

SECURITIES AND EXCHANGE COMMISSION

FORM 10-K

Annual report pursuant to section 13 and 15(d)

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FILER

**CONGOLEUM CORP**

CIK: **23341** | IRS No.: **020398678** | State of Incorporation: **DE** | Fiscal Year End: **1231**  
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SIC: **3089** Plastics products, nec

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SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-K  
FOR ANNUAL AND TRANSITION REPORTS  
PURSUANT TO SECTIONS 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

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

For the fiscal year ended December 31, 1998

OR

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

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

Commission File Number 1-13612

CONGOLEUM CORPORATION  
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE  
(State or Other Jurisdiction of  
Incorporation or Organization)

02-0398678  
(IRS Employer Identification No.)

3705 Quakerbridge Road  
P.O. Box 3127  
Mercerville, NJ 08619-0127  
(Address of Principal Executive Offices)  
Telephone number: (609) 584-3000  
(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 -----
Class A Common Stock, par value \$.01 per share	New York Stock Exchange, Inc.

Securities Registered Pursuant to Section 12(g) of the Act: None

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Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark 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.

As of March 3, 1999, the aggregate market value of all shares of Class A Common Stock held by non-affiliates of the Registrant was approximately \$29.2 million based on the closing price (\$6.8125 per share) on the New York Stock Exchange. For purposes of determining this amount, affiliates are defined as directors and executive officers of the Registrant, American Biltrite Inc. and

Hillside Capital Incorporated. All of the shares of Class B Common Stock of the Registrant are held by affiliates of the Registrant. As of March 3, 1999, an aggregate of 4,308,260 shares of Class A Common Stock and an aggregate of 4,676,050 shares of Class B Common Stock of the Registrant were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

- Part II. Portions of Congoleum Corporation's Annual Report to Shareholders for the year ended December 31, 1998
- Part III. Portions of the Congoleum Corporation's Proxy Statement for the Annual Meeting of Shareholders to be held on May 5, 1999

Some of the information presented in or incorporated by reference in this report constitutes "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Although the Registrant believes that its expectations are based on reasonable assumptions, within the bounds of its knowledge of its business and operations, there can be no assurance that actual results will not differ materially from its expectations. Factors that could cause actual results to differ from expectations include: (i) increases in raw material prices, (ii) increased competitive activity from companies in the flooring industry, some of which have greater resources and broader distribution channels than the Registrant, (iii) unfavorable developments in the national economy or in the housing industry in general, (iv) shipment delays, depletion of inventory and increased production costs resulting from unforeseen disruptions of operations at any of the Registrant's facilities or distributors and (v) the future cost and timing of payments associated with environmental, product and general liability claims.

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PART I

Item 1. BUSINESS

Congoleum Corporation (the "Company") was incorporated in Delaware in 1986, but traces its history in the flooring business back to Nairn Linoleum Co. which began in 1886. On March 11, 1993 (effective on February 28, 1993), the business and assets of the Company and those of the Amtico Tile Division of American Biltrite Inc. (the "Tile Division") were combined (the "Acquisition"). The Acquisition was effected through the organization of a new corporation, Congoleum Holdings Incorporated ("Congoleum Holdings"), to which Hillside Industries Incorporated ("Hillside Industries") contributed all of the outstanding capital stock of Resilient Holdings Incorporated ("Resilient"), the owner of all of the outstanding capital stock of the Company, and to which American Biltrite Inc. ("American Biltrite") contributed the assets and certain liabilities of the Tile Division. Upon consummation of the Acquisition, Congoleum Holdings owned all of the outstanding capital stock of Resilient, which, in turn, owned all of the outstanding capital stock of the Company, and the Company owned the Tile Division. The assets and liabilities comprising the Tile Division which were acquired by the Company in the Acquisition are held directly by the Company. On February 8, 1995, the Company completed a public offering of 4,650,000 shares of Class A Common Stock (the "Offering"). Upon completion of the Offering, the Company implemented a Plan of Repurchase pursuant to which its two-tiered holding company ownership structure was eliminated through the merger of Congoleum Holdings with and into the Company, with the Company as the surviving corporation.

