RAYTECH CORP
Form 10-K
April 19, 2005

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

FORM 10-K

x Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal Year ended January 2, 2005 or

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

Commission File Number **1-9298**

RAYTECH CORPORATION
(Exact Name of Registrant as Specified in its Charter)

DELAWARE (State or Other Jurisdiction of Incorporation or Organization)	**06-1182033** (I.R.S. Employer Identification No.)
Suite 295, Four Corporate Drive **Shelton, Connecticut** (Address of Principal Executive Office)	**06484** (Zip Code)

(203) 925-8021
(Registrant's Telephone Number, Including Area Code)

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

Title of each class	Name of each exchange on which registered
Common Stock - $1.00 Par Value	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: None.

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

Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in part III of this Form 10-K or any amendment to this Form 10-K. [X] Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes o No x

The aggregate market value of the registrant's voting stock held by non-affiliates of the registrant as of June 25, 2004 was $10.7 million.

Indicate by check mark whether the Registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes x No o

The number of shares of the registrant's common stock outstanding as of March 31, 2005 was 41,737,306.

Documents incorporated by reference:
None.

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2004 FORM 10-K

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Caution Regarding Forward Looking Statements

Statements in this Form 10-K relating to management's views of trends, plans, objectives and other matters for future operating periods are "forward looking statements" as defined in the Private Securities Litigation Reform Act of 1995. These forward looking statements are subject to significant risks and uncertainties that could cause actual results to differ materially from the results in the statements. Forward looking statements relating to our businesses are based on assumptions concerning certain factors that are not predictable and are subject to change. These factors include general economic conditions; worldwide demand for automotive and heavy duty vehicles; consumer confidence; actions of our competitors, vendors and customers; factors affecting our costs such as raw material prices, labor relations, environmental compliance and remediation, and interest and foreign currency exchange rates; technological issues; accounting standards; among other factors. The forward-looking statements herein are made as of the date of this report. We have no obligation to update our forward looking statements.

Part I.

Item 1. Business

General

Raytech Corporation (“Raytech” or the “Company”) develops, manufactures and supplies specialty engineered friction and energy absorption components used in oil immersed (wet) and dry transmission and brake systems for on- and off-road vehicles. The Company also makes and markets specialty engineered products for heat resistant, inertia control, and energy absorption applications. Our products are typically found in passenger cars, heavy-duty construction and agricultural equipment, trucks, buses and logging, mining and military vehicles. Unless the context indicates otherwise, all references herein to us, we, Raytech or the Company include the Company and its subsidiaries.

Raytech was incorporated in June 1986 in Delaware as a subsidiary of Raymark Corporation (which, with its subsidiary Raymark Industries, Inc., is collectively referred to in this report as “Raymark”). In October 1986, Raytech became the publicly traded holding company of Raymark stock through a restructuring plan whereby each share of common stock of Raymark was automatically converted into one share of Raytech common stock. In 1988, Raytech divested the Raymark subsidiary. In accordance with the restructuring plan, Raytech, through its subsidiaries, purchased certain non-asbestos businesses of Raymark. Despite the divestiture of Raymark, Raytech was named a co-defendant with Raymark and other named defendants in numerous asbestos-related lawsuits as a successor in liability to Raymark. In order to stay the litigation, on March 10, 1989, Raytech filed a petition seeking relief under Chapter 11 of Title 11, United States Code in the United States Bankruptcy Court, District of Connecticut. In April 2001, Raytech emerged from protection of the Bankruptcy Court under a plan of reorganization. Under the plan of reorganization certain asbestos personal injury claims and certain environmental claims were discharged in exchange for cash and equity of 37,058,900 shares, representing 89.2% of the Company’s outstanding common stock at that time. A channeling injunction was ordered by the Bankruptcy Court that will permanently and forever stay, enjoin and restrain any asbestos-related claims against the Company and its subsidiaries. Under the Bankruptcy Code, the Raytech Asbestos Personal Injury Settlement Trust (“PI Trust”) was established and all future asbestos related claims are to be channeled to the PI Trust for resolution. Additionally, any and all future refunds of taxes, realized by the Company and resulting from the implementation of the plan of reorganization, will inure to the benefit of the PI Trust.

The Company's operations are categorized into three operating segments and a corporate group based on management structure, product type and distribution channel, as described below. During the first quarter of 2004, we restructured our operating segments to facilitate a stronger focus on the European wet friction operations. Oversight of the European wet friction operations, Raybestos Reibtechnik GmbH ("RRT") and Raybestos U.K. Ltd. ("RUK"), and sales of wet friction products outside of North America was transferred to the European management team. The newly defined operating segments are Domestic Wet Friction, International (including the European wet friction operations and European and Asian dry friction operations), and Aftermarket. All prior period segment information presented has been restated to reflect the newly defined segments.

The Domestic Wet Friction segment manufactures and distributes automatic transmission and wet wheel brake system components. The segment markets its products to automotive, heavy-duty truck, farm and construction machinery and mining original equipment manufacturers ("OEMs") in North America.

The International segment manufactures and distributes manual transmission components, manufactures certain wet friction products in the United Kingdom, and distributes automatic transmission and wet wheel brake system components outside of North America. The segment markets its products to automotive, heavy-duty truck, farm and construction machinery and mining OEMs. The International segment markets its dry friction products worldwide and its wet friction products throughout Europe and Asia.

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

The Corporate group consists principally of corporate activities and includes costs to maintain the corporate headquarters, certain environmental costs, and certain assets, liabilities and related income and expense stemming from the reorganization plan implemented when the Company emerged from bankruptcy in 2001. We have chosen not to distribute these costs to the operating segments to preserve the historical comparability at the operating segment level.

During the second quarter of 2004 the Company's President and Chief Executive Officer retired. The Board of Directors has named an interim President and Chief Executive Officer, Larry Singleton, from a financial advisory and consulting firm, effective June 1, 2004. The Board of Directors is currently negotiating the terms of a permanent appointment, as President and Chief Executive Officer, with Mr. Singleton.

We continue to review alternatives to improve our operating results. During 2004, the Company conducted a facilities utilization review and made the decision to close its manufacturing operations in Sterling Heights, Michigan and Liverpool, England. The closure of these facilities is expected to be completed during 2005. During 2004, the Company closed its technical center in Sterling Heights, Michigan and relocated the functions previously performed there to other locations. The Company also began the process of relocating its corporate functions from Shelton, Connecticut to its existing manufacturing and development facilities located in Crawfordsville, Indiana. The closure of the Shelton corporate offices is expected to be completed during 2005.

The percentage of net sales for each segment of the consolidated net sales over the past three years is as follows:

	For the Year Ended Jan. 2, 2005	**For the Year Ended Dec. 28, 2003**	**For the Year Ended Dec. 29, 2002**
Domestic Wet Friction operations	56.7%	57.8%	62.6%
International operations	29.7%	27.5%	23.3%
Aftermarket operations	21.6%	21.8%	22.0%
Intersegment elimination	(8.0%)	(7.1%)	(7.9%)

The net sales, gross profit, operating profit (loss) and other financial information pertaining to the operation of the business segments is contained in Note 10 - Segment Reporting to the Consolidated Financial Statements of the Company.

Our executive offices are located in Shelton, Connecticut. Information about the Company, including its filings with the Securities and Exchange Commission, is available, free of charge, on the Internet at www.raytech.com.

Sales Methods

The Domestic Wet Friction operations serve the on-highway and off-highway vehicular markets through the sale of products to OEMs of automobiles, heavy-duty trucks, buses, construction and mining equipment and agricultural machinery, through sales to distributors that supply components and replacement parts for these vehicles, and through sales by the International segment. The Domestic Wet Friction segment sells certain products to the Aftermarket segment, which in turn distributes these products to warehouse distributors in the aftermarket.

