20.3 million the previous year. This decrease was primarily attributable to operating expense increases partially offset by improved gross profit margins. The operating expense increases were primarily driven by increased promotional and marketing support associated with new distribution initiatives in the Southern region and higher operating expenses associated with our expansion at larger mass merchandiser chains in Mexico.

Europe/ROW

| | 2000 | 2001 |
|---|---|---|
| Revenue from external customers | $50.6 | $48.7 |
| Segment profit | 6.1 | 4.1 |
| Segment profit as a % of net sales | 12.1% | 8.4% |



Our revenue from external customers decreased $1.9 million, or 3.8%, to $48.7 million in fiscal 2001 from $50.6 million the previous year, due primarily to the unfavorable impacts of currency devaluation of $3.4 million. Excluding the negative impact of currency devaluation net sales increased 3.0% reflecting sales increases in hearing aid and alkaline batteries. Alkaline battery sales increases were driven primarily by new distribution.

Our profitability decreased $2.0 million, or 32.8%, due primarily to lower gross profit margins attributable to an unfavorable product mix and increased operating expenses attributable to our new distribution.

***Corporate Expenses.*** Our corporate expenses decreased $7.3 million, or 22.5%, to $25.1 million in fiscal 2001 from $32.4 million the previous year. As a percentage of total sales, our corporate expense was 4.1% compared to 5.1% in the previous year. These decreases were primarily due to lower management incentives and legal expenses partially offset by higher research and development expenses reflecting an increase in technology spending.

***Special Charges.*** We recorded special charges of $22.3 million related to: (i) an organizational restructuring in the U.S., (ii) manufacturing and distribution cost rationalization initiatives in the Company's Tegucigalpa, Honduras and Mexico City, Mexico manufacturing facilities and in our European operations, (iii) the closure of the Company's Wonewoc, Wisconsin, manufacturing facility, (iv) the rationalization of uneconomic manufacturing processes at the Company's Fennimore, Wisconsin, manufacturing facility, and rationalization of packaging operations and product lines, and (v) costs associated with our secondary offering in June 2001. The amount recorded includes $10.1 million of employee termination benefits for approximately 570 employees, $10.2 million of equipment, inventory, and other asset write-offs, and $2.0 million of other expenses.

***Income from Operations.*** Our income from operations decreased $34.9 million, or 39.1%, to $54.4 million in fiscal 2001 from $89.3 million the previous year. This decrease was primarily due to special charges of $22.3 million and decreased profitability attributable to sales volume decreases.

***Interest Expense.*** Interest expense decreased $3.4 million, or 11.1%, to $27.2 million in fiscal 2001 from $30.6 million in the previous year primarily due to lower effective interest rates and the redemption of the majority of our subordinated debt in June 2001.

***Income Tax Expense.*** Our effective tax rate for fiscal 2001 was 35.4% compared to 33.8% for fiscal 2000. The higher rate for fiscal 2001 primarily reflects a higher foreign tax rate attributable to increased tax rates in certain Latin America countries and startup losses in the Southern region of South America not fully benefited.

***Extraordinary Item.*** We recorded extraordinary expense of $5.4 million, net of tax, resulting from the premium on the repurchase of $65.0 million of Senior Subordinated Notes and the related write-off of unamortized debt issuance costs.

## Liquidity and Capital Resources

During fiscal 2002, our operating activities generated $66.8 million of cash, compared to $18.0 million in fiscal 2001, an increase of $48.8 million. Operating cash flows from changes in working capital accounted for $48.1 million of the increase which were primarily driven by lower investments in receivables and inventory, slightly offset by higher prepaid and other assets and lower accrued special charges reflecting the completion of the December 2000 restructuring initiatives.

Capital expenditures for fiscal 2002 were $15.6 million, a decrease of $4.1 million from fiscal 2001. Capital expenditures in 2002 were funded by cash flow from operations. Capital expenditures for fiscal 2003 are expected to be approximately $28.0 million which will include spending for leasehold improvements on our new North American packaging and distribution center, spending required by newly acquired VARTA entities, and continued technology investments as well as continued investment in our manufacturing operations.

As of September 30, 2002, our current credit facilities include a revolving credit facility of $250.0 million and a $75.0 million five-year amortizing term loan. As of September 30, 2002, $174.5 million and $23.1 million, respectively, of the revolver and the term loan were outstanding. In addition, approximately $5.8 million of the remaining availability under the revolver was utilized for outstanding letters of credit. The term facility also provides for annual prepayments, over and above the normal amortization. Such payments would be a portion of "Excess Cash Flow" (EBITDA, as defined, less certain operating expenditures including scheduled principal payments of long-term debt). The quarterly amortization is reduced prorata for the effect of prepayments made as a result of Excess Cash Flow. The fees associated with these facilities have been capitalized and are being amortized over the term of the facilities. Indebtedness under these amended facilities is secured and is guaranteed by certain of our subsidiaries.

During fiscal 2002, our board of directors granted 1,057,190 options to purchase shares of our Common stock to various employees of the Company under the 1997 Rayovac Incentive Plan. All grants were at an exercise price equal to the market price of our Common stock on the date of grant with prices ranging from $13.00 to $16.00 per share. We also granted approximately 24,000 shares of restricted stock on August 16, 2002, from the 1997 Rayovac Incentive Plan to a member of management; the restrictions on these shares will lapse on September 30, 2003. The total market value of the restricted shares on the date of grant totaled approximately $0.3 million and has been recorded as unearned compensation as a separate component of shareholders' equity. Unearned compensation is being amortized to expense over the vesting period.

We believe our cash flow from operating activities and periodic borrowings under our credit facilities will be adequate to meet the short-term and long-term liquidity requirements of our existing business previous to the expiration of those credit facilities, although no assurance can be given in this regard.

We engage in hedging transactions in the ordinary course of our business. See Note 2(r) to the Consolidated Financial Statements.

On October 1, 2002, the Company entered into an Amended and Restated Agreement ("Third Restated Agreement") to finance the acquisition of the consumer battery business of VARTA AG. The Third Restated Agreement includes a $100 million seven-year revolving credit facility, a EUR 50 million seven-year revolving credit facility, a $300 million seven-year amortizing term loan, a EUR 125 million seven-year amortizing term loan and a EUR 50 million six-year amortizing term loan. The term facilities provide for quarterly amortization totaling (assuming an exchange rate of the Euro to the Dollar of 1 to 1) of approximately $9.3 million in 2003 and 2004, $14.3 million in 2005, 2006, and 2007, $61.3 million in 2008 and $352.5 million in 2009. The term facility also provides for annual prepayments, over and above the normal amortization. Such payments would be a portion of "Excess Cash Flow" (EBITDA, as defined, less certain operating expenditures including scheduled principal payments of long-term debt). The quarterly amortization is reduced prorata for the effect of prepayments made as a result of Excess Cash Flow. The fees associated with these facilities will be capitalized and amortized over the term of the facilities. Unamortized fees associated with the replaced facilities will be written off as a charge to earnings in the quarter ended December 29, 2002. Indebtedness under these amended facilities is secured, is guaranteed by certain of our subsidiaries and the Euro-denominated revolving facility is subject to a borrowing base ("Borrowing Base") of certain European assets.

## Impact of Recently Issued Accounting Standards

See discussion in Note 2(w) to the Consolidated Financial Statements.

## Critical Accounting Policies



Our Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States and fairly present the financial position and results of operations of the Company. We believe the following accounting policies are critical to an understanding of our financial statements. The application of these policies requires management judgment and estimates in areas that are inherently uncertain.

*Valuation of Assets and Asset Impairment*

We evaluate certain long-lived assets, such as property, plant and equipment, and certain intangibles for impairment based on the expected future cash flows or earnings projections. An asset's value is deemed impaired if the discounted cash flows or earnings projections generated do not substantiate the carrying value of the asset. The estimation of such amounts requires significant management judgment with respect to revenue and expense growth rates, changes in working capital, and selection of an appropriate discount rate, as applicable. The use of different assumptions would increase or decrease discounted future operating cash flows or earnings projections and could, therefore, change impairment determination.

We adopted Financial Accounting Standards Statement No. 142, *Goodwill and Other Intangible Assets*, effective October 1, 2001. Statement No. 142 requires goodwill and other intangible assets with indefinite useful lives not be amortized, and that impairment of such assets be evaluated as discussed above at least annually.

We evaluate deferred tax assets based on future earnings projections. An asset's value is deemed impaired if the earnings projections do not substantiate the carrying value of the asset. The estimation of such amounts requires significant management judgment with respect to revenue and expense growth rates, changes in working capital, and other assumptions, as applicable. The use of different assumptions would increase or decrease future earnings projections and could, therefore, change the determination of whether the asset is realizable.

See Notes 2(c), 2(h), 2(i), 2(v), 4, 5 and 9 to the Consolidated Financial Statements for more information about these assets.

*Revenue Recognition and Concentration of Credit Risk*

We recognize revenue from product sales at the point at which all risks and rewards of ownership have passed to the customer. The Company is not obligated to allow for product returns.

The Company enters into various promotional arrangements, primarily with retail customers, which require the Company to estimate total purchases from the Company. In addition, the Company enters into promotional programs, primarily with retail customers, which require the Company to estimate and accrue the estimated costs of the promotional program. The Company monitors its commitments for promotional arrangements and programs, and uses statistical measures and past experience to record a liability for the estimate of the earned, but unpaid, promotional costs. The use of different assumptions would increase or decrease the estimate of the earned, but unpaid, promotional costs and could, therefore, change the liability recorded.

The Company's trade receivables subject the Company to credit risk which is evaluated based on changing economic, political, and specific customer conditions. The Company assesses these risks and makes provisions for collectibility based on our best estimate of the risks present and information available at the date of the financial statements. The use of different assumptions may change the estimate of collectibility.

See Notes (2b), (2c), and (2e) to the Consolidated Financial Statements for more information about our Revenue Recognition and Credit policies.

*Pensions*

Our accounting for pension benefits is primarily based on discount rate, expected and actual return on plan assets and other assumptions made by management, and is impacted by outside factors such as equity and fixed income market performance. Pension liability is principally the estimated present value of future benefits, net of plan assets. Pension expense is principally the sum of interest and service cost of the plan, less the expected return on plan assets and the amortization of the difference between our assumptions and actual experience. The expected return on plan assets is calculated by applying an assumed rate of return to the fair value of plan assets. If plan assets decline due to poor performance by the markets and/or interest rate declines, as was experienced in fiscal 2002, our pension liability increases, ultimately increasing future pension expense. See Notes 2(c) and 11 to the Consolidated Financial Statements for a more complete discussion of our employee benefit plans.

*Restructuring*

Restructuring liabilities are recorded for estimated cost of facility closures, significant organizational adjustments, and measures undertaken by management to exit certain activities. Costs for such activities are estimated by management after evaluating detailed analyses of the cost incurred. Such liabilities could include amounts for items such as severance costs and related benefits (including settlements of pension plans), impairment of property and equipment and other current or long term assets, lease termination payments, plus any other items directly related to the exit costs. While the actions are carried out as expeditiously as possible, changes in estimates, resulting in an increase to or a reversal of a previously recorded liability, may be required as management executes the restructuring plan. See Notes 15 and 18 to the Consolidated Financial Statements for discussion of recent restructuring initiatives and related costs.