Congoleum produces both sheet and tile floor covering products with a wide variety of product features, designs and colors. Sheet flooring, in its predominant construction, is produced by applying a vinyl gel to a flexible felt, printing a design on the gel, applying a wearlayer, heating the gel layer sufficiently to cause it to expand into a cushioned foam and, in some products, adding a high-gloss coating. The Company also produces through-chip inlaid products for both residential and commercial markets. These products are produced by applying an adhesive coat and solid vinyl colored chips to a felt backing and laminating the sheet under pressure with a heated drum. Tile flooring is manufactured by creating a base stock (consisting primarily of

limestone and vinyl resin) which is less flexible than the backings for sheet flooring, and transferring or laminating to it preprinted colors and designs followed by a wearlayer and a urethane coating in some cases. Commercial tile is manufactured by including colored vinyl chips in the pigmented base stock. For do-it-yourself tile, an adhesive is applied to the back of the tile. The differences between products within each of the two product lines consist primarily of content and thickness of wearlayers and coatings, the use of chemical embossing to impart a texture, the complexity of designs and the number of colors.

#### Raw Materials

The principal raw materials used in the manufacture of sheet and tile flooring are vinyl resins, plasticizers, latex, limestone, stabilizers, cellulose paper fibers, urethane and transfer print paper. Most of these raw materials are purchased from multiple sources. The Company has had no difficulty in obtaining its requirements for these materials, although significant price increases in certain materials have been experienced at times.

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The Company believes that alternative suppliers are available for substantially all of its raw material requirements. However, the Company does not have readily available alternative sources of supply for specific designs of transfer print paper, which are produced utilizing print cylinders engraved to the Company's specifications. Although no loss of this source of supply is anticipated, replacement could take a considerable period of time and interrupt production of certain products. The Company maintains a raw material inventory and has an ongoing program to develop new sources which will provide continuity of supply for its raw material requirements.

#### Patents and Trademarks

The Company believes that the Congoleum brand name, as well as the other trademarks it holds, are important to maintaining competitive position. In 1993, the Company sold the rights to the Amtico trademark in the United States and began selling tile under the Congoleum brand name.

The Company also believes that patents and know-how play an important role in maintaining competitive position. In particular, the Company utilizes a proprietary transfer printing process for certain tile products that it believes produces visual effects that only one other competitor is presently able to duplicate.

#### Distribution

The Company currently sells its products through approximately 30 distributors providing approximately 90 distribution points in the United States and Canada, as well as directly to a limited number of mass market retailers. The sales pattern is seasonal, with peaks in retail sales typically occurring during March/April/May and September/October. Orders are generally shipped as soon as a truckload quantity has been accumulated, and backorders can be canceled without penalty. At December 31, 1998, the backlog of unshipped orders was \$13.9 million, compared to \$7.5 million at December 31, 1997.

The Company considers its distribution network very important to maintaining competitive position. While most of its distributors have marketed the Company's products for many years, replacements are necessary periodically to maintain the strength of the distribution network. Although the Company has more than one distributor in some of its distribution territories and actively manages its credit exposure to its customers, the loss of a major customer could have a materially adverse impact on the Company's sales, at least until a suitable replacement was in place. For the year ended December 31, 1998, two customers each accounted for over 10% of the Company's sales. These customers were its distributor to the manufactured housing market, LaSalle-Bristol, and its distributor in the Western U.S., LD Brinkman & Co. Together, they accounted for 47% of the Company's net sales in 1998.

## Working Capital

The Company produces goods for inventory and sells on credit to customers. Generally, the Company's distributors carry inventory as needed to meet local or rapid delivery requirements. Credit sales are typically subject to a discount if paid within terms.

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## Product Warranties

The Company offers a limited warranty on all of its products against manufacturing defects. In addition, as a part of efforts to differentiate mid and high-end products through color, design and other attributes, the Company offers enhanced warranties with respect to wear, moisture discoloration and other performance characteristics which increase with the price points of such products.