Our International operation sells dry friction clutch facings to manual transmission system assemblers who, in turn, supply the OEM market and aftermarket in Europe and the Far East. This segment sells wet friction products to OEMs of automobiles, heavy-duty trucks, buses, construction and mining equipment and agricultural machinery, and through distributors supplying components and replacement parts for these vehicles.

The Aftermarket segment sells its products primarily to warehouse distributors and in certain instances directly to retail outlets.

Sales in all segments are made by Company sales representatives. Sales are made under sales contracts for all or a portion of a customer's products over a period of time or on an open order basis and may include price commitments for multiple years. In some cases, these contracts stipulate price reductions in future years that may negatively impact our profitability.

Our products are sold around the world, through export from our plants in the United States, through our wholly-owned manufacturing subsidiaries in Germany, the United Kingdom and China, and through distributors.

Raw Material Availability

The principal raw materials used in the manufacture of our products include cold-rolled steel, metal powders, synthetic resins, plastics and synthetic and natural fibers. All of these materials are available from a number of competitive suppliers. In 2004, worldwide increases in steel demand led to increased prices, which negatively impacted the Company's 2004 profitability. Management expects the increase in steel prices will continue to negatively impact the Company's profitability during 2005. In addition to steel, we use other raw materials, specifically in our paper production process, where a shortage of supply could negatively impact our profitability and our ability to deliver to customers. Other potential future impacts on the Company from the current market conditions could include reduced delivery levels of finished products to customers due to reduced availability of materials.

Patents and Trademarks

Raytech owns a number of patents, both foreign and domestic. Such patents expire between 2006 and 2023. In the opinion of management, our business is not dependent upon the protection of any of its patents and would not be materially affected by the expiration of any of such patents. We operate under a number of registered and common law trademarks, including the trademark "RAYBESTOS." Certain trademarks have been licensed to others on a limited basis. Some trademarks are registered internationally.

Competition

The automotive parts industry is extremely competitive. Each of the Company's operating segments competes with several other manufacturers that produce and sell similar products. Some of our competitors are considerably larger and have substantially greater financial resources than the Company. The wet friction marketplace is comprised of four major competitors, including the Company. The Company has one major competitor in the European dry friction marketplace and competes with several Chinese and other Asian based manufacturers in the Asian market. In the European Dry Friction market, several of the Company's customers are also competitors. There are five major competitors, including the Company, in the Aftermarket segment. Raytech believes that it is competitive in all markets in which it is engaged due to its brand recognition, product quality, service and price.

The Company's businesses are greatly affected by general economic conditions. We are in large part dependent upon consumer demand for automobiles, consumer confidence and business investment in heavy equipment. We are a relatively small supplier of a limited number of components. Our customers are large companies under pressure to cut component costs. The Domestic Wet Friction segment's OEM customers are experiencing margin erosion due to reduced volume, high labor costs and intense foreign competition. Due to their size, our customers are often able to demand component price reductions from their suppliers including the Company. These customers may also demand technological changes and quality improvements at the Company's expense. The Company's competitors have substantially greater resources to respond to these competitive conditions.

Significant Customers

During the years presented, sales to the following customers were greater than 10 percent of the Company's consolidated sales during at least one of the years presented:

	For the Year Ended Jan. 2, 2005	**For the Year Ended Dec. 28, 2003**	**For the Year Ended Dec. 29, 2002**
Caterpillar	11.9%	9.5%	11.4%
DaimlerChrysler	10.1%	12.4%	14.4%

The Company's largest customers, including those listed above, have unionized work forces and could be subject to plant shutdowns in the event of a labor dispute, which could adversely affect the Company's shipments to those customers and the Company's revenues.

From time to time, the Company loses business from existing customers, including its largest customers, due to pricing, technologicial or other competitive pressures. The Company also from time to time gains new business and renewals of existing business from existing or new customers through its continuing cost reduction, sales and development efforts. The cumulative effect of these changes, or the loss of one of its largest customers, could have a material adverse effect on the consolidated financial results of the Company.

Backlog

Sales backlog at the end of fiscal 2004 and 2003, by segment, was as follows:

(in millions)	**2004**	**2003**
Domestic Wet Friction	$ 81.1	$ 76.7
International	25.0	15.6
Aftermarket	2.8	1.5
Total	$ 108.9	$ 93.8

The Company expects that the current backlog will be filled during 2005.

Employees

At January 2, 2005, Raytech employed 1,704 employees, compared with 1,565 employees at the end of 2003. Raytech has agreements with labor unions relating to wages, hours, fringe benefits and other conditions of employment which cover most of its production employees. The labor contract at Raybestos Products Company (“RPC”) in Crawfordsville, Indiana, is due to expire in May 2006. The labor contract at Raybestos Automotive Components Company (“RACC”) in Sterling Heights, Michigan, was renegotiated in 2004 and is due to expire in September 2007. In addition to the customary provisions of such an agreement, the new union contract at RACC provides for severance benefits in the event of a plant closure. The Company’s German subsidiary is a member of an industry employers’ association that is party to various employee union contracts on behalf of its members. The current contract covering German employees’ wages continues through February 2006.

Capital Expenditures

Capital expenditures were $6.7 million, $9.0 million and $9.6 million for fiscal years 2004, 2003 and 2002. Capital expenditures for 2005 are budgeted at $10.7 million. The 2005 capital expenditure budget includes $1.2 million related to the expansion of our operations in China.

Research and Development

Research and development costs were approximately $6.6 million, $7.2 million and $7.3 million in fiscal years 2004, 2003 and 2002, respectively. Separate research and development facilities are maintained at the Crawfordsville, Indiana and Morbach, Germany plants for developing new products, improving existing production techniques and supplying technical service to the business units and customers. During 2004, the Company consolidated the research and development activities that had been performed at the Sterling Heights, Michigan facility into the Crawfordsville, Indiana facility. Research and development costs for 2005 are budgeted at $5.3 million.

Environmental Matters

The Company is subject to federal, state, local and foreign laws and regulations governing the discharge of materials into the environment or otherwise relating to the protection of the environment (“Environmental Laws”). The cost to the Company of complying with these Environmental Laws was approximately $1.2 million during 2004, and it is projected at $1.2 million for 2005. Estimated capital expenditures for environmental control facilities for 2005 are budgeted to be $.6 million. Substantial unanticipated environmental costs could adversely affect profitability.

The compliance costs noted above exclude remediation and related costs incurred by the Company for the same periods. The Company is subject to substantial environmental remediation obligations for past contamination that are not yet fixed in scope or amount. The nature of environmental contamination and its remediation are such that the amount and nature of work necessary is often unknown until late in the process. The level of responsibility of the parties involved and the level of remediation to be required by governmental authorities is also uncertain. See Item 3 - Legal Proceedings for a full description of remediation costs.

Item 2. Properties

The Company conducts business at the following facilities:

The Domestic Wet Friction segment has facilities in Crawfordsville, Indiana and Sterling Heights, Michigan. The Crawfordsville, Indiana, facility is owned and consists of approximately 461,000 square feet of office, production, research and warehousing space. The Sterling Heights, Michigan, facility is owned and consists of approximately 111,000 square feet of office, production, research and warehousing space. The Domestic Wet Friction operation also leases sales office space in Peoria, Illinois and Troy, Michigan and warehouse space in Crawfordsville, Indiana. As a result of a facilities review, the Company has decided to close the Sterling Heights, Michigan manufacturing facility in 2005 and intends to offer the real estate for sale.

The International segment has facilities in Liverpool, England, Morbach, Germany and Suzhou, China and leases a sales office in Shanghai, China. The Liverpool, England, facility is leased and consists of 52,000 square feet of office, production, and warehousing space. The Morbach, Germany, facility is owned and consists of 108,000 square feet of office, production, research and warehousing space. The Suzhou, China, facility is owned and consists of 52,000 square feet of office, production, and warehousing space on a long-term land lease. As a result of a facilities review, the Company has decided to close the Liverpool facility in 2005.