*Loss Contingencies*

Loss contingencies are recorded as liabilities when it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. The outcome of existing litigation and the impact of environmental matters are examples of situations evaluated as loss contingencies. Estimating the probability and magnitude of losses is often dependent upon management judgments of potential actions by third parties and regulators. It is possible that changes in estimates or an increased probability of an unfavorable outcome could materially affect future results of operations. See further discussion in Item 3 ("Legal Proceedings") in our Annual Report on Form 10-K, and Notes 2(c), 2(f), and 13 to the Consolidated Financial Statements.

*Other Significant Accounting Policies*

Other significant accounting policies, primarily those with lower levels of uncertainty than those discussed above, are also critical to understanding the Consolidated Financial Statements. Our notes to the Consolidated Financial Statements contain additional information related to our accounting policies and should be read in conjunction with this discussion.

| | September 30, | |
|---|---|---|
| *(In thousands, except per share amounts)* | 2001 | 2002 |
| **Assets** | | |
| **Current assets:** | | |
| Cash and cash equivalents | $ 11,358 | $ 9,881 |
| Receivables: | | |
| Trade accounts receivable, net of allowance for doubtful receivables of $2,139 and $3,293, respectively | 160,943 | 128,927 |
| Other | 7,802 | 7,683 |
| Inventories | 91,311 | 84,275 |
| Deferred income taxes | 9,831 | 8,586 |
| Prepaid expenses and other | 21,843 | 19,970 |
| Total current assets | 303,088 | 259,322 |
| Property, plant and equipment, net | 107,257 | 102,586 |
| Deferred charges and other | 32,617 | 48,693 |
| Intangible assets, net | 119,074 | 119,425 |
| Debt issuance costs | 4,463 | 3,207 |
| Total assets | $ 566,499 | $ 533,233 |
| **Liabilities and Shareholders' Equity** | | |
| **Current liabilities:** | | |
| Current maturities of long-term debt | $ 24,436 | $ 13,400 |
| Accounts payable | 81,990 | 76,155 |
| Accrued liabilities: | | |
| Wages and benefits | 7,178 | 8,910 |
| Accrued interest | 1,930 | 1,664 |
| Other special charges | 5,883 | 1,701 |
| Other | 23,124 | 16,954 |
| Total current liabilities | 144,541 | 118,784 |
| Long-term debt, net of current maturities | 233,541 | 188,471 |
| Employee benefit obligations, net of current portion | 19,648 | 24,009 |
| Deferred income taxes | 7,428 | 20,957 |
| Other | 3,756 | 6,219 |
| Total liabilities | 408,914 | 358,440 |
| **Shareholders' equity:** | | |
| Common stock, $.01 par value, authorized 150,000 shares; issued 61,579 and 61,594 shares, respectively; outstanding 32,043 and 32,058 shares, respectively | 616 | 616 |
| Additional paid-in capital | 180,752 | 180,823 |
| Retained earnings | 119,984 | 149,221 |
| Accumulated other comprehensive loss | (6,868) | (19,859) |
| Notes receivable from officers/shareholders | (3,665) | (4,205) |
| | 290,819 | 306,596 |
| Less treasury stock, at cost, 29,536 shares | (130,070) | (130,070) |
| Less unearned restricted stock compensation | (3,164) | (1,733) |
| Total shareholders' equity | 157,585 | 174,793 |
| Total liabilities and shareholders' equity | $ 566,499 | $ 533,233 |

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF OPERATIONS

Rayovac Corporation and Subsidiaries

| | Years Ended September 30, | | |
|---|---|---|---|
| *(In thousands, except per share amounts)* | 2000 | 2001 | 2002 |
| Net sales | $630,914 | $616,172 | $572,736 |
| Cost of goods sold | 371,470 | 361,173 | 334,147 |
| Special charges | — | 22,103 | 1,210 |
| Gross profit | 259,444 | 232,896 | 237,379 |
| Operating expenses: | | | |
| Selling | 110,559 | 119,606 | 104,374 |
| General and administrative | 48,791 | 46,526 | 56,900 |
| Research and development | 10,763 | 12,191 | 13,084 |
| Special charges | — | 204 | — |
| | 170,113 | 178,527 | 174,358 |
| Income from operations | 89,331 | 54,369 | 63,021 |
| Interest expense | 30,626 | 27,189 | 16,048 |
| Other expense, net | 753 | 1,094 | 1,290 |
| Income before income taxes and extraordinary item | 57,952 | 26,086 | 45,683 |
| Income tax expense | 19,602 | 9,225 | 16,446 |
| Income before extraordinary item | 38,350 | 16,861 | 29,237 |
| Extraordinary item, loss on early extinguishment of debt, net of income tax benefit of $3,260 | — | (5,327) | — |
| Net income | $ 38,350 | $ 11,534 | $ 29,237 |
| Basic net income per common share: | | | |
| Income before extraordinary item | $ 1.39 | $ 0.59 | $ 0.92 |
| Extraordinary item | — | (0.19) | — |
| Net income | $ 1.39 | $ 0.40 | $ 0.92 |
| Weighted-average shares of common stock outstanding | 27,504 | 28,746 | 31,775 |
| Diluted net income per common share: | | | |
| Income before extraordinary item | $ 1.32 | $ 0.57 | $ 0.90 |
| Extraordinary item | — | (0.18) | — |
| Net income | $ 1.32 | $ 0.39 | $ 0.90 |
| Weighted-average shares of common stock and equivalents outstanding | 29,069 | 29,702 | 32,414 |

See accompanying notes to consolidated financial statements.

| | Years Ended September 30, | | |
|---|---|---|---|
| *(In thousands)* | 2000 | 2001 | 2002 |
| Net income | $38,350 | $11,534 | $29,237 |
| Other comprehensive income: | | | |
| Foreign currency translation adjustment | (1,964) | (1,141) | (7,875) |
| Cumulative effect of accounting change, net of tax effect of ($167) | — | (150) | — |
| Loss on derivative instruments and available for sale securities, net of tax effect of ($1,973) and ($689), respectively | — | (2,929) | (1,477) |
| Minimum pension liability adjustment, net of tax effect of $223, ($1,776), and ($1,959), respectively | 415 | (3,298) | (3,639) |
| Comprehensive income, net of tax | $36,801 | $ 4,016 | $16,246 |

See accompanying notes to consolidated financial statements.

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**
Rayovac Corporation and Subsidiaries

Years Ended September 30, 2000, 2001 and 2002

| | Common Stock | | | | Accumulated Other Comprehensive Income (Loss) | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *(In thousands)* | Shares | Amount | Additional Paid-In Capital | Retained Earnings | Foreign Currency Translation Adjustment | Unrecognized Loss on Derivative Instruments and Available for Sale Securities | Minimum Pension Liability Adjustment | Total | Notes Receivable from Officers/ Shareholders | Treasury Stock | Unearned Compensation | Total Shareholders' Equity |
| Balances at September 30, 1999 | 27,490 | $570 | $103,577 | $ 70,100 | $ 2,666 | $ — | $ (467) | $ 2,199 | $ (890) | $(129,096) | $ — | $ 46,460 |
| Net income | — | — | — | 38,350 | — | — | — | — | — | — | — | 38,350 |
| Treasury stock acquired | (51) | — | — | — | — | — | — | — | — | (886) | — | (886) |
| Exercise of stock options | 131 | 1 | 620 | — | — | — | — | — | — | — | — | 621 |
| Notes receivable from officers/shareholders | — | — | — | — | — | — | — | — | (2,300) | — | — | (2,300) |
| Adjustment of additional minimum pension liability | — | — | — | — | — | — | 415 | 415 | — | — | — | 415 |
| Translation adjustment | — | — | — | — | (1,964) | — | — | (1,964) | — | — | — | (1,964) |
| Balances at September 30, 2000 | 27,570 | 571 | 104,197 | 108,450 | 702 | — | (52) | 650 | (3,190) | (129,982) | — | 80,696 |
| Net income | — | — | — | 11,534 | — | — | — | — | — | — | — | 11,534 |
| Sale of common stock | 3,500 | 35 | 64,144 | — | — | — | — | — | — | — | — | 64,179 |
| Issuance of restricted stock | 277 | 3 | 4,743 | — | — | — | — | — | — | — | (4,746) | — |
| Treasury stock acquired | (5) | — | — | — | — | — | — | — | — | (88) | — | (88) |
| Exercise of stock options | 701 | 7 | 7,668 | — | — | — | — | — | — | — | — | 7,675 |
| Notes receivable from officers/shareholders | — | — | — | — | — | — | — | — | (475) | — | — | (475) |
| Amortization of unearned compensation | — | — | — | — | — | — | — | — | — | — | 1,582 | 1,582 |
| Adjustment of additional minimum pension liability | — | — | — | — | — | — | (3,298) | (3,298) | — | — | — | (3,298) |
| Translation adjustment | — | — | — | — | (1,141) | — | — | (1,141) | — | — | — | (1,141) |
| Cumulative effect of accounting change | — | — | — | — | — | (150) | — | (150) | — | — | — | (150) |
| Net loss on derivative instruments and available for sale securities | — | — | — | — | — | (2,929) | — | (2,929) | — | — | — | (2,929) |
| Balances at September 30, 2001 | 32,043 | 616 | 180,752 | 119,984 | (439) | (3,079) | (3,350) | (6,868) | (3,665) | (130,070) | (3,164) | 157,585 |
| Net income | — | — | — | 29,237 | — | — | — | — | — | — | — | 29,237 |
| Forfeiture of restricted stock | (24) | — | (413) | — | — | — | — | — | — | — | 413 | — |
| Issuance of restricted stock | 24 | — | 313 | — | — | — | — | — | — | — | (313) | — |
| Exercise of stock options | 15 | — | 171 | — | — | — | — | — | — | — | — | 171 |
| Notes receivable from officers/shareholders | — | — | — | — | — | — | — | — | (540) | — | — | (540) |
| Amortization of unearned compensation | — | — | — | — | — | — | — | — | — | — | 1,331 | 1,331 |
| Adjustment of additional minimum pension liability | — | — | — | — | — | — | (3,639) | (3,639) | — | — | — | (3,639) |
| Translation adjustment | — | — | — | — | (7,875) | — | — | (7,875) | — | — | — | (7,875) |
| Net loss on derivative instruments and available for sale securities | — | — | — | — | — | (1,477) | — | (1,477) | — | — | — | (1,477) |
| Balances at September 30, 2002 | 32,058 | $616 | $180,823 | $149,221 | $(8,314) | $(4,556) | $(6,989) | $(19,859) | $(4,205) | $(130,070) | $(1,733) | $174,793 |