## Competition

The market for the Company's products is highly competitive. Resilient sheet and tile compete for both residential and commercial customers primarily with carpeting, hardwood, melamine laminate and ceramic tile. In residential applications, both tile and sheet products are used primarily in kitchens, bathrooms, laundry rooms and foyers and, to a lesser extent, in playrooms and basements. Ceramic tile is used primarily in kitchens, bathrooms and foyers. Carpeting is used primarily in bedrooms, family rooms and living rooms. Hardwood flooring and melamine laminate are used primarily in family rooms, foyers and kitchens. Commercial grade resilient flooring faces substantial competition from carpeting, ceramic tile, rubber tile, hardwood flooring and stone in commercial applications. The Company believes, based upon its market research, that purchase decisions are influenced primarily by fashion elements such as design, color and style, durability, ease of maintenance, price and ease of installation. Both tile and sheet resilient flooring are easy to replace for repair and redecoration and, in the Company's view, have advantages over other floor covering products in terms of both price and ease of installation and maintenance.

The Company encounters competition from domestic and, to a much lesser extent foreign manufacturers. Certain of the Company's competitors, including Armstrong in the resilient category, have substantially greater financial and other resources than the Company.

## Research and Development

The Company's research and development efforts concentrate on new product development, trying to increase product durability and expanding technical expertise in the manufacturing process. Expenditures for research and development for the year ended December 31, 1998 were \$3.8 million, compared to \$3.7 million and \$4.6 million for the years ended December 31, 1997 and 1996, respectively.

## Environmental Regulation

Due to the nature of the Company's business and certain of the substances which are or have been used, produced or discharged by the Company, the Company's operations are subject to extensive federal, state and local laws and regulations relating to the generation, storage, disposal, handling, emission, transportation and discharge into the environment of hazardous substances. The Company, pursuant to administrative consent orders signed in 1986 and in connection with a prior restructuring, is in the process of implementing cleanup measures at its Trenton sheet facility under New Jersey's Environmental Clean-up Responsibility Act, as amended by the New Jersey

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Industrial Site Recovery Act. The Company does not anticipate that the additional costs of these measures will be material. In connection with the Acquisition of the Tile Division, American Biltrite signed a similar consent order with respect to the Trenton tile facility, and the Company agreed to be financially responsible for any cleanup measures required. In 1998, the Company incurred capital expenditures of approximately \$.3 million for environmental compliance and control facilities.

The Company has historically expended substantial amounts for compliance with existing environmental laws and regulations, including those matters described above. The Company will continue to be required to expend amounts in the future, due to the nature of historic activities at its facilities, to comply with existing environmental laws, and those amounts may be substantial but should not, in the Company's judgment, have a material adverse effect on the financial position of the Company. Because environmental requirements have grown increasingly strict, however, the Company is unable to determine the ultimate cost of compliance with environmental laws and enforcement policies.

#### Employees

At December 31, 1998, the Company employed a total of 1,250 personnel compared to 1,234 employees at December 31, 1997.

The Company has entered into collective bargaining agreements with hourly employees at three of its plants and with the drivers of the trucks that provide interplant transportation. These agreements cover approximately 702 of the Company's employees. The Trenton tile plant has a five-year collective bargaining agreement which expires in May 2003. The Marcus Hook plant has a five-year collective bargaining agreement which expires in November 2003. The Trenton sheet plant has a five-year collective bargaining agreement which expires in February 2001. The Finksburg plant has no union affiliation. In the past five years, there have been no significant strikes by employees at the Company and the Company believes that its employee relations are satisfactory.

#### Year 2000

The information required by this item is incorporated by reference to all information under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" on pages 23 and 24 of the Company's Annual Report to Shareholders for the year ended December 31, 1998 (included as Exhibit 13.1 to this Annual Report on Form 10-K).

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#### Executive Officers of the Registrant

The following information is furnished with respect to each of the executive officers of the Company, each of whom is elected by and serves at the pleasure of the Board of Directors. The business experience shown for each officer has been his principal occupation for at least the past five years. Ages are shown as of February 1, 1999.