The Aftermarket segment has two facilities in Sullivan, Indiana, that are owned and consist of 130,000 and 37,500 square feet of office and warehousing space. These facilities are underutilized, leaving space for future demand. A separate Crawfordsville, Indiana, aftermarket facility is owned and consists of approximately 41,000 square feet. A portion of this facility has been leased to the Company’s Domestic Wet Friction segment; the remaining space houses sales offices. The Aftermarket segment also leases sales office space in Floral Park, New York.

The Company also leases 7,000 square feet of office space in Shelton, Connecticut, for its headquarters staff. In December 2004, the Company decided to relocate its corporate functions to its Crawfordsville, Indiana facility and to close the Shelton office in 2005.

The Company believes that its properties are suitable and adequate and have sufficient production capacity to meet the reasonably anticipated demand for the Company’s products.

The Company’s operating lease commitments are discussed in Note 15 - Commitments to the Consolidated Financial Statements.

Item 3. Legal Proceedings

Environmental Remediation

Crawfordsville, Indiana - Shelly Ditch Contamination Removal

In October 1987, RPC, a wholly-owned subsidiary of the Company, purchased a major manufacturing facility (the "RPC Facility") in Crawfordsville, Indiana. Sometime thereafter, the Company learned that the previous owner of the RPC Facility had released polychlorinated biphenyls ("PCBs") to the ground at the RPC Facility in the mid-1960s and that such PCBs were leaching from the RPC Facility into an adjacent ditch ("Shelly Ditch").

In 1996, the Indiana Department of Environmental Management (the "IDEM") advised RPC that the RPC Facility may have contributed to, and was potentially responsible for, the release of lead and PCBs found in Shelly Ditch. In the late 1990s, RPC and the IDEM entered into an agreed order (the "Agreed Order") for a risk-based remediation of PCBs and lead in Shelly Ditch. When the IDEM later sought to unilaterally withdraw from the Agreed Order, RPC appealed and the Marion County Superior Court ordered the IDEM to reinstate the Agreed Order. Meanwhile, at the IDEM's request, the United States Environmental Protection Agency (the "EPA") became involved in Shelly Ditch.

In December 2000, before the Agreed Order was reinstated, the EPA issued a Unilateral Administrative Order to RPC under CERCLA (the "EPA Removal Order") demanding removal of contaminated soils from those Shelly Ditch areas identified as Reaches 1 through 3 (the "Site"). The EPA Removal Order required more work at greater expense than the IDEM Agreed Order. Thereafter, RPC proceeded with the work required under the EPA Removal Order.

On January 9, 2004, the EPA confirmed that RPC had completed the action required under the EPA Removal Order, including the removal and proper disposal of Site soils and sediments contaminated with PCBs and lead. In its confirmation, the EPA noted that RPC would continue to be subject to certain obligations under that order, including record retention and the payment of oversight costs. Whether RPC will be required to pay oversight costs relating to the work under the EPA Removal Order will depend on the outcome of future negotiations with the EPA regarding potential environmental remediation downstream of the Site.

At January 2, 2005, RPC had spent approximately $18.7 million on removal of lead and PCB contaminated soils from the Site and had accrued $.4 million for potential EPA oversight costs relating to that work.

Crawfordsville, IN - Environmental Remediation Downstream of the Site

On May 6, 2003, the EPA indicated that RPC is potentially liable for PCB and lead contamination downstream of the Site. The EPA has not issued an order to RPC regarding this downstream area. However, during the third quarter of 2003, the Company began negotiations with the EPA concerning such possible additional remediation. As a result, during the third quarter of 2003, the Company recorded a $2.4 million accrual relating to this potential liability for future cleanup costs. The Company has an accrual of $2.2 million at January 2, 2005 related to this matter.

Crawfordsville, IN - Environmental Remediation and Expenses relating to the RPC Facility

On May 15, 2001, the EPA issued a Pre-filing Notice and Opportunity to Confer to RPC (the "Pre-filing Notice"). This notice stated that the EPA might file a civil action lawsuit against RPC for violations of various environmental statutes and would offer RPC the opportunity to participate in pre-filing negotiations to resolve this matter. The EPA stated that it had reason to believe that RPC committed violations of the Clean Air Act, Clean Water Act, Resource Conservation and Recovery Act, and Toxic Substances Control Act and that RPC could be subject to substantial penalties. On September 3, 2003, the EPA proposed that the parties settle the Pre-filing Notice. The EPA stated that penalties for violations alleged in the Pre-filing Notice could total approximately $180.0 million and suggested the

following resolution: RPC should pay approximately $2.4 million in fines and undertake compliance activities, on-site investigative work that the EPA estimated would cost about $1.0 million, and corrective action to resolve the Pre-filing Notice. During 2004, RPC performed on-site investigative work. RPC is currently engaged in negotiations with the EPA regarding potential on-site corrective action and the amount of any penalty. The Company has an accrual of $3.4 million as of January 2, 2005, based on the EPA position.

Ferndale, MI - Potential Responsibility for Environmental Remediation

In a January 8, 2002 letter, the Michigan Department of Environmental Quality asserted Company responsibility for trichloroethylene contamination at a Ferndale, Michigan industrial site that Advanced Friction Materials Company ("AFM") leased from approximately 1974 to 1985. The Company acquired 47% of the stock of AFM in 1996 and the balance of the shares in 1998. The Company's liability at this site is indeterminable at this time and no liability has been recorded as of January 2, 2005.

Environmental Litigation

Cost Recovery Actions against Insurers regarding Shelly Ditch

In 1996, RPC notified its insurers and demanded defense and indemnity regarding any environmental issues relating to alleged lead and PCB contamination of Shelly Ditch. In January 1997, one insurer filed a complaint in the U.S. District Court, Southern District of Indiana, captioned Reliance Insurance Company vs. Raybestos Products Company (the "Insurance Case"). The complaint sought a declaratory judgment that the Reliance Insurance policies do not provide coverage to RPC for defense and indemnity relating to investigation and remediation of contamination in Shelly Ditch. In January 2000, the District Court rejected Reliance's claims and granted summary judgment to RPC. In June 2001, Reliance Insurance Company was placed in liquidation in Pennsylvania. The Company has filed claims in the Reliance liquidation for recovery of its Shelly Ditch expenses but has not received a decision.

In February 2002, RPC filed a third-party complaint in the Insurance Case against three insurance carriers. The third-party complaint seeks defense and indemnity from the insurers relating to investigation and remediation of contamination in Shelly Ditch. Later that year, two of the insurance carriers, USF&G and Westchester, filed motions to compel arbitration of the insurance coverage issues under these policies. The U.S. District Court denied these motions to compel and the two insurance companies appealed to the U.S. Court of Appeals for the Seventh Circuit ("Appeals Court"). On August 27, 2004, the Court of Appeals reversed the District Court's order refusing to compel such arbitration and remanded the case to the District Court for entry of an order compelling arbitration. On October 15, 2004, the District Court entered its order compelling arbitration and RPC promptly submitted the USF&G and Westchester insurance issues to arbitration. The arbitration is currently scheduled to take place during January 2006.

In February 2004, the third insurance carrier, National Union and its affiliates, commenced an adversary proceeding against the Company, RPC and others by filing a complaint in U.S. Bankruptcy Court (the "Adversary Proceeding"). In the Adversary Proceeding, National Union claims that RPC's complaint against National Union is barred by a 2002 order of the U.S. Bankruptcy Court in the Raymark Chapter 11 cases that prohibits RPC from pursuing its third-party complaint against National Union and declares that the National Union insurance policies issued to the Company and RPC have been exhausted. Also in February 2004, National Union filed a motion in the U.S. District Court, Southern District of Indiana, asking that court to stay the Insurance Case against National Union. On September 10, 2004, the U.S. District Court granted National Union's motion for stay. The outcome of this Adversary Proceeding and related stay and their effects, if any, on the Insurance Case against National Union cannot be predicted.