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Rayovac Corporation and Subsidiaries

| | Years Ended September 30, | | |
|---|---|---|---|
| *(In thousands)* | 2000 | 2001 | 2002 |
| Cash flows from operating activities: | | | |
| Net income | $ 38,350 | $ 11,534 | $ 29,237 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Extraordinary item, loss on early retirement of debt | — | 8,587 | — |
| Amortization | 6,309 | 5,608 | 1,894 |
| Depreciation | 16,024 | 17,667 | 18,828 |
| Deferred income taxes | 2,905 | (3,751) | 4,257 |
| Non-cash restructuring charges | — | 9,958 | 542 |
| Stock option income tax benefit | 625 | 4,348 | 37 |
| Amortization of unearned restricted stock compensation | — | 1,582 | 1,331 |
| (Gain) loss on disposal of fixed assets | (1,297) | 187 | 224 |
| Changes in assets and liabilities: | | | |
| Accounts receivable | (16,140) | (35,844) | 26,272 |
| Inventories | (20,344) | 5,168 | 3,579 |
| Prepaid expenses and other assets | (5,416) | (1,657) | (4,221) |
| Accounts payable and accrued liabilities | 16,973 | (10,223) | (11,310) |
| Accrued special charges | (5,147) | 4,883 | (3,844) |
| Net cash provided by operating activities | 32,842 | 18,047 | 66,826 |
| Cash flows from investing activities: | | | |
| Purchases of property, plant and equipment | (18,996) | (19,693) | (15,641) |
| Investments in available for sale securities | — | (797) | — |
| Proceeds from sale of property, plant and equipment | 1,051 | 863 | 168 |
| Proceeds from sale of investments | — | 1,354 | — |
| Net cash used by investing activities | (17,945) | (18,273) | (15,473) |
| Cash flows from financing activities: | | | |
| Reduction of debt | (215,394) | (416,699) | (224,192) |
| Proceeds from debt financing | 203,189 | 421,914 | 169,100 |
| Debt issuance costs | — | — | (387) |
| Loans to officers/shareholders | (2,300) | (475) | (540) |
| Issuance of stock | — | 64,179 | — |
| Acquisition of treasury stock | (886) | (88) | — |
| Exercise of stock options | 621 | 3,327 | 134 |
| Extinguishment of debt | — | (69,652) | (239) |
| Payments on capital lease obligation | (1,233) | (837) | (590) |
| Net cash (used) provided by financing activities | (16,003) | 1,669 | (56,714) |
| Effect of exchange rate changes on cash and cash equivalents | (202) | 158 | 3,884 |
| Net (decrease) increase in cash and cash equivalents | (1,308) | 1,601 | (1,477) |
| Cash and cash equivalents, beginning of period | 11,065 | 9,757 | 11,358 |
| Cash and cash equivalents, end of period | $ 9,757 | $ 11,358 | $ 9,881 |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid for interest | $ 27,691 | $ 28,938 | $ 14,671 |
| Cash paid for income taxes | 14,318 | 8,166 | 11,373 |

See accompanying notes to consolidated financial statements.

## (1) Description of Business

Rayovac Corporation and its wholly owned subsidiaries (Company) manufacture and market batteries. Products include general (alkaline, rechargeables, heavy duty, lantern and general purpose), button cell and lithium batteries. The Company also produces a variety of battery powered lighting devices such as flashlights and lanterns. The Company's products are sold primarily to retailers in the United States, Canada, Latin America, Europe, and the Far East.

## (2) Significant Accounting Policies and Practices

***(a) Principles of Consolidation and Fiscal Year End*** The consolidated financial statements include the financial statements of Rayovac Corporation and its wholly owned subsidiaries and are prepared in accordance with accounting principles generally accepted in the United States of America. All inter-company transactions have been eliminated. The Company's fiscal year ends September 30. References herein to 2000, 2001 and 2002 refer to the fiscal years ended September 30, 2000, 2001 and 2002.

***(b) Revenue Recognition*** The Company recognizes revenue from product sales upon shipment to the customer which is the point at which all risks and rewards of ownership of the product is passed. The Company is not obligated to allow for returns.

***(c) Use of Estimates*** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

***(d) Cash Equivalents*** For purposes of the statements of cash flows, the Company considers all highly liquid debt instruments purchased with original maturities of three months or less to be cash equivalents.



***(e) Concentrations of Credit Risk, Major Customers and Employees*** Trade receivables potentially subject the Company to credit risk. The Company extends credit to its customers based upon an evaluation of the customer's financial condition and credit history and generally does not require collateral. The Company monitors its customer's credit and financial conditions based on changing economic conditions and will make adjustments to credit policies as required. The Company has historically incurred minimal credit losses, but in 2002 experienced a significant loss resulting from the bankruptcy filing of a large retailer in the United States.

The Company has a broad range of customers including many large retail outlet chains, one of which accounts for a significant percentage of its sales volume. This major customer represented approximately 20% and 23%, respectively, of receivables as of September 30, 2001 and September 30, 2002.

Approximately 25% of the Company's sales occur outside of North America, and these sales and related receivables are subject to varying degrees of credit, currency, political and economic risk. The Company monitors these risks and makes appropriate provisions for collectability based on an assessment of the risks present. The Argentine Peso and Venezuelan Bolivars devaluation did not have a significant impact on the Company's estimate of collectability.

The Company has one customer that represented over 10% of its net sales. The Company derived 22%, 27% and 26% of its net sales from this customer during 2000, 2001 and 2002, respectively.

Approximately 45% of the total labor force is covered by collective bargaining agreements. The Company believes its relationship with its employees is good and there have been no work stoppages involving Company employees since 1981 in North America and since 1991 in the United Kingdom.

The Company has entered into collective bargaining agreements with expiration dates as follows:

| Location | Expiration Date |
|---|---|
| Mexico City, Mexico | February 2003 |
| Madison, WI | August 2003 |
| Washington, UK Production | December 2003 |
| Guatemala City, Guatemala | March 2004 |
| Fennimore, WI | March 2005 |
| Portage, WI | June 2006 |

Bargaining agreements that expire in 2003 represent approximately 14% of the total labor force.

The Mexico City, Mexico manufacturing facility was closed during the first quarter of fiscal 2003. Additionally, it was announced on October 10, 2002, that the Madison, Wisconsin facility would be closed during fiscal 2003, prior to its bargaining agreement's expiration. (See Subsequent Events footnote 18).

***(f) Displays and Fixtures*** The costs of temporary displays are capitalized as a prepaid asset and charged to expense when shipped to a customer location. Permanent fixtures are capitalized as deferred charges and amortized over an estimated useful life of one to two years.

***(g) Inventories*** Inventories are stated at lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method for approximately 83% and 78% of the inventories at September 30, 2001 and 2002, respectively. Costs for other inventories have been determined primarily using the average cost method.

***(h) Property, Plant and Equipment*** Property, plant and equipment are stated at cost. Depreciation on plant and equipment is calculated on the straight-line method over the estimated useful lives of the assets. Depreciable lives by major classification are as follows:

| | |
|---|---|
| Building and improvements | 20–30 years |
| Machinery, equipment and other | 2–15 years |

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company evaluates recoverability of assets to be held and used by comparing the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

***(i) Intangible Assets*** Intangible assets are recorded at cost. Non-compete agreements and proprietary technology intangibles are amortized, using the straight-line method, over their estimated useful lives of 5 to 17 years. Excess cost over fair value of net assets acquired (goodwill) and trade name intangibles are not amortized. Goodwill is tested for impairment at least annually at the reporting unit level. If impairment is indicated, a write-down to fair value (normally measured by discounting estimated future cash flows) is recorded. Trade name intangibles are tested for impairment at least annually by comparing the fair value with the carrying value. Any excess of carrying value over fair value is recognized as an impairment loss in income from operations.

The Company assesses the recoverability of its intangible assets with finite useful lives by determining whether the amortization of the remaining balance over its remaining life can be recovered through projected undiscounted future cash flows. If projected future cash flows indicate that the unamortized carrying value of intangible assets with finite useful lives will not be recovered, an adjustment would be made to reduce the carrying value to an amount equal to projected future cash flows discounted at the Company's incremental borrowing rate. Cash flow projections used by the Company are based on trends of historical performance and management's estimate of future performance, giving consideration to existing and anticipated competitive and economic conditions. (See also Adoption of New Accounting Pronouncements footnote 2(v), and Intangible Assets footnote 5).

***(j) Debt Issuance Costs*** Debt issuance costs are capitalized and amortized to interest expense over the lives of the related debt agreements.

(***k) Accounts Payable*** Included in accounts payable at September 30, 2001 and 2002, is approximately $16,464 and $6,247, respectively, of book overdrafts on disbursement accounts which were replenished when checks were presented for payment.

***(l) Income Taxes*** Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

***(m) Foreign Currency Translation*** Assets and liabilities of the Company's foreign subsidiaries are translated at the rate of exchange existing at year-end, with revenues, expenses, and cash flows translated at the average of the monthly exchange rates. Adjustments resulting from translation of the financial statements are recorded as a component of accumulated other comprehensive income. Also included are the effects of exchange rate changes on inter-company balances of a long-term nature and transactions designated as hedges of net foreign investments. Currency devaluations in Argentina and Venezuela, along with the weakening currency in Mexico, had significant impacts on these balances in 2002. The changes in accumulated foreign currency translation (gains) losses for 2001 and 2002, respectively, in these countries were: Argentina, ($1) and $2,616; Venezuela, ($32) and $3,411; and Mexico, $220 and $955.

Exchange losses on foreign currency transactions aggregating $1,334, $2,091 and $2,412 for 2000, 2001 and 2002, respectively, are included in other expense, net, in the Consolidated Statements of Operations.

***(n) Shipping and Handling Costs*** The Company incurred shipping and handling costs of $26,086, $28,710 and $24,081 in 2000, 2001 and 2002, respectively, which are included in selling expense.

***(o) Advertising Costs*** The Company incurred expenses for advertising of $22,554, $19,367 and $10,317 in 2000, 2001 and 2002, respectively. The Company expenses advertising production costs the first time the advertising takes place.

***(p) Research and Development Costs*** Research and development costs are charged to expense in the year they are incurred.



***(q) Net Income Per Common Share*** Basic net income per common share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period. Basic net income per common share does not consider common stock equivalents. Diluted net income per common share reflects the dilution that would occur if convertible debt securities and employee stock options were exercised or converted into common shares or resulted in the issuance of common shares that then shared in the net income of the entity. The computation of diluted net income per common share uses the "if converted" and "treasury stock" methods to reflect dilution. The difference between the basic and diluted number of shares is due to assumed conversion of employee stock options where the exercise price is less than the market price of the underlying stock.

Net income per common share is calculated based upon the following shares:

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| Basic | 27,504 | 28,746 | 31,775 |
| Effect of restricted stock and assumed conversion of stock options | 1,565 | 956 | 639 |
| Diluted | 29,069 | 29,702 | 32,414 |

In 2000, 2001, and 2002, respectively, approximately 841, 1,031, and 2,998 stock options were excluded from the calculation of diluted earnings per share because their effect was antidilutive.

***(r) Derivative Financial Instruments*** Derivative financial instruments are used by the Company principally in the management of its interest rate, foreign currency and raw material price exposures. The Company does not hold or issue derivative financial instruments for trading purposes.

The Company uses interest rate swaps to manage its interest rate risk. The swaps are designated as cash flow hedges with the fair value recorded as a hedge asset or liability, as applicable, with changes in fair value recorded in Other Comprehensive Income ("OCI"). The swaps settle periodically in arrears with the related amounts for the current settlement period payable to, or receivable from, the counter-parties included in accrued liabilities or accounts receivable and recognized in earnings as an adjustment to interest expense from the underlying debt to which the swap is designated. During 2002, $5,133 of pretax derivative losses from such hedges were recorded as an adjustment to interest expense. At September 30, 2002, the Company had a portfolio of interest rate swaps outstanding which effectively fixes the interest rates on floating rate debt at rates as follows: 6.403% for a notional principal amount of $70,000 through October 2002, 4.458% for a notional principal amount of $70,000 from October 2002 through July 2004 and 3.769% for a notional principal amount of $100,000 through August 2004. The derivative net losses on these contracts recorded in OCI at September 30, 2002 was an after-tax loss of $3,998.