Roger S. Marcus (Age 53)

Roger S. Marcus has been a Director and President and Chief Executive Officer of the Company since 1993, and Chairman since 1994. Mr. Marcus is also a Director (since 1981), Chairman of the Board (since 1992) and Chief Executive Officer (since 1983) of American Biltrite. From 1983 to 1992, Mr. Marcus served as Vice Chairman of the Board of American Biltrite.

Richard G. Marcus (Age 51)

Richard G. Marcus has been Vice Chairman of the Company since 1994, and a Director since 1993. Mr. Marcus is also a Director (since 1982) and President (since 1983) and Chief Operating Officer (since 1992) of American Biltrite.

Robert N. Agate (Age 54)

Robert N. Agate has been Executive Vice President of the Company since 1998. Prior thereto, he was Senior Vice President - Manufacturing of the Company since 1993, and was Vice President of Manufacturing of the Tile Division of American Biltrite (since 1981).

David W. Bushar (Age 52)

David W. Bushar has been Senior Vice President - Manufacturing of the Company since 1998. Prior thereto, he was Manager, Technical Services since 1997 and as Plant Manager of the Company's Trenton, New Jersey sheet facility since 1993.

Howard N. Feist III (Age 42)

Howard N. Feist III has been Senior Vice President - Finance and Secretary of the Company since 1993. Prior thereto, he had served as Vice President Finance and Secretary of the Company since 1988.

Dennis P. Jarosz (Age 53)

Dennis P. Jarosz has been Senior Vice President - Marketing since 1995. Prior thereto, he had served as Vice President - Marketing since 1993 and Vice President - Sales & Marketing of the Tile Division of American Biltrite (since 1986).

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James K. Morando (Age 35)

James K. Morando has been Senior Vice President - Sales of the Company since 1998. Prior thereto, he had served as National Sales Manager (since 1995) and Regional Sales Manager (since 1991).

Peter J. Rohrbacher (Age 47)

Peter J. Rohrbacher has been Senior Vice President - Research and Engineering of the Company since 1997. Prior thereto, he had served as Senior Vice President - Engineering (since 1993), Vice President - Coatings of the Company (since 1993), and Vice President - Research & Development of the Tile Division of American Biltrite (since 1988).

Thomas A. Sciortino (Age 52)

Thomas A. Sciortino has been Senior Vice President - Administration of the Company since 1993. Prior thereto, he was Vice President - Finance of the Tile Division of American Biltrite (since 1982).

Merrill M. Smith (Age 73)

Merrill M. Smith has been Senior Vice President - Technology of the Company since 1993. Prior thereto, he was Vice President - Technology of American Biltrite (since 1985).

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## Item 2. PROPERTIES

The Company owns four manufacturing facilities located in Maryland, Pennsylvania and New Jersey and leases corporate and marketing offices in Mercerville, New Jersey, where it has a lease expiring in 2000, as well as storage space in Trenton, New Jersey, which are described below:

Location	Owned/Leased	Usage	Square Feet
-----	-----	-----	-----
Finksburg, MD	Owned	Felt	107,000

Marcus Hook, PA	Owned	Sheet Flooring	1,000,000
Trenton, NJ	Owned	Sheet Flooring	1,050,000
Trenton, NJ	Owned	Tile Flooring	282,000
Trenton, NJ	Leased	Warehousing	20,000
Mercerville, NJ	Leased	Corporate Offices	33,597

The Finksburg facility consists primarily of a 16-foot wide felt production line.

The Marcus Hook facility is capable of manufacturing rotogravure printed sheet flooring in widths of up to 16 feet. Major production lines at this facility include a 12-foot wide oven, two 16-foot wide ovens, a 12-foot wide printing press and a 16-foot wide printing press.

The Trenton sheet facility is capable of manufacturing rotogravure printed and through-chip inlaid sheet products in widths up to 6 feet. Major production lines, all six-foot wide, include an oven, a rotary laminating line and a press. The examination, packing and warehousing of all sheet products (except products for the manufactured housing segment) occur at the Trenton plant distribution center.