RPC Claims against IDEM

In July 2002, RPC filed an action against the IDEM for breach of contract claiming damages based on the difference between the costs of cleanup under the EPA Removal Order and the IDEM Agreed Order. The outcome of this litigation cannot be predicted.

Commercial Litigation

On April 22, 2003, Automation by Design, Inc. (“ABD”) filed a civil action against RPC in U.S. District Court for the Southern District of Indiana. The complaint alleged copyright infringement and breach of contract in connection with RPC’s purchase of certain equipment. RPC denied liability and filed counterclaims for breach of contract and declaratory judgment. The court granted ABD’s motion to amend its complaint to include as defendants Raytech Corporation and Production Design Services, Inc., which manufactured certain equipment allegedly involved in this court action and which RPC agreed to defend and indemnify against certain liabilities. On December 8, 2004, the District Court granted RPC’s motion for summary judgment, ruling that ABD’s claims fail as a matter of law. In January 2005, RPC filed a petition for reimbursement of its legal fees and costs incurred in defending the action. ABD has filed an appeal of the summary judgment ruling. The Company does not believe that the outcome of this litigation will have a material adverse effect on its consolidated results of operations, financial condition or cash flow.

Equity Holders Litigation

In February 2002, lawyers representing the Committee of Equity Holders of Raytech Corporation filed a motion in U.S. Bankruptcy Court to compel the Company to either issue up to approximately 700,000 additional shares to the pre-reorganization holders of shares in the Company or their successors, or to proportionately reduce the shareholdings of the general unsecured creditor shareholders under the Plan of Reorganization. On October 27, 2004 the Bankruptcy Court approved a settlement of the Equity Holders litigation, pursuant to which each “Record Date Registered Holder”, as defined in Section 4 of the approved settlement agreement, was entitled to receive a payment of $0.16 per share. These payments, plus other payments required under the settlement, were $.6 million, which was accrued by the Company during the third quarter of 2004 and paid by the Company during the fourth quarter of 2004. The payment of these costs was funded by the Company’s majority shareholder. The Company has recorded a liability to its majority shareholder for this amount on its books at January 2, 2005.

The Company is subject to certain other legal matters that have arisen in the ordinary course of business, and management does not expect them to have a significant adverse effect on the Company’s results of consolidated operations, financial condition or cash flow.

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

There were no matters submitted to a vote of security holders during the fourth quarter of 2004.

Part II.

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's common stock is traded on the New York Stock Exchange under the trading symbol RAY. As of March 11, 2005, there were 1,469 holders of record of the Company's common stock.

Information regarding the quarterly high and low sales prices for 2004 and 2003 is set forth in Note 21 to the Consolidated Financial Statements, Part II, Item 8 hereof.

The Company continues not to pay dividends. As a holding company, Raytech Corporation's ability to pay dividends is dependent upon the receipt of dividends or other payments from its subsidiaries. The payment of dividends by certain of the Company's subsidiaries is subject to certain restrictions under the Company's credit agreements. See Note 8 - Debt to the Consolidated Financial Statements.

Information regarding securities authorized for issuance under equity compensation plans is included in Part III, Item 12 hereof.

Item 6. Selected Financial Data

Selected historical consolidated financial data is presented below for the most recent five fiscal years. The information is separated between Predecessor Company, pre-emergence from bankruptcy, and Successor Company, post-emergence from bankruptcy. As a result of reorganization and fresh-start adjustments recorded in conjunction with the Company's emergence from bankruptcy, the financial data of the Successor Company for the years ended January 2, 2005, December 28, 2003, December 29, 2002 and the period April 3, 2001 to December 30, 2001 are not comparable to the Predecessor Company for the period January 1, 2001 to April 2, 2001 and for the year ended December 30, 2000.

The effective date of the Company's reorganization was April 18, 2001, however for accounting purposes, the reorganization and the related fresh-start adjustments were recorded as of April 2, 2001.

FIVE-YEAR REVIEW OF OPERATIONS
(in thousands, except per share data)

	Successor Company				**Predecessor Company**	
	Year Ended Jan. 2, 2005	Year Ended Dec. 28 2003	Year Ended Dec. 29 2002	Period Apr 3, 2001 to Dec. 30, 2001	Period Jan 1, 2001 to Apr. 2, 2001 (6)	Year Ended Dec. 30, 2000
Operating results:						
Net sales	$ 227,313	$ 205,865	$ 209,866	$ 146,050		

$
55,205

$
239,532

Gross profit

40,935

26,126

36,771

21,460

11,394

59,489

Operating (loss) profit [1]

(3,051
)

(57,473
)

4,440

(3,291
)

3,652

27,215

Interest expense [2]

1,231

1,061

903

873

444

2,218

Gain on settlement of debt [3]	—	—	—	1,548	—	—
Reorganization items [4]	—	—	—	(784)	7,158,896	—
Net (loss) income [1] [4] [5]	(2,750)	(66,443)	(2,825)	(5,577)	6,995,257	(7,058,978)
Share data:						
Basic (loss) earnings						

per share [1] [4] [5]

$
(.07
)
$
(1.59
)
$
(.07
)
$
(.13
)
$
1,778.88

$
(2,015.40
)
Weighted average

basic shares

41,737

41,728

41,608

41,527

3,932

3,503

Diluted (loss) earnings

per share [1] [4] [5]

$
(.07
)
$
(1.59
)
$
(.07
)
$
(.13

)
$
1,772.62

$
(2,015.40
)
Weighted average

diluted shares

41,737

41,728

41,608

41,527

3,946

3,503

Balance Sheet (at period end):

Total assets

$
205,686

$
206,024

$
294,221

$
320,788

$
323,636

$
320,316

Working capital

33,653

25,414

23,317

28,157

26,753

21,402

Long-term obligations [7]

71,707
71,772
82,850
85,410
69,330
31,238

Liabilities subject to

compromise [5]

—

—

—

—

—

7,211,433

Total shareholders'

equity (deficit)

73,180

75,910

142,110

144,083

158,352

(6,979,138
)

Property, plant and equipment:

Capital expenditures

	$ 6,668
	$ 8,968
	$ 9,648
	$ 7,488
	$ 2,717
	$ 13,539
Depreciation	14,267
	16,107
	14,943
	10,585
	3,180
	11,545

(1) 2004 includes $1.6 million impairment charge. 2003 includes $48.8 million impairment charge. See Note 6 - Property, Plant and Equipment and Note 7 - Goodwill and Other Intangible Assets to the Consolidated Financial Statements.

(2) Predecessor Company includes cessation of interest accruals on the Raymark note in connection with a Bankruptcy Court Order.

(3) Represents gain on the settlement of a note payable to a former AFM principal. Prior to the settlement, the Company had a note payable of $3.0 million and accrued interest of $1.6 million recorded related to this debt. The settlement agreement required a payment of $3.1 million.

(4) Reorganization items include fresh-start accounting adjustments, gain on the settlement of liabilities subject to compromise and professional fees.

(5) The year ended December 30, 2000 includes recording of the estimated amount of allowed claims in the amount of $7.2 billion relating to asbestos personal injury, environmental and employee benefits issues.

(6) Includes the reorganization and the adoption of fresh-start reporting as a result of the Company's emergence from bankruptcy.

(7) Includes long-term liabilities and minority interest.

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

The following discussion should be read in conjunction with the Consolidated Financial Statements, including the related notes, included in “Item 8 - Financial Statements and Supplemental Data.” This discussion contains forward-looking statements that are subject to significant risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those described in the section entitled "Caution Regarding Forward Looking Statements.” Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect our present expectations and analysis and are inherently susceptible to uncertainty and changes in circumstances. 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.