The Company enters into forward and swap foreign exchange contracts to hedge the risk from forecasted settlement in local currencies of inter-company purchases and sales, trade sales, and trade purchases. These contracts generally require the Company to exchange foreign currencies for U.S. dollars or Pounds Sterling. These contracts are designated as cash flow hedges with the fair value recorded as a hedge asset or liability, as applicable, with changes in fair value recorded in OCI. Once the forecasted transaction has been recognized as a purchase or sale and a related liability or asset recorded in the balance sheet, the gain or loss on the related derivative hedge contract is reclassified from OCI into earnings as an offset to the change in value of the liability or asset. During 2002, $17 of pretax derivative losses were recorded as an adjustment to earnings for cash flow hedges related to an asset or liability. During 2002, $61 of pretax derivative gains were recorded as an adjustment to earnings for forward and swap contracts settled at maturity. At September 30, 2002, the Company had a series of swap contracts outstanding with a contract value of $247. The derivative net loss on these contracts at September 30, 2002 was immaterial.

The Company periodically enters into forward foreign exchange contracts to hedge the risk from changes in fair value from unrecognized firm purchase commitments. These firm purchase commitments generally require the Company to exchange U.S. dollars for foreign currencies. These hedge contracts are designated as fair value hedges with the fair value recorded as a hedge asset or liability, as applicable, with changes in fair value recorded in earnings on a pretax basis. To the extent effective, changes in the value of the forward contracts recorded in earnings will be offset by changes in the value of the hedged item, also recorded in earnings on a pretax basis and as an asset or liability, as applicable. Once the firm purchase commitment has been consummated, the firm commitment asset or liability balance will be reclassified as an addition to or subtraction from the carrying value of the purchased asset. The Company previously entered into a series of forward contracts through October 2001 to hedge the exposure from a firm commitment to purchase certain battery manufacturing equipment denominated in Japanese Yen. During 2002, $63 of pretax derivative gains were recorded as an adjustment to earnings for fair value hedges of this firm purchase commitment and $63 of pretax losses were recorded as an adjustment to earnings for changes in fair value of this firm purchase commitment. During 2002, $78 of pretax derivative losses were recorded as an adjustment to earnings for fair value hedges of this firm purchase commitment that were settled at maturity and $78 of pretax gains were recorded as an adjustment to earnings for payments made against this firm purchase commitment. No forward exchange contracts were held by the Company at September 30, 2002.

The Company is exposed to risk from fluctuating prices for zinc used in the manufacturing process. The Company hedges a portion of this risk through the use of commodity swaps. The swaps are designated as cash flow hedges with the fair value recorded in OCI and as a hedge asset or liability, as applicable. The fair value of the swaps is reclassified from OCI into earnings when the hedged purchase of zinc metal-based items also affects earnings. The swaps effectively fix the floating price on a specified quantity of zinc through a specified date. During 2002, $2,645 of pretax derivative losses were recorded as an adjustment to cost of sales for swap contracts settled at maturity. At September 30, 2002, the Company had a series of swap contracts outstanding through August 2003 with a contract value of $6,350. The derivative net losses on these contracts recorded in OCI at September 30, 2002 was an after-tax loss of $328.

***(s) Fair Value of Financial Instruments*** The carrying values of cash and cash equivalents, accounts and notes receivable, accounts payable and short-term debt approximate fair value. The fair values of long-term debt and derivative financial instruments are generally based on quoted market prices.

***(t) Environmental Expenditures*** Environmental expenditures which relate to current ongoing operations or to conditions caused by past operations are expensed. The Company determines its liability on a site-by-site basis and records a liability at the time when it is probable and can be reasonably estimated. The estimated liability is not reduced for possible recoveries from insurance carriers.

***(u) Reclassifications*** Certain prior year amounts have been reclassified to conform with the current year presentation.

***(v) Adoption of New Accounting Pronouncements*** Effective October 1, 2000, the Company adopted Financial Accounting Standards Board (FASB) Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. If the derivative is designated as a fair value hedge, the change in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in Other Comprehensive Income (OCI) and are recognized in the income statement when the hedged item affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings.

The adoption of Statement No. 133 resulted in a pretax reduction to OCI of $317 ($150 after tax) in 2001. The reduction of OCI was primarily attributable to losses of approximately $500 for foreign exchange forward cash flow hedges partially offset by gains of approximately $200 on interest rate swap cash flow hedges. (See also footnote 2(r)).

In May 2000, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 00-14, "Accounting for Certain Sales Incentives". This Issue addresses the recognition, measurement, and income statement classification for various types of sales incentives including discounts, coupons, rebates and free products. In April 2001, the EITF reached a consensus on Issue No. 00-25, "Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products or Services". This Issue addresses when consideration from a vendor to a retailer or distributor in connection with the purchase of the vendor's products to promote sales of the vendor's products should be classified in the vendor's income statement as a reduction of revenue or expense. The Company adopted EITF 00-14 and EITF 00-25 in the second fiscal quarter of 2002.

The adoption resulted in the following reclassifications in the Company's results of operations in 2000, 2001 and 2002. Net sales were reduced by $62,452, $59,319 and $52,577, respectively; cost of sales were increased by $11,200, $12,880 and $15,480, respectively; and selling expenses were reduced by $73,652, $72,199 and $68,057, respectively.

Concurrent with the adoption of EITF 00-25, the Company reclassified certain accrued trade incentives as a contra receivable versus the Company's previous presentation as a component of accounts payable. Historically, customers offset earned trade incentives when making payments on account. Therefore, the Company believes the reclassification of these accrued trade incentives as a contra receivable better reflects the underlying economics of the Company's net receivable due from trade customers. The reclassification resulted in a reduction in accounts receivable and accounts payable in our Consolidated Balance Sheets of $21,383 and $21,277 at September 30, 2001 and September 30, 2002, respectively.

Effective July 1, 2001, the Company adopted Statement No. 141, *Business Combinations,* and effective October 1, 2001, Statement No. 142, *Goodwill and Other Intangible Assets.*

Statement No. 141 requires that the purchase method of accounting be used for all business combinations initiated or completed on or after July 1, 2001. Statement No. 141 also specifies criteria that intangible assets acquired in a purchase method business combination must meet to be recognized and reported apart from goodwill. Statement No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of Statement No. 142. Statement No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of.* Upon the transition to Statement No. 142, no goodwill was deemed to be impaired. (See also footnote 2(i)).

The table below presents net income and earnings per share information as if Statement No. 142 had been adopted at the beginning of periods presented:

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| Reported net income | $38,350 | $11,534 | $29,237 |
| Add back: Goodwill amortization, net of tax of $0 | 1,241 | 1,050 | — |
| Add back: Trade name amortization, net of tax of $855 | 1,395 | 1,395 | — |
| Adjusted net income | $40,986 | $13,979 | $29,237 |
| **Basic Earnings Per Share:** | | | |
| Reported net income | $ 1.39 | $ 0.40 | $ 0.92 |
| Goodwill amortization | 0.05 | 0.04 | — |
| Trade name amortization | 0.05 | 0.05 | — |
| Adjusted net income | $ 1.49 | $ 0.49 | $ 0.92 |
| **Diluted Earnings Per Share:** | | | |
| Reported net income | $ 1.32 | $ 0.39 | $ 0.90 |
| Goodwill amortization | 0.04 | 0.03 | — |
| Trade name amortization | 0.05 | 0.05 | — |
| Adjusted net income | $ 1.41 | $ 0.47 | $ 0.90 |

***(w) Impact of Recently Issued Accounting Standards*** In August 2001, the FASB issued Statement No. 143, *Accounting for Asset Retirement Obligations.* Statement No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Company is required to adopt this statement no later than its fiscal year beginning October 1, 2002. Management believes that the impact of adoption on the consolidated financial statements will be immaterial.

In October 2001, the FASB Issued Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* This statement supersedes FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of,* and the accounting and reporting provisions of APB Opinion No. 30, *Reporting Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions,* for the disposal of a segment of a business. The Company is required to adopt this statement no later than its fiscal year beginning October 1, 2002. Management believes that the impact of adoption on the consolidated financial statements will be immaterial.

In April 2002, the FASB issued Statement No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections.* The Statement addresses, among other things, the income statement treatment of gains and losses related to debt extinguishments, requiring such expenses to no longer be treated as extraordinary items, unless the items meet the definition of extraordinary per APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions.* The Company is required to adopt this statement no later than its fiscal year beginning October 1, 2002. Upon adoption, the 2001 loss on early extinguishment of debt will be reclassified to other expense.

In July 2002, the FASB issued Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities.* The Statement requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The Statement replaces EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The Company is required to apply this Statement prospectively to exit or disposal activities initiated after December 31, 2002.

## (3) Inventories

Inventories consist of the following:

| | September 30, 2001 | September 30, 2002 |
|---|---|---|
| Raw materials | $ 24,271 | $ 19,893 |
| Work-in-process | 14,015 | 19,004 |
| Finished goods | 53,025 | 45,378 |
| | $ 91,311 | $ 84,275 |

## (4) Property, Plant and Equipment

Property, plant and equipment consist of the following:

| | September 30, 2001 | September 30, 2002 |
|---|---|---|
| Land, buildings and improvements | $ 34,350 | $ 34,559 |
| Machinery, equipment and other | 175,724 | 184,087 |
| Construction in process | 11,271 | 10,303 |
| | 221,345 | 228,949 |
| Less accumulated depreciation | 114,088 | 126,363 |
| | $107,257 | $102,586 |



Machinery, equipment and other includes capitalized leases, net of amortization, totaling $1,242 and $615 at September 30, 2001 and 2002, respectively.

## (5) Intangible Assets

Intangible assets consist of the following:

| | 2001 | | | 2002 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Intangible | Gross Carrying Amount | Accumulated Amortization | Net Intangible |
| **Amortized Intangible Assets** | | | | | | |
| Non-compete agreement | $ 700 | $ 490 | $ 210 | $ 700 | $ 630 | $ 70 |
| Proprietary technology | 525 | 275 | 250 | 525 | 308 | 217 |
| | $ 1,225 | $ 765 | $ 460 | $ 1,225 | $ 938 | $ 287 |
| **Pension Intangibles** | | | | | | |
| Under-funded pension | $ 3,081 | $ — | $ 3,081 | $ 3,446 | $ — | $ 3,446 |
| **Unamortized Intangible Assets** | | | | | | |
| Trade name | $90,000 | $4,875 | $85,125 | $90,000 | $4,875 | $85,125 |

| | North America | Latin America | Europe/ROW | Total |
|---|---|---|---|---|
| **Goodwill** | | | | |
| Balance as of September 30, 2001, net | $1,035 | $26,884 | $2,489 | $30,408 |
| Effect of translation | — | — | 159 | 159 |
| Balance as of September 30, 2002, net | $1,035 | $26,884 | $2,648 | $30,567 |

The non-compete agreement is being amortized on a straight-line basis over 5 years. The proprietary technology assets are being amortized on a straight-line basis over 15 to 17 years.

The trade name and Latin America segment goodwill are associated with the 1999 acquisition of ROV Limited and were being amortized on a straight-line basis over 40 years. The North America segment goodwill is associated with the 1998 acquisition of Best Labs and was being amortized on a straight-line basis over 15 years. The Europe/ROW segment goodwill is associated with the 1998 acquisition of Brisco GmbH in Germany and was being amortized on a straight-line basis over 15 years.

Pursuant to Statement No. 142, the Company ceased amortizing goodwill on October 1, 2001. Upon initial application of Statement No. 142, the Company reassessed the useful lives of its intangible assets and deemed only the trade name asset to have an indefinite useful life because it is expected to generate cash flows indefinitely. Based on this, the Company ceased amortizing the trade name on October 1, 2001.