The Trenton tile facility consists of three major production lines, a four-foot wide commercial tile line, a two-foot wide residential tile line and a one-foot wide residential tile line.

Productive capacity and extent of utilization of the Company's facilities are dependent on a number of factors, including the size, construction, and quantity of product being manufactured, some of which also dictate which production line(s) must be utilized to make a given product. The Company's major production lines were operated an average of 76% of the hours available on a five-day, three-shift basis in 1998, with the corresponding figure for individual production lines ranging from 13% to 120%.

Although many of the Company's manufacturing facilities have been substantially depreciated, the Company has generally maintained and improved the productive capacity of these facilities over time through a program of regular capital expenditures. The Company considers its manufacturing facilities to be adequate for its present and anticipated near-term production needs.

### Item 3. LEGAL PROCEEDINGS

As of December 31, 1998 the Company was named as a defendant, together in most cases with numerous other defendants, in approximately 657 pending lawsuits (including workers' compensation cases) involving approximately 1,984 individuals alleging personal injury from exposure to asbestos or asbestos-containing products. The plaintiffs in these cases seek compensation for injuries sustained in the course of their employment by third parties (or, in the workers' compensation cases, by the Company) as a result of exposure to asbestos in products manufactured by the Company or the Tile Division of American Biltrite. The Company discontinued the manufacture of asbestos-containing sheet vinyl flooring products in 1983 and the Tile Division ceased manufacturing asbestos-containing vinyl tile flooring products in 1984. In general, asbestos-containing products have not been found to pose a health risk unless significant amounts of free asbestos fibers become airborne. All of the asbestos in the asbestos-containing products previously sold by the Company and the Tile Division was fully bonded or encapsulated during the manufacturing process. During 1998 approximately 200 personal injury cases involving the Company were either settled or dismissed and approximately 203 new cases were commenced against the Company. The total indemnity costs incurred during 1998 to settle personal injury claims involving the Company (other than the cost of the partial settlement in the personal injury case described below) was approximately \$2.2 million. All of these costs were paid by the Company's insurance carriers. The average indemnity cost per resolved personal injury claim was \$11 thousand in 1998. Costs per claim vary depending on a number of factors, including the number of plaintiffs, the nature of their alleged exposure and the forum in which the claim is brought. In 1997 a judgment was

entered by the Superior Court of California in Los Angeles following a jury trial holding the Company and another defendant jointly and severally liable for \$3.3 million in damages, subject to any applicable setoffs for previous settlements and proportionate liability under California law. The jury found that the Company was only liable for 25% of the non-economic damages sustained by the plaintiff. However, as a result of post-verdict motions the court ruled that California Proposition 51 establishing proportionate liability for non-economic damages did not apply. The Company has appealed this decision to the Court of Appeals of the State of California. The Company's insurance carrier has paid the Company's defense costs in this matter and has indicated that it would be responsible for paying the ultimate judgment in this case, subject to the insurance carrier's denial of liability with respect to a partial settlement of certain related claims effected by the Company which the company is contesting. Although there can be no assurance, the Company believes, based upon the nature of the asbestos-containing products formerly manufactured by the Company and the Tile Division and its experience with cases to date, that any potential liabilities it may have with respect to these personal injury cases will not have a material adverse effect on the results of operations or financial condition of the Company.

Together with a large number (in most cases, hundreds) of other companies, the Company is named as a "Potentially Responsible Party" ("PRP") in pending proceedings under the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") and similar state laws. In two instances, although not named as a PRP, the Company has received a request for information. These pending proceedings currently relate to seven disposal sites in New Jersey, Pennsylvania, Maryland, Connecticut and Delaware in which recovery from generators of hazardous substances is sought for the cost of cleaning up the contaminated waste sites. The Company's ultimate liability, if any, in connection with these sites will depend on many factors, including the

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volume of material contributed to the site, the number of other PRPs and their financial viability, the remediation methods and technology to be used and the extent to which costs may be recoverable from insurance. However, under CERCLA and certain other laws, as a PRP the Company could be held jointly and severally liable for all remediation costs associated with a site.