Executive Summary

On January 2, 2005 we completed our third full year of operation post emergence from bankruptcy. We continue to face significant challenges as we look toward our future. Reduced volumes in the U.S. auto industry and new transmission technology have had a dramatic impact on our business. In order to succeed in the current environment we need to adapt and seek alternatives to improve our operating results.

The Company’s businesses are greatly affected by general economic conditions. Our businesses sell components for transmissions and brakes to automotive and heavy-duty OEMs as well as the automotive aftermarket, and in large part are dependent upon consumer demand for automobiles, consumer confidence and business investment in heavy equipment. Economic conditions may adversely affect revenues in all of our business segments.

The Company’s customers are large companies under pressure to cut component costs. In particular, the Domestic Wet Friction segment’s largest customers are experiencing margin erosion due to reduced volume, high labor and benefit costs and intense foreign competition. We are a relatively small supplier of a limited number of components. Due to their size, our customers are often able to demand component price reductions from their suppliers, including all segments of the Company. These customers may also demand technological changes and quality improvements at our expense. In addition, the trend in the automotive aftermarket is toward longer transmission service and replacement cycles due to improved quality. Our revenues and margins may be adversely affected by these factors.

During the first quarter of 2004, the Company restructured its operating segments to facilitate a stronger focus on the European wet friction operations. Management of the European wet friction operations, RRT and RUK and sales of wet friction products outside of North America, was transferred to the European management team. The newly defined operating segments are Domestic Wet Friction, International (including the European wet friction operations and European and Asian dry friction operations), and Aftermarket. All prior period segment information presented has been restated to reflect the newly defined segments.

Although we are reporting an operating loss for 2004, there are many positive items to discuss regarding our performance. All three of our operating segments reported increased sales, improved gross margin and improved operating profit in 2004.

The Domestic Wet Friction segment, most directly impacted by the decline in the U.S. auto market, managed to increase sales modestly due to increased volume in the heavy-duty sector partially offset by the continued decline in volume in the automotive sector. The segment was able to improve gross margin performance as a result of the volume increase, cost reductions and the non-recurrence of certain one-time charges incurred during 2003.

The International segment benefited from increasing demand in China and to a lesser degree in Europe. During 2004, we began a third expansion of our operations in China. When completed, the new facility in China will increase our

capacity, positioning us to take advantage of the growing market in China and increase our exports from China.

The Aftermarket segment grew sales through expanding its foreign customer base and increased volume in newer product lines including gaskets and solenoids. Subsequent to the end of fiscal 2004, but prior to filing this report, we increased the Company's indirect ownership of Allomatic Products Company ("APC"), a company within our Aftermarket segment, from approximately 57% of its outstanding common stock to approximately 96% of its outstanding common stock. See Note 22 - Subsequent Event to the Consolidated Financial Statements.

In 2004, worldwide increases in steel demand led to increased prices, which negatively impacted our profitability. However, the Company was able to mitigate the impact of the increase in steel cost through increased sales prices and increased proceeds from the sale of scrap steel. We expect the increase in the price of steel, net of any benefit derived from increased sales prices and proceeds from scrap sales, will continue to negatively impact our profitability during 2005. In addition to steel, we use other raw materials, specifically in our paper production process, where a shortage of supply could negatively impact our profitability and our ability to deliver to customers.

During the second quarter of 2004, the Company's President and Chief Executive Officer retired. The board of directors has named an interim President and Chief Executive Officer, Larry Singleton, from a financial advisory and consulting firm, effective June 1, 2004. The Company is obligated to pay that firm a monthly fee. In addition to the monthly fee, the Company has agreed to pay a one-time success fee of $.2 million, which was accrued as of January 2, 2005.

During the third quarter of 2004, we reorganized our domestic management team. The purpose of this reorganization was to centralize and streamline the management of the domestic sales, research and manufacturing activities.

On October 26, 2004, the Board of Directors of the Company approved decisions of the Boards of Directors of RACC, and RUK, its indirect wholly-owned subsidiaries, that those companies should completely close their manufacturing facilities. The decisions were the result of a facilities utilization review indicating that improved overhead absorption and performance might be obtained through consolidation of the Company's facilities. The manufacturing operations of RACC are located in Sterling Heights, Michigan. Our best estimate of the timing of the RACC closing, which will depend on production requirements and commitments to customers, is that it will be completed by the end of 2005. The manufacturing operations of RUK are located in Liverpool, England. Manufacturing at the RUK facility ended during March of 2005, however, the removal of equipment and other exit activities will continue over the next few months.

During the fourth quarter of 2004, we reached terms with certain major customers on revised sales contract provisions that will enable the Company to close its manufacturing plant in Sterling Heights, Michigan. The new sales contract provisions, in addition to more favorable pricing, allow the Company to transfer the production of certain products to other facilities and to discontinue the production of other products upon closure of the Sterling Heights, Michigan facility. In some cases the new pricing was retroactive to July or August of 2004. The impact of the retroactive price increase was approximately $.8 million which will be recognized, prospectively over the estimated remaining period of production for those customers.

We believe that the changes that have occurred in our industry are fundamental and will be long-term. In order to succeed and return to profitability, we must adapt to the new climate and reduce our costs while continuing to manage our resources. We have taken steps during 2004 to lower our costs and increase our revenues. Certain of the steps taken during 2004 will have a negative impact on our operating cash flows in 2005. As we move forward, and embark on strategic initiatives to enhance our operating profitability, we need to be cognizant of managing our working capital and other financial resources to ensure our future liquidity. We will continue to reassess our operating and business strategy to determine the best use of our resources and will attempt to identify strategic initiatives that we might pursue to improve our performance.

Results of Operations

The following table sets forth selected data from the statement of operations for the Company for the fiscal years ended January 2, 2005, December 28, 2003 and December 29, 2002:

(amounts in thousands)	**Fiscal 2004**	**% of sales**	**Fiscal 2003**	**% of sales**	**Fiscal 2002**	**% of sales**
Net sales	$ 227,313	100.0%	$ 205,865	100.0%	$ 209,866	100.0%
Gross profit	40,935	18.0	26,126	12.7	36,771	17.5
Selling, general and administrative expense	39,014	17.2	34,795	16.9	32,331	15.4
Impairment charge	1,560	.7	48,804	23.7	—	—
Restructuring expenses	3,412	1.5	—	—	—	—
Operating (loss) profit	(3,051)	-1.3	(57,473)	-27.9	4,440	2.1
Other income (expense)	2,828	1.2	25,666	12.5	(726)	-.3
Environmental claims	—	—	(7,262)	-3.5	(5,400)	-2.6
Income (loss) before income taxes and minority interest	(223)	-.1	(39,069)	-19.0	(1,686)	-.8
Income taxes	1,895	.8	26,745	13.0	84	0
Minority interest	632	.3	629	.3	1,055	.5
Net loss	$ (2,750)	-1.2%	$ (66,443)	-32.3%	$ (2,825)	-1.3%

Fiscal 2004 Compared to Fiscal 2003

Sales increased in all three of our operating segments in 2004 compared to 2003 levels. As a result, worldwide sales increased $21.4 million or 10.4% in 2004 compared to the prior year. The increase in sales was due primarily to increased demand in the heavy-duty component of the Domestic Wet Friction segment, increased demand in China and Europe, expansion into foreign markets and increased product offerings in the Aftermarket segment and favorable currency translation adjustments in Europe. We continue to experience pressure to reduce prices from certain major customers, most notably in the Domestic OEM market and to a lesser degree in China and Europe.