The amortization expense for 2000, 2001, and 2002 are as follows:

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| **Amortization Expense** | | | |
| Goodwill amortization | $1,241 | $1,050 | $ — |
| Trade name amortization | 2,250 | 2,250 | — |
| Non-compete and proprietary technology | 429 | 173 | 173 |
| | $3,920 | $3,473 | $173 |

## (6) Debt

Debt consists of the following:

| | September 30, | |
|---|---|---|
| | 2001 | 2002 |
| Revolving credit facility | $213,200 | $174,500 |
| Term loan facility | 34,365 | 23,061 |
| Series B Senior Subordinated Notes, due November 1, 2006, with interest at 10¼% payable semi-annually | 239 | — |
| Capitalized lease obligations | 1,098 | 500 |
| Notes and obligations, weighted-average interest rate of 3.77% at September 30, 2002 | 9,075 | 3,810 |
| | 257,977 | 201,871 |
| Less current maturities | 24,436 | 13,400 |
| Long-term debt | $233,541 | $188,471 |

In 1999, the Company entered into an Amended and Restated Credit Agreement (“Second Restated Agreement”). The Second Restated Agreement provided for senior bank facilities, including term and revolving credit facilities in an aggregate amount of $325,000. Interest on borrowings was computed, at the Company’s option, based on the base rate, as defined (“Base Rate”), or the Interbank Offering Rate (“IBOR”). Indebtedness under these amended facilities was secured by substantially all of the assets of the Company and was guaranteed by certain of our subsidiaries. The Company recorded fees paid as a result of the amendments as a debt issuance cost which was being amortized over the remaining life of the Second Restated Agreement.

The term facility included in the Second Restated Agreement initially totaled $75,000. The facility provided for quarterly amortization totaling $10,000 in 2000, $15,000 in 2001, 2002 and 2003, and $20,000 in 2004. The term facility also provided for annual prepayments, over and above the normal amortization. Such payments would be a portion of “Excess Cash Flow” (EBITDA less certain operating expenditures including scheduled principal payments of long-term debt). The quarterly amortization is reduced prorata for the effect of prepayments made as a result of Excess Cash Flow.

The Second Restated Agreement was subsequently amended over time primarily to permit increased levels of: letters of credit, capital spending, loans to employees and investments by a domestic subsidiary in a foreign subsidiary; and amend the definition of EBITDA to exclude certain non-recurring charges including a bad debt reserve for the Kmart bankruptcy.

Interest on these borrowings was at the Base Rate plus a margin (0.00% to 0.75%) per annum (5.00% at September 30, 2002) or IBOR plus a margin (0.75% to 1.75%) per annum. The Company was required to pay a commitment fee (0.25% to 0.50%) per annum (0.375% at September 30, 2002) on the average daily-unused portion of the revolving facility. The Company had outstanding letters of credit of approximately $5,750 at September 30, 2002. A fee (0.75% to 1.75%) per annum (1.25% at September 30, 2002) was payable on the outstanding letters of credit. The Company also incurred a fixed fee of 0.25% per annum of the average daily maximum amount available to be drawn on each letter of credit issued. The facilities' margin, revolving commitment fee and fees on outstanding letters of credit could be adjusted if the Company's leverage ratio, as defined, increased or decreased.

The Second Restated Agreement contained financial covenants with respect to borrowings which included maintaining minimum interest coverage and maximum leverage ratios. In accordance with the Agreement, the limits imposed by such ratios became more restrictive over time. In addition, the Second Restated Agreement restricted the Company's ability to incur additional indebtedness, create liens, make investments or specified payments, give guarantees, pay dividends, make capital expenditures, and merge or acquire or sell assets.

The Series B Senior Subordinated Notes ("Notes"), initially scheduled to mature on November 1, 2006, were redeemed in connection with the Company's initial public offering of common stock, and a subsequent primary offering, with the final residual amount redeemed in November 2001.



The Company entered into no new capital leases in 2002. Aggregate capitalized lease obligations are payable in installments of $340 in 2003 and $160 in 2004.

In connection with the acquisition of the consumer battery business of VARTA AG on October 1, 2002, the Company entered into an Amended and Restated Credit Agreement ("Third Restated Agreement") which replaced the Second Restated Agreement discussed above. The Third Restated Agreement provides for senior bank facilities, including term and revolving credit facilities in an initial aggregate amount (assuming an exchange rate of the Euro to the Dollar of 1 to 1) of approximately $625,000. The Third Restated Agreement includes a $100,000 seven-year revolving credit facility, a EUR 50,000 seven-year revolving facility, a $300,000 seven-year amortizing term loan, a EUR 125,000 seven-year amortizing term loan and a EUR 50,000 six-year amortizing term loan. The U.S. Dollar revolving credit facility may be increased, at the Company's option, by up to $50,000.

The interest on Dollar-denominated borrowings is computed, at the Company's option, based on the base rate, as defined ("Base Rate"), or the London Interbank Offered Rate ("LIBOR") for Dollar-denominated deposits. The interest on Euro-denominated borrowings is computed on LIBOR for Euro-denominated deposits. The fees associated with these facilities will be capitalized and amortized over the term of the facilities. Unamortized fees associated with the replaced facilities above will be written off as a charge to earnings in the quarter ending December 29, 2002. Indebtedness under these amended facilities is secured by substantially all of the assets of the Company, is guaranteed by certain of our subsidiaries and the Euro-denominated revolving facility is subject to a borrowing base ("Borrowing Base") of certain European assets.

The term facilities provide for quarterly amortization totaling (assuming an exchange rate of the Euro to the Dollar of 1 to 1) of approximately $9,250 in 2003 and 2004, $14,250 in 2005, 2006, and 2007, $61,250 in 2008 and $352,500 in 2009. The term facility also provides for annual prepayments, over and above the normal amortization. Such payments would be a portion of "Excess Cash Flow" (EBITDA, as defined, less certain operating expenditures including scheduled principal payments of long-term debt). The quarterly amortization is reduced prorata for the effect of prepayments made as a result of Excess Cash Flow.

Interest on Dollar-denominated revolving borrowings is, at the Company's option, at the Base Rate plus a margin (1.25% to 2.50%) per annum or Dollar-denominated LIBOR plus a margin (2.25% to 3.50%) per annum. Interest on Euro-denominated revolving borrowings and the Euro-denominated six-year term loan is Euro-denominated LIBOR plus a margin (2.25% to 3.50%) per annum (6.58% at October 1, 2002). Interest on the Dollar-denominated seven-year term loan is, at the Company's option, at the Base Rate plus a fixed 2.75% margin per annum or Dollar-denominated LIBOR plus a fixed 3.75% margin per annum (5.57% at October 1, 2002). Interest on the Euro-denominated seven-year term loan is Euro-denominated LIBOR plus a fixed 3.75% margin per annum (7.08% at October 1, 2002). The Company is required to pay a commitment fee of 0.50% per annum

on the average daily-unused portion of the revolving facilities. A fee (2.25% to 3.50%) per annum (3.25% at October 1, 2002) is payable on the outstanding letters of credit. The Company also incurs a fee of 0.25% per annum of the average daily maximum amount available to be drawn on each letter of credit issued. The margin on the revolving facilities, six-year amortizing term loan and fees on outstanding letters of credit may be adjusted if the Company's leverage ratio, as defined, increases or decreases.

The Third Restated Agreement contains financial covenants with respect to borrowings which include maintaining minimum interest and fixed charge and maximum leverage ratios. In accordance with the Agreement, the limits imposed by such ratios become more restrictive over time. In addition, the Third Restated Agreement restricts the Company's ability to incur additional indebtedness, create liens, make investments or specified payments, give guarantees, pay dividends, make capital expenditures, and merge or acquire or sell assets.

The aggregate scheduled maturities of debt as of October 1, 2002 are as follows: (1)

| | |
|---|---|
| 2003 | $ 13,400 |
| 2004 | 9,411 |
| 2005 | 14,250 |
| 2006 | 14,250 |
| 2007 | 14,250 |
| Thereafter | 413,750 |
| | $479,311 |

(1) Reflects debt structure resulting from the acquisition of the consumer battery business of VARTA AG. Amounts do not include debt held by the purchased entities at October 1, 2002.

## (7) Shareholders' Equity

On October 1, 2000, the Company granted approximately 277 shares of restricted stock to certain members of management. The total market value of the restricted shares on date of grant was approximately $4,746 and has been recorded as unearned compensation as a separate component of shareholders' equity. During 2002, the Company recognized the forfeiture of approximately 24 restricted shares of stock. The total market value on the date of grant for the forfeited shares was approximately $413 and has been recorded as an adjustment to unearned compensation. Approximately 186 of these shares will vest on September 30, 2003 provided the recipient is still employed by the Company. The remainder vests one third each year from the date of grant. Unearned compensation is being amortized to expense over the three-year vesting period.

On June 22, 2001, the Company completed a primary offering of 3,500 shares of Common stock. The net proceeds of approximately $64,200 after deducting the underwriting discounts and offering expenses, were used to repurchase approximately $64,800 principal amount of 10¼% Series B Senior Subordinated Notes.

Concurrently, the Thomas H. Lee Group and its affiliates sold approximately 4,200 shares and certain Rayovac officers and employees sold approximately 900 shares in a secondary offering of Common stock. The Company did not receive any proceeds from the sales of the secondary offering shares but incurred expenses for the offering of approximately $200 which are included in Special Charges.

On August 16, 2002, the Company granted approximately 24 shares of restricted stock to a certain member of management. These shares will vest on September 30, 2003 provided the recipient is still employed with the Company. The total market value of the restricted shares on the date of grant was approximately $313 and has been recorded as unearned compensation as a separate component of shareholders' equity. Unearned compensation is being amortized over a 13 month vesting period.

## (8) Stock Option Plans

In 1996, the Company's Board of Directors ("Board") approved the Rayovac Corporation 1996 Stock Option Plan ("1996 Plan"). Under the 1996 Plan, stock options to acquire up to 2,318 shares of Common stock, in the aggregate, may be granted to select employees and directors of the Company under either or both a time-vesting or a performance-vesting formula at an exercise price equal to the market price of the Common stock on the date of grant. The time-vesting options become exercisable primarily in equal 20% increments over a five-year period. The performance-vesting options become exercisable at the end of ten years with accelerated vesting over each of the first five years if the Company achieves certain performance goals. Accelerated vesting may occur upon sale of the Company, as defined in the 1996 Plan. As of September 30, 2002, there were options with respect to 1,237 shares of Common stock outstanding under the 1996 Plan.

In 1997, the Board adopted the 1997 Rayovac Incentive Plan ("Incentive Plan"). The Incentive Plan replaces the 1996 Plan and no further awards will be granted under the 1996 Plan other than awards of options for shares up to an amount equal to the number of shares covered by options that terminate or expire prior to being exercised. Under the Incentive Plan, the Company may grant to employees and non-employee directors stock options, stock appreciation rights ("SARs"), restricted stock, and other stock-based awards, as well as cash-based annual and long-term incentive awards. Accelerated vesting will occur in the event of a change in control, as defined in the Incentive Plan. Up to 5,000 shares of Common stock may be issued under the Incentive Plan. The Incentive Plan expires in August 2007. As of September 30, 2002, there were options with respect to 2,868 shares of Common stock outstanding under the Incentive Plan.