The most significant disposal site environmental matter in which the Company has been named as a PRP relates to a recycling facility in Elkton, Maryland. Two removal actions are substantially complete as of December 31, 1998, however, the groundwater remediation phase has not begun and the remedial investigation/feasibility study related to the groundwater remediation has not been approved. The PRP group for this site has estimated that the future costs of groundwater remediation would be approximately \$26 million of which, based on waste allocations among members of the PRP group, the Company's share was estimated to be approximately 5.5%. At December 31, 1998, the Company believes its probable liability with respect to this site, based upon present facts and circumstances, will be approximately \$.5 million (\$2 million estimated liability net of anticipated insurance recoveries of \$1.5 million). Although there can be no assurance, the Company does not believe, based upon present facts and circumstances, that its probable liability with respect to any of the other pending disposal site environmental remediation matters to which it is a party will be material to the results of operations or financial condition of the Company.

The Company is also a party to a pending proceeding relating to the investigation and potential remediation of soil and groundwater contamination at its manufacturing facility located at 1945 East State Street in Trenton, New Jersey. The investigation of the nature and extent of any contamination at this site has not been completed and the Company is therefore unable to estimate the amount, if any, of its probable liability with respect to the potential remediation of this site.

#### Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

## PART II

## Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The information required by this item is incorporated by reference to all information under the caption "Market Information" on page 41 of the Company's Annual Report to Shareholders for the year ended December 31, 1998 (included as Exhibit 13.1 to this Annual Report on Form 10-K).

## Item 6. SELECTED FINANCIAL DATA

The information required by this item is incorporated by reference to all information under the heading "Selected Financial Data" on page 20 of the Company's Annual Report to Shareholders for the year ended December 31, 1998 (included as Exhibit 13.1 to this Annual Report on Form 10-K).

## Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The information required by this item is incorporated by reference to all information under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" on pages 21 through 24 of the Company's Annual Report to Shareholders for the year ended December 31, 1998 (included as Exhibit 13.1 to this Annual Report on Form 10-K).

## Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to changes in prevailing market interest rates affecting the return on its investments but does not consider this interest rate market risk exposure to be material to its financial condition or results of operations. The Company invests primarily in highly liquid debt instruments with strong credit ratings and short-term (less than one year) maturities. The carrying amount of these investments approximates fair value due to the short-term maturities. Substantially all of the Company's outstanding long-term debt as of December 31, 1998 consisted of indebtedness with a fixed rate of interest which is not subject to change based upon changes in prevailing market interest rates. Under its current policies, the Company does not use derivative financial instruments, derivative commodity instruments or other financial instruments to manage its exposure to changes in interest rates, foreign currency exchange rates, commodity prices or equity prices.

## Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements of the Company are incorporated by reference and the financial statement schedule is included in this report on Form 10-K, as listed in Item 14(a) Part IV of this report.

## Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

## PART III

## Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

## Item 11. EXECUTIVE COMPENSATION

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information called for by these Items (except for the information regarding executive officers called for by Item 401 of Regulation S-K which is included in Part I hereof in accordance with General Instruction G(3)), is hereby incorporated by reference to the Registrant's definitive Proxy Statement for its Annual Meeting of Shareholders to be held on May 5, 1999.

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PART IV

Item 14. EXHIBITS, FINANCIAL STATEMENTS, SCHEDULES AND REPORTS ON FORM 8-K

- (a) (1) The following financial statements of the Company and the report of independent auditors are incorporated herein by reference in the Company's Annual Report to Shareholders for the year ended December 31, 1998 (included as Exhibit 13.1 to this Annual Report on Form 10-K).

	Annual Report Page Number -----
Report of Independent Auditors	40
Balance Sheets at December 31, 1998 and December 31, 1997	25
Statements of Operations for each of the three years ended December 31, 1998, 1997 and 1996	26
Statements of Changes in Stockholders' Equity for each of the three years ended December 31, 1998, 1997 and 1996	27
Statements of Cash Flows for each of the three years ended December 31, 1998, 1997 and 1996	28
Notes to Financial Statements	29
Supplementary Data	
Quarterly Financial Data (Unaudited)	39

- (2) The following financial statement schedule is included in this report on Form 10-K:

	Page Number -----
Schedule II - Valuation and Qualifying Accounts	23

All other schedules are omitted because they are not required, inapplicable, or the information is otherwise shown in the financial statements or notes thereto.