Gross profit increased $14.8 million or 56.7% in 2004 compared to the prior year. As a percent of sales, gross profit improved to 18.0% from 12.7% in 2003. Gross margin performance improved in all three operating segments. The Domestic Wet Friction segment realized the most significant improvement in gross margin as a result of the implementation of cost reduction programs and the non-recurrence of certain one-time expenses incurred during the fourth quarter of 2003. The International segment benefited from favorable currency translation adjustments, a modest increase in demand and increased sales of higher margin products. The Aftermarket segment benefited from increased sales of its high margin friction plate line, principally to new foreign customers.

SG&A increased $4.2 million or 12.1% in 2004 compared to 2003. As a percent of sales, SG&A expense increased slightly to 17.2% from 16.9% in the prior year. The overall increase in SG&A expense was due principally to

severance costs, increased consulting costs, increased incentive compensation expense and currency translation, partially offset by operating cost reductions. The severance expense charged to SG&A during 2004 related to the retirement of our President and Chief Executive and a reorganization of the domestic management team.

The restructuring expense and impairment charge recorded in 2004 relate to the announced closure of our manufacturing facilities in Sterling Heights, Michigan and Liverpool, England and the relocation of our corporate functions. See Note 3 - Restructuring Costs to the Consolidated Financial Statements for further details regarding the 2004 restructuring costs. The impairment charge recorded in 2003 related to the write down of certain tangible and intangible assets triggered by the decline in profitability in the Domestic Wet Friction segment during 2003.

As a result of the foregoing, operating losses were reduced $54.4 million year over year.

Other income, in both 2004 and 2003, is principally the result of the reduction of certain net deferred tax assets and the corresponding payable to the PI Trust. This is explained more fully in Note 11 - Income Taxes to the Consolidated Financial Statements. Additionally, the cost associated with settlement of the equity holders litigation, during 2004, is reported in this line. This is explained more fully in Note 9 - Litigation to the Consolidated Financial Statements.

The Company is subject to substantial environmental remediation obligations for past contamination that are not yet fixed in scope or amount. The nature of environmental contamination and its remediation is such that the amount and nature of work necessary is often unknown until late in the process. The level of responsibility of the parties involved and the level of remediation to be required by governmental authorities is also uncertain. The Company also incurs substantial ongoing environmental compliance costs in operating its production facilities. Substantial unanticipated environmental costs could adversely affect profitability. Environmental claims are discussed in Item 3. Legal Proceedings -- Environmental Remediation and Environmental Investigation.

The minority interest expense relates to APC, which is 57% owned by the Company, 40% owned by Raymark, a related party, and 3% owned by certain employees of the Company. APC is consolidated in the financial results and a minority interest is recorded to reflect the minority shareholders' interest in APC. On March 21, 2005, the Company, through its majority owned subsidiary, APC, purchased the APC common stock owned by Raymark in exchange for a ten-year unsecured subordinated promissory note in the original principal amount of $7.2 million. See Note 22 - Subsequent Event to the Consolidated Financial Statements.

Fiscal 2003 Compared to Fiscal 2002

Worldwide sales decreased $4.0 million or 1.9% in 2003 compared to 2002. Although the overall decline in sales was only 1.9%, by segment the fluctuations year-over-year were more significant. The Domestic Wet Friction segment's sales declined 9.5% reflecting lower demand from our domestic OEM customers. Sales in the International segment increased 15.8%, principally due to favorable currency translation adjustments and a modest increase in demand for dry friction products. Sales decreased modestly in the Aftermarket segment reflecting lower demand.

Gross profit decreased $10.6 million or 28.9% in 2003 compared to 2002. As a percent of sales, gross profit decreased to 12.7% from 17.5% in 2002. The decline in gross profit as a percentage of sales was due principally to the decline in the wet friction business, partially offset by increased gross margin in the dry friction business.

SG&A expense increased $2.5 million or 7.6% in 2003 compared to 2002. As a percent of sales, SG&A increased to 16.9% compared to 15.4% in 2002. The increase was driven by certain severance and new hire costs in the Domestic Wet Friction segment and an additional provision for certain trade accounts receivable in the Aftermarket segment. Additionally, the International segment incurred increased SG&A in support of higher sales volume.

Other income in 2003 is principally the result of the reduction of certain net deferred tax assets and the corresponding payable to the PI Trust. This is explained more fully in Note 11 - Income Taxes to the Consolidated Financial Statements.

Environmental claims are discussed in Item 3. Legal Proceedings -- Environmental Remediation and Environmental Investigation.

Domestic Wet Friction

The following table sets forth selected data from the statement of operations for the Domestic Wet Friction segment for the fiscal years ended January 2, 2005, December 28, 2003 and December 29, 2002:

(amounts in thousands)	Fiscal 2004	% of sales	Fiscal 2003	% of sales	Fiscal 2002	% of sales
Net sales	$ 128,892	100.00%	$ 119,002	100.00%	$ 131,445	100.00%
Gross profit	12,926	10.0	4,563	3.8	18,784	14.3
Selling, general and administrative expense	11,578	9.0	12,756	10.7	12,023	9.1
Impairment charge	—	—	8,093	6.8	—	—
Restructuring expenses	1,723	1.3	—	—	—	—
Operating (loss) profit	(375)	-0.3	(16,286)	-13.7	6,761	5.1

Fiscal 2004 Compared to Fiscal 2003

Sales for the Domestic Wet Friction segment increased $9.9 million or 8.3% in 2004 compared to 2003. The increase in sales year over year is principally due to increase in heavy-duty volume, offset partially by a decrease in automotive volume. Although this segment continues to experience pricing pressure from customers, in the fourth quarter of 2004 we reached terms with certain major customers that included more favorable pricing. The net impact of the price changes in 2004 was not significant to the overall change in sales.

Gross profit increased $8.4 million or 183.3% in 2004 compared to the prior year. Gross profit as a percent of sales increased to 10.0% in 2004 from 3.8% in 2003. Overall, the improvement in gross profit is due to cost reductions and increased leverage on fixed costs due to higher sales volume. As a result of the impairment charge recorded during the fourth quarter of 2003, depreciation expense was reduced by $1.0 million in 2004. During 2003 we established a reserve for the expected loss on products in inventory and customer purchase orders received by the balance sheet date, in the amount of $1.5 million. Finally, the increase in the price of steel resulted in an increase of our raw material costs that was partially offset through increased sales prices and increased proceeds from the sale of scrap steel.

The Domestic Wet Friction segment sells product to its customers, in certain instances, using longer-term contracts that include price commitments for multiple years. In some cases these contracts stipulate price reductions in future years that may negatively impact on our gross profit.

SG&A expense decreased $1.2 million or 9.2% in 2004 compared to 2003. The decrease in SG&A expense is principally due to the consolidation of the research and development activities that had been performed at the Sterling Heights, Michigan facility into the Crawfordsville, Indiana facility during March of this year and an increased emphasis on managing expenses, partially offset by increased freight costs.

The impairment charge recorded in 2003 related to the write-down of the segment’s long-lived assets triggered by the marked decline in profitability.

The restructuring expense recorded in 2004 relates to the planned closure of our manufacturing facility in Sterling Heights, Michigan. See Note 3 - Restructuring Cost to the Consolidated Financial Statements for further details regarding the 2004 restructuring costs.

As a result of the foregoing, operating losses were reduced $15.9 million in 2004 compared to the prior year.

The Company continues to review alternatives to improve the operating results for this segment. Actions taken or being contemplated are as follows:

- During the first quarter of 2004, the Company reorganized its operating segments to facilitate a stronger focus on the European wet friction operations. Oversight of the European wet friction operations, RRT and RUK, was transferred to the European management team.
- During March of 2004, the technical center located in Sterling Heights, Michigan was closed. The research and development activities, that had been conducted at this facility, were consolidated into the Crawfordsville, Indiana facility. The automotive sales and applications engineering groups previously located in this building have been relocated to a nearby office building in the Detroit area.