A summary of the status of the Company's plans is as follows:

| | 2000 | | 2001 | | 2002 | |
|---|---|---|---|---|---|---|
| | Options | Weighted-Average Exercise Price | Options | Weighted-Average Exercise Price | Options | Weighted-Average Exercise Price |
| Outstanding, beginning of period | 2,832 | $ 9.14 | 3,276 | $12.15 | 3,266 | $14.12 |
| Granted | 729 | 21.62 | 857 | 14.83 | 1,057 | 14.37 |
| Exercised | (132) | 4.71 | (701) | 4.75 | (15) | 8.81 |
| Forfeited | (153) | 8.39 | (166) | 18.43 | (203) | 11.30 |
| Outstanding, end of period | 3,276 | $12.15 | 3,266 | $14.12 | 4,105 | $14.01 |
| Options exercisable, end of period | 1,325 | $ 7.67 | 1,304 | $11.81 | 1,884 | $11.39 |

The Company also granted approximately 277 and 24 shares of restricted stock during 2001 and 2002, respectively, under the Incentive Plan. The restrictions lapse over the three-year period ending September 30, 2003. As of September 30, 2002, the restrictions had lapsed on 44 of these shares and the Company recognized the forfeiture of 24 of these shares.

The following table summarizes information about options outstanding and outstanding and exercisable as of September 30, 2002:

| | Options Outstanding | | | Options Outstanding and Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Number of Shares | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Number of Shares | Weighted-Average Exercise Price |
| $ 4.39 | 1,009 | 4 years | $ 4.39 | 1,009 | $ 4.39 |
| $13.00–$20.938 | 2,246 | 8.1 | 15.24 | 443 | 16.78 |
| $21.25–$29.50 | 850 | 6.7 | 22.19 | 432 | 22.22 |

The Company has adopted the provisions of Statement No. 123, *Accounting for Stock-Based Compensation,* and continues to apply Accounting Principles Board Opinion No. 25 and related interpretations in accounting for its stock plans. Accordingly, the Company recognized $1,582 and $1,331, respectively, of compensation cost, before tax, related to restricted stock in 2001 and 2002, respectively, and no compensation cost, before tax, related to options for the stock plans. If the Company had elected to recognize compensation cost for all of the plans based upon the fair value at the grant dates for awards under those plans, consistent with an alternative method prescribed by Statement No. 123, net income per common share would have been reduced to the pro forma amounts indicated below:

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| Net income reported | $38,350 | $11,534 | $29,237 |
| Pro forma net income | $35,887 | $ 7,932 | $25,271 |
| Pro forma basic net income per common share | $ 1.30 | $ 0.28 | $ 0.80 |
| Pro forma diluted net income per common share | $ 1.23 | $ 0.27 | $ 0.78 |

The fair value of the Company's stock options used to compute pro forma net income and basic and diluted net income per common share disclosures is the estimated fair value at grant date using the Black-Scholes option-pricing model with the following weighted-average assumptions:

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| Assumptions used: | | | |
| Volatility | 28.6% | 34.7% | 37.6% |
| Risk-free interest rate | 6.17% | 4.48% | 3.40% |
| Expected life | 8 years | 8 years | 8 years |
| Dividend yield | — | — | — |
| Weighted-average grant-date fair value of options granted during period | $10.49 | $7.27 | $6.89 |

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's options have characteristics significantly different from traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in the opinion of management, the existing models do not necessarily provide a reliable single value of its options and may not be representative of the future effects on reported net income or the future stock price of the Company. For purposes of pro forma disclosure, the estimated fair value of the options is amortized to expense over the option's vesting period.

## (9) Income Taxes

Pretax income (income before income taxes and extraordinary item) and income tax expense consist of the following:

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| Pretax income (loss): | | | |
| United States | $30,383 | $13,660 | $47,288 |
| Outside the United States | 27,569 | 12,426 | (1,605) |
| Total pretax income | $57,952 | $26,086 | $45,683 |
| Income tax expense (benefit): | | | |
| Current: | | | |
| Federal | $ 7,850 | $ 6,617 | $10,484 |
| Foreign | 8,142 | 6,217 | 895 |
| State | 705 | 142 | 204 |
| Total current | 16,697 | 12,976 | 11,583 |
| Deferred: | | | |
| Federal | 2,032 | (1,977) | 6,666 |
| Foreign | 731 | (1,638) | (2,374) |
| State | 142 | (136) | 571 |
| Total deferred | 2,905 | (3,751) | 4,863 |
| | $19,602 | $ 9,225 | $16,446 |

In 2001, a tax benefit of $3,260 was recorded in conjunction with the loss on the early extinguishment of debt.

The following reconciles the Federal statutory income tax rate with the Company's effective tax rate:

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| Statutory Federal income tax rate | 35.0% | 35.0% | 35.0% |
| Foreign Sales Corporation/Extraterritorial | | | |
| Income Exclusion benefit | (0.6) | (1.4) | (0.6) |
| Effect of foreign items and rate differentials | (0.9) | 0.8 | (0.1) |
| State income taxes and other | 1.0 | 1.3 | 1.5 |
| Adjustment of prior year taxes | (1.3) | (1.4) | 0.2 |
| Other | 0.6 | 1.1 | 0.0 |
| | 33.8% | 35.4% | 36.0% |

The tax effects of temporary differences which give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

| | September 30, | |
|---|---|---|
| | 2001 | 2002 |
| Current deferred tax assets: | | |
| Employee benefits | $ — | $ 970 |
| Restructuring and asset impairments | 3,151 | 212 |
| Inventories and receivables | 3,019 | 2,105 |
| Marketing and promotional accruals | 2,113 | 351 |
| Tax loss carry forwards | 2,348 | 1,861 |
| Currency hedges | 1,731 | 1,370 |
| Other | 1,856 | 1,717 |
| Total current deferred tax assets | 14,218 | 8,586 |
| Current deferred tax liabilities: | | |
| Inventories | (2,494) | — |
| Other | (1,389) | — |
| Total current deferred tax liabilities | (3,883) | — |
| Net current deferred tax assets | $ 10,335 | $ 8,586 |
| Noncurrent deferred tax assets: | | |
| Employee benefits | $ 3,462 | $ 5,103 |
| Operating loss and credit carry forwards | 1,328 | 4,163 |
| Property, plant and equipment | 477 | 147 |
| Other | 3,626 | 2,930 |
| Total noncurrent deferred tax assets | 8,893 | 12,343 |
| Noncurrent deferred tax liabilities: | | |
| Property, plant, and equipment | (12,178) | (12,954) |
| Intangibles | (2,240) | (4,488) |
| Employee benefits | — | (2,200) |
| Other | (903) | (1,315) |
| Total noncurrent deferred tax liabilities | (15,321) | (20,957) |
| Net noncurrent deferred tax liabilities | $ (6,428) | $ (8,614) |

At September 30, 2002, net noncurrent deferred tax assets of $12,343 are included in Deferred charges and other in the Consolidated Balance Sheets. At September 30, 2001, net noncurrent deferred tax assets of $1,505 are included in Deferred charges and other and net current deferred tax liabilities of $1 are included in Other accrued liabilities in the Consolidated Balance Sheets.

The Company believes that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax assets.

Provision has not been made for United States income taxes on a portion of the undistributed earnings of the Company's foreign subsidiaries (approximately $33,366 and $30,881 at September 30, 2001 and 2002, respectively), either because any taxes on dividends would be offset substantially by foreign tax credits or because the Company intends to reinvest those earnings. Such earnings would become taxable upon the sale or liquidation of these foreign subsidiaries or upon remittance of dividends. It is not practicable to estimate the amount of the deferred tax liability on such earnings.

## (10) Leases

Future minimum rental commitments under non-cancelable operating leases, principally pertaining to land, buildings and equipment, are as follows:

| | |
|---|---|
| 2003 | $ 6,271 |
| 2004 | 5,014 |
| 2005 | 4,794 |
| 2006 | 3,959 |
| 2007 | 3,633 |
| Thereafter | 14,248 |
| | $37,919 |



The leases on the properties require annual lease payments of $2,788 subject to annual inflationary increases. All of the leases expire during the years 2003 through 2014.

Total rental expenses were $6,924, $7,137 and $7,341 for 2000, 2001 and 2002, respectively.

During 2002, the Company entered into a long-term lease for a facility being built in Dixon, Illinois (see Subsequent Events footnote 18). The Company anticipates that construction will be completed and the lease payments will be fixed for this facility during the second fiscal quarter of 2003. As amounts are not fixed, minimum rental commitments for this lease are not included above.

## (11) Employee Benefit Plans

***Pension Benefits*** The Company has various defined benefit pension plans covering substantially all of its domestic hourly employees and union members. Plans generally provide benefits of stated amounts for each year of service. The Company's practice is to fund pension costs at amounts within the acceptable ranges established by the Employee Retirement Income Security Act of 1974, as amended.

The Company also has various nonqualified deferred compensation agreements with certain of its employees. Under certain agreements, the Company has agreed to pay certain amounts annually for the first 15 years subsequent to retirement or to a designated beneficiary upon death. It is management's intent that life insurance contracts owned by the Company will fund these agreements. Under the other agreements, the Company has agreed to pay such deferral amounts in up to 15 annual installments beginning on a date specified by the employee, subsequent to retirement or disability, or to a designated beneficiary upon death. The Company established a rabbi trust to fund these agreements.

***Other Benefits*** The Company provides certain health care and life insurance benefits to eligible retired employees. Participants earn retiree health care benefits after reaching age 45 over the next 10 succeeding years of service and remain eligible until reaching age 65. The plan is contributory; retiree contributions have been established as a flat dollar amount with contribution rates expected to increase at the active medical trend rate. The plan is unfunded. The Company is amortizing the transition obligation over a 20-year period.

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| | 2001 | 2002 | 2001 | 2002 |
| **Change in benefit obligation** | | | | |
| Benefit obligation at beginning of year | $17,731 | $ 20,619 | $ 2,925 | $ 2,677 |
| Service cost | 616 | 693 | 343 | 299 |
| Interest cost | 1,415 | 1,512 | 213 | 188 |
| Amendments | 371 | 677 | — | (20) |
| Actuarial loss (gain) | 1,180 | 1,132 | (701) | (41) |
| Benefits paid | (694) | (879) | (103) | (27) |
| Benefit obligation at end of year | $20,619 | $ 23,754 | $ 2,677 | $ 3,076 |
| **Change in plan assets** | | | | |
| Fair value of plan assets at beginning of year | $11,258 | $ 12,316 | $ — | $ — |
| Actual return on plan assets | (1,252) | (1,279) | — | — |
| Employer contribution | 3,114 | 1,414 | 103 | 27 |
| Benefits paid | (694) | (879) | (103) | (27) |
| Plan expenses paid | (110) | (78) | — | — |
| Fair value of plan assets at end of year | $12,316 | $ 11,494 | $ — | $ — |
| Funded status | $ (8,303) | $(12,260) | $(2,677) | $(3,076) |
| Unrecognized net transition obligation | 213 | 168 | 343 | 309 |
| Unrecognized prior service cost | 2,917 | 3,278 | — | — |
| Unrecognized net actuarial loss (gain) | 3,297 | 6,985 | (121) | (161) |
| Adjustment for minimum liability | (6,431) | (10,435) | — | — |
| Accrued benefit cost | $ (8,307) | $(12,264) | $(2,455) | $(2,928) |
| Weighted-average assumptions: | | | | |
| Discount rate | 7.5% | 7.0% | 7.5% | 7.25% |
| Expected return on plan assets | 8.5% | 8.5% | N.A. | N.A. |

| | Pension Benefits | | | Other Benefits | | |
|---|---|---|---|---|---|---|
| | 2000 | 2001 | 2002 | 2000 | 2001 | 2002 |
| **Components of net periodic benefit cost** | | | | | | |
| Service cost | $ 506 | $ 616 | $ 693 | $335 | $343 | $299 |
| Interest cost | 1,239 | 1,415 | 1,512 | 209 | 213 | 188 |
| Actual return on assets | (604) | 1,252 | 1,279 | — | — | — |
| Amortization of prior service cost | 234 | 311 | 315 | — | — | — |
| Recognized net actuarial (gain) loss | (272) | (2,368) | (2,433) | 96 | 61 | 32 |
| Net periodic benefit cost | $1,103 | $ 1,226 | $ 1,366 | $640 | $617 | $519 |

Pension plan assets and obligations are measured at June 30 each year. The contributions to the pension plans between July 1 and September 30 were $495 and $2,814 in 2001 and 2002, respectively.