- (3) Exhibits

These exhibits, required to be filed by Item 601 of Regulation S-K, are listed in the Exhibit Index included in this report at pages 20 through 22.

Exhibit  
Number  
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Exhibit  
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- 2.1 Plan of Repurchase dated as of February 1, 1995 by and among American Biltrite Inc., Hillside Industries Incorporated ("Hillside"), Congoleum Holdings Incorporated ("Congoleum Holdings"), Resilient Holdings Incorporated ("Resilient Holdings") and the Company.

Exhibit  
Number  
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Exhibit  
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- 3.1 Certificate of Incorporation of the Company, as amended.
- 3.2 Amended and Restated Bylaws of the Company.
- 4.1 Financing Agreement, dated April 19, 1991 (the "CIT Financing Agreement"), by and among the CIT Group/Business Credit, Inc. ("CIT"), The Bank of New York Commercial Corporation ("BONY/CC"), Chemical Bank ("Chemical") and The Chase Manhattan Bank, N.A. ("Chase") (collectively, the "Senior Lenders") and the Company.
- 4.2 First Amendment, dated March 11, 1993, to the CIT Financing Agreement by and among the Senior Lenders and the Company.
- 4.3 Indenture, dated as of February 1, 1994, between the Company and Chemical, as trustee.
- 4.4 Registration Rights Agreement, dated as of February 8, 1995 by and between the Company and Hillside.
- 4.5 Indenture, dated as of August 3, 1998 (the "1998 Indenture"), by and between the Company and First Union National Bank, as trustee.
- 4.6 Loan and Security Agreement, dated December 18, 1998 (the "First Union Loan Agreement"), by and between First Union National Bank (the "Lender") and the Company.
  - 4.6.1 Joinder Amendment, dated December 21, 1998 (the "Joinder Agreement"), by and among the Company, Congoleum Intellectual Properties, Inc., Congoleum Financial Corporation and the Lender.
- 10.1 The CIT Financing Agreement (see Exhibit 4.1).
- 10.2 First Amendment to the CIT Financing Agreement (see Exhibit 4.2).
- 10.8 Joint Venture Agreement, dated as of December 16, 1992, by and among Resilient Holdings, Hillside, the Company (collectively the "Congoleum Group"), Hillside Capital Incorporated ("Hillside Capital") and American Biltrite.
- 10.9 Closing Agreement, dated as of March 11, 1993, by and among the Congoleum Group, Hillside Capital and American Biltrite.
- 10.12 Stockholders Agreement, dated as of March 11, 1993 (the "Stockholders Agreement"), by and among the Congoleum Group, American Biltrite and Congoleum Holdings.
  - 10.12.1 First Amendment, dated February 8, 1995, to the Stockholders Agreement, by and among Hillside, American Biltrite and the Company.
  - 10.13 Personal Services Agreement, dated as of March 11, 1993 (the "Personal Services Agreement"), by and between American Biltrite and the Company.
    - 10.13.1 First Amendment, dated February 8, 1995, to Personal Services Agreement, by and between American Biltrite and the Company.
    - 10.13.2 Second Amendment, dated November 15, 1996, to Personal Services Agreement, by and between American Biltrite and the Company.