- The Company has implemented cost savings programs during 2004 and is continuing to evaluate all aspects of its operations for additional cost savings alternatives.
- During the third quarter of 2004, the Company announced a domestic management reorganization. The purpose of the management reorganization is to centralize and streamline the management of the domestic sales, research and manufacturing activities.
- The Company has conducted a facilities utilization review and has determined that improved performance can be obtained through the closure of its facility located in Sterling Heights, Michigan. The Company's plan for the closure of this facility is discussed more fully in Note 3 - Restructuring Costs to the Consolidated Financial Statements.
- During the fourth quarter of 2004 we reached terms with certain major customers on more favorable pricing. We continue to work with certain other customers to negotiate more favorable pricing.
- The Company has reached terms with certain customers to transfer production of certain profitable product lines to other facilities upon the closure of the Sterling Heights, Michigan manufacturing facility.

Fiscal 2003 Compared to Fiscal 2002

Sales for the Domestic Wet Friction segment decreased $12.4 million or 9.5% in 2003 compared to 2002. The decline in sales is due to lower sales to the automotive OEM component of the segment of $4.5 million, due to lower demand for our product and reduced pricing. The domestic automotive manufacturers, who comprise our OEM customers, continued to lose market share to foreign competition, which directly impacts Raytech. A significant portion of the lost North American market share had been consumed by Asian automakers, a market we have not penetrated. In addition, sales to the heavy-duty component of the segment declined $5.0 million compared to the prior year. The decline represents certain part sales lost to competition as well as price reductions.

Gross profit declined $14.2 million or 75.7%, in 2003 compared to the prior year. The decline in gross profit reflects the impact of lower sales and reduced pricing. Gross profit was negatively impacted during 2003 by the establishment of a reserve for the expected loss on products in inventory and customer purchase orders received by the balance sheet date in the amount of $1.5 million. The lack of gross profit in this segment was the driving force in the losses sustained by the Company in 2003.

SG&A expense increased $.7 million or 6.1% in 2003 compared to 2002. The increased costs were principally due to certain severance and new hire costs.

The impairment charge recorded in 2003 related to the write-down of the segment’s long-lived assets triggered by the marked decline in profitability.

As a result of the above, operating profit decreased $23.0 million or 340.9% in 2003 compared to 2002.

International

The following table sets forth selected data from the statement of operations for the International segment for the fiscal years ended January 2, 2005, December 28, 2003 and December 29, 2002:

(amounts in thousands)	**Fiscal 2004**	**% of sales**	**Fiscal 2003**	**% of sales**	**Fiscal 2002**	**% of sales**
Net sales	$ 67,433	100.0%	$ 56,698	100.0%	$ 48,981	100.0%
Gross profit	18,487	27.4	14,064	24.8	9,796	20.0
Selling, general and administrative expense	11,025	16.3	9,808	17.3	8,366	17.1
Impairment charge	1,560	2.3	-	-	-	-
Restructuring expenses	644	.9	-	-	-	-
Operating profit	5,258	7.8	4,256	7.5	1,430	2.9

Fiscal 2004 Compared to Fiscal 2003

Sales for the International segment increased $10.7 million or 18.9% in 2004 compared to 2003. Sales were impacted by favorable currency translation of $5.0 million. The currency translation impact reflects the increase period-over-period in the exchange rate of the Euro and the British pound to the U.S. dollar. After adjusting for currency translation, the increase in sales for the year is due to increasing demand most notably in China and to a lesser degree in Europe. In China, demand is higher in both the passenger and commercial components of the market. In Europe, demand has increased for heavy-duty products in the segment's wet friction business, with more modest demand increases for the segment's commercial products in its dry friction business.

Gross profit increased $4.4 million or 31.4% year-over-year. As a percentage of sales, gross profit increased to 27.4% compared to 24.8% in the prior year. The segment's gross profit was favorably impacted by currency translation in the amount of $1.1 million. After adjusting for currency translation, the increase in gross margin for the year is primarily due to a more profitable sales mix and cost reductions in the segment's wet friction business. We have experienced competitive pricing pressures in the dry friction market in both China and Europe.

SG&A expense increased $1.2 million or 12.4% in 2004 compared to 2003. SG&A expense was unfavorably impacted by currency translation of $.9 million. The slight decrease in SG&A as a percent of sales, after adjusting for currency translation, is principally due to savings realized from the consolidation of our wet friction sales office into our dry friction facility in Morbach, Germany, in late 2003.

The restructuring expenses and impairment charge recorded in 2004 relate to the closure of our manufacturing facilities in Liverpool, England. See Note 3 - Restructuring Cost to the Consolidated Financial Statements for further details regarding the 2004 restructuring costs.

As a result of the above, operating profit improved $1.0 million or 23.5% in 2004 compared to 2003. The impact of currency translation on operating profit was negligible year over year.

Fiscal 2003 Compared to Fiscal 2002

Sales for the International segment increased $7.7 million or 15.8% in 2003 compared to 2002. Sales were favorably impacted by currency translation of $7.3 million. The currency translation reflect the increase period-over-period in the exchange rate of the Euro and the British pound to the U.S. dollar. After adjusting for currency translation, the increase in sales for year is due to increased volume in the Europe dry friction business and in China, partially offset by reduced volume in the European wet friction business. The decline in the European wet friction business was

principally the result of a management decision in late 2002 to eliminate a non-core business product line produced at the United Kingdom facility.

Gross profit increased $4.3 million or 43.6% year-over-year. As a percentage of sales, gross profit increased to 24.8% compared to 20.0% in the prior year. The segment's gross profit was favorably impacted by currency translation in the amount of $1.3 million. After adjusting for currency translation, the increase in gross margin for the year is primarily due to increased sales volume.

SG&A expense increased $1.4 million or 17.2% in 2003 compared to 2002. The increase in SG&A expense was principally due to the unfavorable impact of currency translation of $1.2 million.

As a result of the above, operating profit improved $2.8 million or 197.6% in 2003 compared to 2002.

Aftermarket

The following table sets forth selected data from the statement of operations for the Aftermarket segment for the fiscal years ended January 2, 2005, December 28, 2003 and December 29, 2002:

(amounts in thousands)	**Fiscal 2004**	**% of sales**	**Fiscal 2003**	**% of sales**	**Fiscal 2002**	**% of sales**
Net sales	$ 49,186	100.0%	$ 44,931	100.0%	$ 46,192	100.0%
Gross profit	14,565	29.6	12,725	28.3	12,993	28.1
Selling, general and administrative expense	6,471	13.2	5,447	12.1	4,587	9.9
Operating profit	8,094	16.5	7,278	16.2	8,406	18.2

Fiscal 2004 Compared to Fiscal 2003

Sales for the Aftermarket segment increased $4.3 million or 9.5% in 2004 compared to 2003. The increase was the result of increased sales of friction plates, principally to foreign customers, and an increase in newer product lines such as gaskets and solenoids.

Gross profit increased $1.8 million or 14.5% year over year. As a percentage of sales, gross profit increased to 29.6% compared to 28.3% in the prior year. The increase in gross profit is driven by increased sales volume, most notably higher margin friction plates. The segment was negatively impacted by an increase in coil steel, a key raw material. A portion of the impact of the increased raw material cost was recovered through increased sales prices. We expect that the increased price of steel will continue to negatively impact profitability in 2005.

SG&A expense increased $1.0 million or 18.8% in 2004 compared to 2003. The increase in SG&A was driven by increased medical, incentive compensation and distribution costs.

As a result of the foregoing, operating profit increased $.8 million or 11.2% for the 2004 fiscal year compared to the 2003 fiscal year.

Fiscal 2003 Compared to Fiscal 2002

Sales for the Aftermarket segment decreased $1.3 million or 2.7% in 2003 compared to 2002. The decrease was driven by reduced demand for aftermarket parts as a result of longer lasting OEM parts. The decrease was most notable in sales for assembled kits for transmission rebuilding which decreased $1.5 million from 2002 levels.