The Company has recorded an additional minimum pension liability of $6,431 and $10,435 at September 30, 2001 and 2002, respectively, to recognize the under funded position of its benefit plans. An intangible asset of $3,081 and $3,446 at September 30, 2001 and 2002, respectively, equal to the unrecognized prior service cost of these plans, has also been recorded. The excess of the additional minimum liability over the unrecognized prior service cost of $3,350 and $6,989 at September 30, 2001 and 2002, respectively, has been recorded as a component of accumulated other comprehensive income, net of tax.

The Company sponsors a defined contribution pension plan for its domestic salaried employees, which allows participants to make contributions by salary reduction pursuant to Section 401(k) of the Internal Revenue Code. The Company contributes annually from 3% to 6% of participants' compensation based on age, and may make additional discretionary contributions. The Company also sponsors defined contribution pension plans for employees of certain foreign subsidiaries. Company contributions charged to operations, including discretionary amounts, for 2000, 2001 and 2002 were $2,171, $2,147, and $1,804, respectively.

For measurement purposes, annual rates of increase of 8.0% in the per capita costs of covered health care benefits were assumed for 2000, 2001 and 2002, respectively, gradually decreasing to 5.5%. The health care cost trend rate assumption has a significant effect on the amounts reported. For example, increasing the assumed health care cost trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of September 30, 2002 by $181 and the aggregate of the service and interest cost components of net periodic postretirement benefit cost for the year ended September 30, 2002 by $51. Decreasing the assumed health care cost trend rates by one percentage point in each year would decrease the accumulated postretirement benefit obligation as of September 30, 2002 by $166 and the aggregate of the service and interest cost components of net periodic postretirement benefit cost for the year ended September 30, 2002 by $46.



## (12) Segment Information

The Company manages operations in three reportable segments based upon geographic area. North America includes the United States and Canada; Latin America includes Mexico, Central America, South America, and the Caribbean; Europe/Rest of World ("Europe/ROW") includes the United Kingdom, continental Europe and all other countries in which the Company does business.

The Company manufactures and markets dry cell batteries including alkaline, zinc carbon, alkaline rechargeable, hearing aid, and other specialty batteries and lighting products throughout the world. These product lines are sold in all geographic areas. Latin America revenues have historically been derived primarily from zinc carbon and alkaline batteries.

Net sales and cost of sales to other segments have been eliminated. The gross contribution of intersegment sales is included in the segment selling the product to the external customer. Segment revenues are based upon the geographic area in which the product is sold.

The reportable segment profits do not include interest expense, interest income, and income tax expense. Also, not included in the reportable segments are corporate expenses including corporate purchasing expense, general and administrative expense and research and development expense. All depreciation and amortization included in income from operations is related to reportable segments. Costs are identified to reportable segments or corporate, according to the function of each cost center.

The reportable segment assets do not include cash, deferred tax benefits, investments, long-term intercompany receivables, most deferred charges, and miscellaneous assets. All capital expenditures are related to reportable segments. Variable allocations of assets are not made for segment reporting.

Wal-Mart Stores, Inc., the Company's largest mass merchandiser customer, represented 22%, 27% and 26% of its net sales during 2000, 2001 and 2002, respectively, primarily in North America.

***Revenues from external customers***

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| North America | $468,150 | $448,788 | $435,600 |
| Latin America | 112,150 | 118,665 | 84,677 |
| Europe/ROW | 50,614 | 48,719 | 52,459 |
| Total segments | $630,914 | $616,172 | $572,736 |

***Inter segment revenues***

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| North America | $ 23,563 | $ 30,634 | $ 34,069 |
| Latin America | 1,293 | 9,518 | 5,556 |
| Europe/ROW | 1,058 | 2,593 | 2,504 |
| Total segments | $ 25,914 | $ 42,745 | $ 42,129 |

***Depreciation and amortization***

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| North America | $ 13,266 | $ 14,253 | $ 15,401 |
| Latin America | 5,253 | 5,393 | 2,879 |
| Europe/ROW | 1,504 | 1,573 | 715 |
| Total segments | $ 20,023 | $ 21,219 | $ 18,995 |

***Segment profit***

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| North America | $ 95,351 | $ 80,774 | $ 85,490 |
| Latin America | 20,273 | 16,913 | 5,330 |
| Europe/ROW | 6,085 | 4,061 | 5,087 |
| Total segments | 121,709 | 101,748 | 95,907 |
| Corporate expenses | 32,378 | 25,072 | 31,676 |
| Special charges | — | 22,307 | 1,210 |
| Interest expense | 30,626 | 27,189 | 16,048 |
| Other expense, net | 753 | 1,094 | 1,290 |
| Income before income taxes and extraordinary items | $ 57,952 | $ 26,086 | $ 45,683 |

***Segment assets***

| | September 30, | | |
|---|---|---|---|
| | 2000 | 2001 | 2002 |
| North America | $274,798 | $289,215 | $256,446 |
| Latin America | 199,865 | 205,918 | 191,002 |
| Europe/ROW | 31,233 | 30,010 | 31,356 |
| Total segments | 505,896 | 525,143 | 478,804 |
| Corporate | 43,708 | 41,356 | 54,429 |
| Total assets at year end | $549,604 | $566,499 | $533,233 |

***Expenditures for segment assets***

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| North America | $ 14,668 | $ 17,521 | $ 13,158 |
| Latin America | 3,448 | 1,761 | 1,514 |
| Europe/ROW | 880 | 411 | 969 |
| Total segments | $ 18,996 | $ 19,693 | $ 15,641 |

***Product Line Revenues***

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| Alkaline | $280,700 | $302,900 | $295,700 |
| Heavy Duty | 142,300 | 139,100 | 96,500 |
| Rechargeables | 29,700 | 29,800 | 31,800 |
| Hearing Aid batteries | 60,800 | 65,300 | 67,600 |
| Specialty batteries | 41,400 | 17,800 | 15,300 |
| Lighting products and Lantern batteries | 76,000 | 61,300 | 65,800 |
| Total revenues from external customers | $630,900 | $616,200 | $572,700 |



## (13) Commitments and Contingencies

In March 1998, the Company entered into an agreement to purchase certain equipment and to pay annual royalties. In connection with this 1998 agreement, the Company committed to pay royalties of $2,000 in 1999, $3,000 in 2000 through 2002, and $500 in each year thereafter, as long as the related equipment patents are enforceable (until 2022). The Company incurred royalty expenses of $2,250 for 2000, $3,000 for 2001, and $3,000 for 2002.

The Company has provided for the estimated costs associated with environmental remediation activities at some of its current and former manufacturing sites. In addition, the Company, together with other parties, has been designated a potentially responsible party of various third-party sites on the United States EPA National Priorities List (Superfund). The Company provides for the estimated costs of investigation and remediation of these sites when such losses are probable and the amounts can be reasonably estimated. The actual cost incurred may vary from these estimates due to the inherent uncertainties involved. The Company believes that any additional liability in excess of the amounts provided of $1,640, which may result from resolution of these matters, will not have a material adverse effect on the financial condition, liquidity, or cash flow of the Company.

The Company has certain other contingent liabilities with respect to litigation, claims and contractual agreements arising in the ordinary course of business. Such litigation includes the suit filed against the Company by Eveready Battery Company and shareholder lawsuits. In the opinion of management, such contingent liabilities are not likely to have a material adverse effect on the financial condition, liquidity or cash flow of the Company.

## (14) Related Party Transactions

The Company and Thomas H. Lee Company (THL Co.) were parties to a Management Agreement pursuant to which the Company engaged THL Co. to provide consulting and management advisory services for an initial period of five years through September 2001. The agreement was renewed for another year through 2002. The agreement was not renewed upon expiration in September 2002. The Company paid THL Co. aggregate fees and expenses of $458, $473 and $364 for 2000, 2001 and 2002, respectively.

The Company has notes receivable from officers/shareholders in the amount of $3,665 and $4,205 at September 30, 2001 and 2002, respectively, generally payable in fiscal 2003 through fiscal 2005, which bear interest at 4.6% to 8.0%. Since the officers utilized the proceeds of the notes to purchase common stock of the Company, directly or through the exercise of stock options, the notes have been recorded as a reduction of shareholders' equity.

## (15) Special Charges

During 1999, the Company recorded special charges as follows: (i) $2,528 of employee termination benefits for 43 employees related to organizational restructuring in the U.S. and Europe, (ii) $1,300 of charges related to the discontinuation of the manufacturing of silver-oxide cells at the Company's Portage, Wisconsin, facility, and (iii) $2,100 of charges related to the termination of non-performing foreign distributors. The Company also recognized special charges of $803 related to the investigation of financing options and developing organizational strategies for the Latin American acquisition. A summary of the 1999 restructuring activities follows:

***1999 Restructuring Summary***

| | Termination Benefits | Other Costs | Total |
|---|---|---|---|
| Expense accrued | $ 2,500 | $ 3,400 | $ 5,900 |
| Cash expenditures | (200) | — | (200) |
| Balance September 30, 1999 | $ 2,300 | $ 3,400 | $ 5,700 |
| Change in estimate | — | 100 | 100 |
| Cash expenditures | (2,200) | — | (2,200) |
| Non-cash charges | — | (3,300) | (3,300) |
| Balance September 30, 2000 | $ 100 | $ 200 | $ 300 |
| Cash expenditures | (100) | — | (100) |
| Non-cash charges | — | (200) | (200) |
| Balance September 30, 2001 | $ — | $ — | $ — |

During 2001, the Company recorded special charges related to: (i) an organizational restructuring in the U.S., (ii) manufacturing and distribution cost rationalization initiatives in the Company's Tegucigalpa, Honduras and Mexico City, Mexico manufacturing facilities and in our European operations, (iii) the closure of the Company's Wonewoc, Wisconsin, manufacturing facility, (iv) the rationalization of uneconomic manufacturing processes at the Company's Fennimore, Wisconsin, manufacturing facility, and rationalization of packaging operations and product lines, and (v) costs associated with our June 2001 secondary offering. The amount recorded includes $9,100 of employee termination benefits for approximately 570 employees, $9,900 of equipment, inventory, and other asset write-offs, and $2,000 of other expenses. A summary of the 2001 restructuring activities follows:

***2001 Restructuring Summary***

| | Termination Benefits | Other Costs | Total |
|---|---|---|---|
| Expense accrued | $ 5,000 | $11,000 | $16,000 |
| Change in estimate | 4,400 | 100 | 4,500 |
| Expense as incurred | 700 | 1,100 | 1,800 |
| Cash expenditures | (5,800) | (1,300) | (7,100) |
| Non-cash charges | — | (9,300) | (9,300) |
| Balance September 30, 2001 | $ 4,300 | $ 1,600 | $ 5,900 |
| Change in estimate | (1,000) | (300) | (1,300) |
| Cash expenditures | (3,100) | — | (3,100) |
| Non-cash charges | — | (700) | (700) |
| Balance September 30, 2002 | $ 200 | $ 600 | $ 800 |

During 2002, the Company announced a restructuring initiative in Latin America including: (i) the closure of the Company's Santo Domingo, Dominican Republic manufacturing operations, and (ii) outsourcing a portion of its heavy duty battery production, previously manufactured at its Mexico City, Mexico location. The amount recorded includes $1,200 of employee termination benefits for approximately 115 employees, $900 of equipment, inventory, and other asset write-offs, and $300 of other expenses. A summary of the 2002 restructuring activities follows:

***2002 Restructuring Summary***

| | Termination Benefits | Other Costs | Total |
|---|---|---|---|
| Expense accrued | $ 1,200 | $ 1,400 | $ 2,600 |
| Change in estimate | — | (400) | (400) |
| Expense as incurred | — | 200 | 200 |
| Cash expenditures | (1,100) | (200) | (1,300) |
| Non-cash charges | — | (1,000) | (1,000) |
| Balance September 30, 2002 | $ 100 | $ — | $ 100 |

## (16) Acquisitions and Divestitures

In 2000, the Company entered into an asset purchase agreement and a license agreement with a Hong Kong company to sell certain inventory and for the exclusive right to use the Rayovac trade name for the manufacture, sale and distribution of the Company's camcorder battery product line. In exchange for the license, the Company received a $6,000 promissory note, payable over five years, and will receive a royalty on future sales of camcorder batteries. The Company will receive a minimum royalty of $100 over the balance of the license arrangement and will receive a variable royalty on sales of camcorder batteries. The Company has no substantive future obligation relative to this agreement. As a result of this transaction, the Company recognized a pretax gain on the sale of the trade name licensing rights of $1,997, net of write-off of related tangible and intangible assets.