The decrease in gross profit of $.3 million or 2.1% in 2003 compared to the prior year is due to the lower sales volume. Gross profit as a percent of sales increased slightly in 2003 compared to 2002.

SG&A expense increased $.9 million or 18.7% in 2003 compared to 2002. The increase in SG&A is principally due to an additional provision for accounts receivable.

As a result of the above, operating profit decreased $1.1 million or 13.4% in 2003 compared to 2002.

Liquidity, Capital Resources and Future Liquidity

The Company's cash and cash equivalents at January 2, 2005 totaled $13.6 million compared to $16.4 million at December 28, 2003, a decrease of $2.8 million. Capital expenditures for the year were $6.7 million, a reduction of $2.3 million compared with the capital spending for the prior year. Net cash provided by operating activities was $.1 million compared to cash provided by operating activities of $5.5 million in the prior year period. Cash outflows for operating assets and liabilities were $15.0 million during 2004. Significant cash flows relating to operating assets and liabilities were a $2.6 million increase in trade accounts receivable, a $8.3 million increase in inventories, a $5.5 million cash payment for pension funding, partially offset by an increase in accruals, most notably severance and incentive compensation.

Cash and cash available under existing lines of credit at January 2, 2005 were $19.7 million compared to $27.0 million at year-end 2003, a decrease in cash and available lines of credit of $7.3 million.

The total borrowings at January 2, 2005 of $26.7 million compares to total borrowings of $22.4 million at year-end 2003, an increase of $4.3 million period-over-period. The available lines of credit at January 2, 2005 of $6.1 million compares to $10.6 million at year-end 2003, a decrease in availability of $4.5 million. Full details of the Company’s debt are contained in Note 8 - Debt to the Consolidated Financial Statements.

As a result of the recognition of the costs associated with the closure of the Sterling Heights, Michigan manufacturing facility, the Company requested and obtained a waiver of a fixed charge coverage ratio contained in one of its domestic bank agreements.

On March 21, 2005 the Company, through, its majority owned subsidiary, APC, purchased shares of APC owned by Raymark in exchange for a ten-year unsecured promissory note of $7.2 million which increased the Company’s indirect ownership of APC from approximately 57% of its outstanding common stock to approximately 96% of its outstanding common stock. In connection with this transaction the Company requested and obtained a waiver of the negative covenant restricting the repurchase or acquisition of the borrowers' capital stock contained in one of its domestic bank agreements during the fourth quarter of 2004.

Subsequent to the end of 2004, but prior to the filing of this report, the Company amended its domestic debt agreements. The primary purpose of the amendments was the modification of the debt covenant calculations to provide the Company greater flexibility to manage its cash resources and certain one-time costs that will be incurred during 2005 related to the plant closures announced during 2004. Additionally, the amendment to the Domestic Wet Friction loan and security agreement provides for a remedy of future non-compliance with the quarterly debt covenants, by an irrevocable cash contribution by the parent. In April 2005, the parent made an irrevocable cash

contribution of $1.0 million to RPC, a borrower, to remedy the debt covenant non-compliance occurring at the end of the first quarter of 2005. The parent may be required to make additional cash contributions in the future in the event of any further non-compliance of the borrowers. The amendments are discussed in Note 8 - Debt to the Consolidated Financial Statements.

Refer to the Notes 8 - Debt and 15 - Commitments to the Consolidated Financial Statements for information regarding the Company's obligations and commitments by year. These obligations and commitments consist of long-term debt, capital leases and rental agreements.

The Company's potential obligations regarding environmental remediation are explained fully in Note 9 - Litigation to the Consolidated Financial Statements.

The Company assumed the liability for the Raymark pension plans as part of the reorganization. Funding for the plans in 2004 was $4.6 million. Funding for these plans in 2005 is expected to be approximately $1.3 million.

Certain tax issues are discussed in Note 11 - Income Taxes to the Consolidated Financial Statements, which provides detail concerning the status of the current Internal Revenue Service audit and the use of certain future tax benefits.

The Company incurred costs associated with the retirement of its President and Chief Executive Officer during the second quarter and the reorganization of its domestic management team during the third quarter of 2004. The total cost associated with these items is approximately $1.4 million of which $.8 million was paid during 2004, with the balance to be paid during 2005.

The Company has conducted a facilities utilization review and has determined that improved performance can be obtained through the closure of certain facilities. The Company estimates that the total cash outflows related to these closures to be approximately $5.5 million, of which we expect to expend $4.6 million during 2005 and the remaining balance will be spent during 2006 and 2007. The expenses related to these closures as more fully explained in Note 3 - Restructuring Costs to the Consolidated Financial Statements.

During 2004, we reached terms with certain major customers on revised sales contract provisions that will enable us to close our manufacturing plant in Sterling Heights, Michigan. The new sales contract provisions require the Company, in certain instances, to build up inventory levels to facilitate the transition to a new vendor or to another manufacturing location within the Company. As a result, we expect our inventory levels to increase through September 2005 by as much as $3.5 million. During the fourth quarter of 2005, we expect this trend will reverse and inventory levels will begin to decrease. We currently expect that the amount of inventory related to the build up will be less than $2.0 million at year end 2005.

During 2004, we began a third expansion of our operations in China. When completed, the new facility in China will increase our capacity, positioning us to take advantage of the growing market in China and increase our exports from China. The expected cost of the expansion project in China is $1.9 million, with $.9 million expended during 2004 and the remainder of these expenditures to be incurred before the end of 2005.

Management believes that existing cash balances, the Company’s lending facilities and cash flow from operations will be sufficient to meet all of the Company’s obligations arising in the normal course of business, the anticipated non-operating requirements discussed above and anticipated capital investments over the next year. However, the ability of the Company to utilize its lending facilities is dependent on the Company’s ability to meet its financial forecasts, which is not assured, and to meet the financial covenants contained in its credit facilities. These forecasts include modest revenue growth in all three operating segments as well as certain cost-saving initiatives, partially offset by certain cost increases and inflation assumptions. If the Company does not comply with the financial covenants, an event of default would occur and could result in the acceleration of the Company’s indebtedness under its domestic credit facilities. If that were to occur, the ability of the Company to continue would be dependent upon, among other things, its ability to amend its credit facilities, undertake certain actions to generate cash and/or to seek additional alternative financing from other lenders.

Contractual Obligations

Securities and Exchange Commission regulations require that we present our contractual obligations, and we have done so in the table that follows. However, our future cash flow prospects cannot reasonably be assessed based on such obligations. The most significant factor affecting our future cash flows is our ability to earn and collect cash from customers. Future cash outflows, whether they are contractual obligations or not, will vary based on our future needs. While some such outflows are completely fixed (for example, commitments to repay principal and interest on fixed-rate borrowings) most depend on future events (for example, supply agreements to purchase commodity raw materials at quantities to be determined in the future at then-market prices). Further, normal operations involve significant expenditures that are not based on "commitments," for example, expenditures for income taxes or for payroll.

As defined by reporting regulations, our consolidated contractual obligations as of January 2, 2005, follow:

	Total	Less Than 1 Year	1-3 Years	4-5 Years	More Than 5 Years
			(in thousands)		
Long-term debt (a)	$ 26,490	$ 15,169	$ 6,146	$ 3,831	$ 1,344
Capital lease obligations (b)	206	111	95	—	—
Operating leases (c)	4,909	1,051	1,193	415	2,250
Purchase obligations (d)	1,104	1,104	—	—	—
Other liabilities (e)					
Pension (f)	2,248	2,248	—	—	—
Postretirement (g)	918	918	—	—	—
Environmental (h)	5,975	500	5,475	—	—
Severance (i)	4,009	3,084	925	—	—
Total	$ 45,859	$ 24,			