In 2002, the Company entered into similar agreements with the same Hong Kong company for the cordless product line and licensing agreements on other product lines not currently sold by the Company. The Company received promissory notes in the amount of $800 payable over terms of up to five years. The Company will receive variable royalties on sales of product lines licensed. As a result of these transactions, the Company recognized a pretax gain of $701.

## (17) Quarterly Results (unaudited)

| | Quarter Ended | | | |
|---|---|---|---|---|
| | December 30, 2001 | March 31, 2002 | June 30, 2002 | September 30, 2002 |
| Net sales | $161,883 | $121,153 | $135,412 | $154,288 |
| Gross profit | 62,732 | 49,934 | 54,401 | 70,312 |
| Net income | 402 | 5,380 | 10,314 | 13,141 |
| Basic net income per common share | 0.01 | 0.17 | 0.32 | 0.41 |
| Diluted net income per common share | 0.01 | 0.17 | 0.32 | 0.41 |

| | Quarter Ended | | | |
|---|---|---|---|---|
| | December 31, 2000 | April 1, 2001 | July 1, 2001 | September 30, 2001 |
| Net sales | $164,307 | $134,679 | $146,969 | $170,217 |
| Gross profit | 51,991 | 55,942 | 59,104 | 65,859 |
| (Loss) income before extraordinary item | (1,766) | 4,125 | 8,072 | 6,430 |
| Net (loss) income | (1,766) | 4,125 | 2,722 | 6,453 |
| Basic net (loss) income per common share | (0.06) | 0.15 | 0.10 | 0.20 |
| Diluted net (loss) income per common share | (0.06) | 0.14 | 0.09 | 0.20 |

### (18) Subsequent Events

On October 1, 2002, the Company acquired the consumer battery business of VARTA AG (VARTA) for approximately 262 million Euros. The transaction did not include VARTA's Brazilian joint venture, its automotive or micro-power business. The Company acquired all of the VARTA consumer subsidiaries located outside of Germany and became the majority owner of a new joint venture entity that will conduct all consumer battery business within Germany. The Company has not yet finalized the purchase price allocation for the acquisition. (See also footnote 6.)

On October 10, 2002, the Company committed to and announced a series of initiatives to position the Company for future growth opportunities and to optimize the global resources of the combined VARTA and Rayovac companies. The Company expects to take a restructuring charge of approximately $20 million pretax to be recorded in the first quarter of fiscal 2003 and an additional $10–$15 million to be recorded as incurred. Cash cost of the restructuring program is expected to total $15–$20 million. Cost savings related to these initiatives are projected to be in the range of $35–$40 million when fully realized in fiscal 2005. Initiatives include: closure of the Mexico City, Mexico zinc carbon manufacturing plant; closure of operations at its Middleton, Wisconsin distribution center and its Madison, Wisconsin packaging center and combination of the two operations into a new leased complex being built in Dixon, Illinois. Transition to the new facility is expected by June 2003. In addition to the manufacturing, packaging, and distribution changes, the Company anticipates a series of sales, marketing, operations and administrative restructuring initiatives on all three continents. These changes are the result of duplication synergies between the Rayovac and VARTA organizations and ongoing cost containment initiatives. The combination of all these restructuring initiatives is expected to ultimately reduce the workforce by approximately 630 or 14 percent of the current worldwide workforce.

## MANAGEMENT'S STATEMENT OF RESPONSIBILITY FOR FINANCIAL STATEMENTS

Rayovac Corporation and Subsidiaries

Rayovac Corporation's financial statements are prepared by management, which is responsible for their fairness, integrity and objectivity. The accompanying financial statements have been prepared in conformity with generally accepted accounting principles in the United States applied on a consistent basis except for accounting changes as disclosed and accordingly, include amounts that are estimates and judgments. All historical financial information in this annual report is consistent with the accompanying financial statements.

Rayovac maintains accounting systems, including internal accounting controls monitored by internal audit, that are designed to provide reasonable assurance of the reliability of financial records and the protection of assets. The concept of reasonable assurance is based on recognition that the cost of a system should not exceed the related benefits. The effectiveness of those systems depends primarily upon the careful selection of financial and other managers, clear delegation of authority and assignment of accountability, inculcation of high business ethics and conflict-of-interest standards, policies and procedures and the leadership and commitment of top management.

Rayovac's financial statements are audited by independent auditors, in accordance with generally accepted auditing standards in the United States. These standards provide for a review of Rayovac's internal accounting controls to the extent they deem appropriate in order to issue their opinion on the financial statements.

The Audit Committee of the Board of Directors, which consists solely of non-employee directors, is responsible for overseeing the functioning of the accounting system and related controls and the preparation of annual financial statements. The Audit Committee members periodically meet with management to review and evaluate their accounting, auditing and financial reporting activities and responsibilities. The independent accountants and internal audit have full and free access to the Audit Committee with and without management present.

The Board of Directors and Shareholders
Rayovac Corporation:

We have audited the accompanying consolidated balance sheets of Rayovac Corporation and subsidiaries as of September 30, 2001 and 2002, and the related consolidated statements of operations, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended September 30, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Rayovac Corporation and subsidiaries as of September 30, 2001 and 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended September 30, 2002 in conformity with accounting principles generally accepted in the United States of America.



KPMG LLP

KPMG LLP

Milwaukee, Wisconsin
November 1, 2002

# INFORMATION FOR INVESTORS

Rayovac Corporation and Subsidiaries

## Common Stock Information

Our common stock, $0.01 par value per share (the "Common Stock"), is traded on the New York Stock Exchange (the "NYSE") under the symbol "ROV." The Common Stock commenced public trading on November 21, 1997. As of November 30, 2002, there were approximately 279 holders of record of Common Stock based upon data provided by the transfer agent for the Common Stock. The following table sets forth the reported high and low prices per share of the Common Stock as reported on the New York Stock Exchange Composite Transaction Tape for the fiscal periods indicated:

| | High | Low |
|---|---|---|
| Fiscal 2002 | | |
| Quarter ended December 30, 2001 | $18.05 | $13.60 |
| Quarter ended March 31, 2002 | $17.93 | $12.81 |
| Quarter ended June 30, 2002 | $19.10 | $14.80 |
| Quarter ended September 30, 2002 | $18.52 | $11.75 |
| Fiscal 2001 | | |
| Quarter ended December 31, 2000 | $18.81 | $11.69 |
| Quarter ended April 1, 2001 | $20.78 | $13.63 |
| Quarter ended July 1, 2001 | $25.25 | $16.93 |
| Quarter ended September 30, 2001 | $23.50 | $12.60 |

We have not declared or paid and do not anticipate paying cash dividends in the foreseeable future, but intend to retain any future earnings for reinvestment in our business. In addition, the terms of our credit facility restrict our ability to pay dividends to our shareholders. Any future determination to pay cash dividends will be at the discretion of the Board of Directors and will be dependent upon our financial condition, results of operations, capital requirements, contractual restrictions and such other factors as the Board of Directors deems relevant.

## Shareholder Information

The Annual Report is a principal means of communicating Rayovac's business strategies and financial performance to its shareholders. Rayovac's 2002 Annual Report on Form 10-K, which is filed with the U.S. Securities and Exchange Commission, provides certain additional information.

Rayovac's Investor Relations Department is responsible for shareholder communications and welcomes shareholder inquiries about Rayovac, either by telephone or in writing.

Mellon Investor Services is Rayovac's stock transfer agent and registrar and maintains shareholder records. Shareholders needing information about account records, stock certificates, change of address and dividend payments should contact: Mellon Investor Services LLC, 85 Challenger Road, Ridgefield Park, NJ 07660, 1-888-213-0965, http://www.melloninvestor.com.

The Annual Report and filings with the U.S. Securities and Exchange Commission can be obtained upon request to Mellon Investor Services or: Investor Relations, Attention: John Daggett, Rayovac Corporation, P.O. Box 44960, Madison, WI 53744-4960, 608-275-4912.

## General Corporate Communications

For general information about Rayovac, and its products, write or call: Corporate Communications, Rayovac Corporation, P.O. Box 44960, Madison, WI 53744-4960, 608-275-4414.

Visit Rayovac on the World Wide Web:www.rayovac.com.

## BOARD OF DIRECTORS

| | |
|---|---|
| David A. Jones | *Chairman and Chief Executive Officer* |
| Kent J. Hussey | *President and Chief Operating Officer* |
| Thomas R. Shepherd | *Chairman, TSG Equity Partners, LLC (Compensation Committee and Audit Committee)* |
| John S. Lupo | *Principal in the consulting firm Renaissance Partners, LLC., Former Executive Vice President, Sales and Marketing, Bassett Furniture, Inc. (Corporate Governance and Nominating Committee)* |
| Philip F. Pellegrino | *Senior Vice President and President of Sales, Kraft Foods (Audit Committee and Compensation Committee)* |
| Barbara S. Thomas | *Interim CEO of Ocean Spray Cranberries, Inc. and former President of Warner-Lambert Consumer Healthcare (Corporate Governance and Nominating Committee)* |
| William P. Carmichael | *Retired Senior Vice President and Chief Administrative Officer of Sara Lee Corporation (Audit Committee)* |

## EXECUTIVE OFFICERS

| | |
|---|---|
| David A. Jones | *Chairman and Chief Executive Officer* |
| Kent J. Hussey | *President and Chief Operating Officer* |
| Kenneth V. Biller | *Executive Vice President—Operations* |
| Remy E. Burel | *Executive Vice President—Europe* |
| Luis A. Cancio | *Executive Vice President—Latin America* |
| Stephen P. Shanesy | *Executive Vice President—North America* |
| Randall J. Steward | *Executive Vice President and Chief Financial Officer* |
| Merrell M. Tomlin | *Executive Vice President—Global Sales* |
| Paul G. Cheeseman | *Senior Vice President—Technology* |

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**RAYOVAC CORPORATION**
**WORLD HEADQUARTERS**
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