Exhibit  
Number  
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Exhibit  
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- 10.13.3 Third Amendment, dated as of March 15, 1998, to Personal Services Agreement, by and between American Biltrite and the Company.
- 10.14 Business Relations Agreement, dated as of March 11, 1993, by and between American Biltrite and the Company.
- 10.14.1 First Amendment, dated August 19, 1997, to Business Relations Agreement, by and between American Biltrite and the Company.
- 10.15 Tax Sharing and Indemnification Agreement, dated as of March 11, 1993, by and among Congoleum Holdings, Resilient Holdings, Hillside Capital and the Company.
- 10.15.1 Tax Sharing Agreement, dated as of November 1, 1996, between American Biltrite and the Company.
- 10.19 Commitment Letter, dated January 19, 1994 regarding Financing Agreement dated April 19, 1991, as amended, by and among CIT, BONYCC and the Company.
- 10.20 Trademark Purchase Agreement, dated November 29, 1993, by and between the Company and The Amtico Company LTD ("Amtico Company").
- 10.21 First Right of Refusal, dated November 29, 1993, by and between American Biltrite (Canada) Limited and Amtico Company.
- 10.22 Undertaking Concerning Amtico Trademark, dated November 29, 1993, by and between American Biltrite and Amtico Company.
- 10.23 Form of 1995 Stock Option Plan.
- 10.23.1 Form of Amendment to 1995 Stock Option Plan.
- 10.24 License Agreement, dated as of September 20, 1995 between Congoleum Intellectual Properties, Inc. and the Company.
- 10.25 Registration Rights Agreement, dated as of August 3, 1998, by and among the Company, Goldman, Sachs & Co., Credit Suisse First Boston Corporation and ING Barings Furman Selz LLC.
- 10.26 The First Union Loan Agreement (see Exhibit 4.6).
- 10.26.1 The Joinder Agreement (see Exhibit 4.6.1).
- 11.1 Statement regarding computation of earnings per common share.
- 13.1 Pages 20 through 41 of the Congoleum Annual Report to Shareholders for the year ended December 31, 1998.
- 21.1 Subsidiaries of the Company.
- 23.1 Consent of Ernst & Young LLP.
- 27.1 Financial Data Schedule.

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(b) Reports on Form 8-K.

During the quarter ended December 31, 1998 the Company filed no current reports on Form 8-K.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on the 26th day of March, 1999.

## CONGOLEUM CORPORATION

By: /s/

-----  
 Roger S. Marcus  
 President, Chairman & Chief Executive Officer  
 (Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature -----	Title -----	Date ----
/s/ ----- Roger S. Marcus	President, Chairman, Chief Executive Officer and Director (Principal Executive Officer)	March 26, 1999
/s/ ----- Howard N. Feist	Senior Vice President - Finance (Principal Financial and Accounting Officer)	March 26, 1999
/s/ ----- Richard G. Marcus	Vice Chairman and Director	March 26, 1999
/s/ ----- William M. Marcus	Director	March 26, 1999
/s/ ----- John N. Irwin III	Director	March 26, 1999
/s/ ----- Cyril C. Baldwin, Jr.	Director	March 26, 1999
/s/ ----- David N. Hurwitz	Director	March 26, 1999
/s/ ----- Mark N. Kaplan	Director	March 26, 1999
/s/ ----- C. Barnwell Straut	Director	March 26, 1999

## INDEX TO EXHIBITS

Exhibit

- \*\*\*2.1 Plan of Repurchase dated as of February 1, 1995 by and among American Biltrite Inc., Hillside Industries Incorporated ("Hillside Industries"), Congoleum Holdings Incorporated ("Congoleum Holdings"), Resilient Holdings Incorporated ("Resilient Holdings") and the Company.
- \*\*\*\*3.1 Certificate of Incorporation of the Company, as amended.
- \*\*\*\*3.2 Amended and Restated Bylaws of the Company.
- \*\*4.1 Financing Agreement, dated April 19, 1991 (the "CIT Financing Agreement"), by and among the CIT Group/Business Credit, Inc. ("CIT"), The Bank of New York Commercial Corporation ("BONY/CC"), Chemical Bank ("Chemical") and The Chase Manhattan Bank, N.A. ("Chase") (collectively, the "Senior Lenders") and the Company.
- \*\*4.2 First Amendment, dated March 11, 1993, to the CIT Financing Agreement by and among the Senior Lenders and the Company.
- \*\*4.3 Indenture, dated as of February 1, 1994, between the Company and Chemical, as trustee.
- \*\*\*4.4 Registration Rights Agreement, dated as of February 8, 1995 by and between the Company and Hillside.
- \*\*\*\*\*4.5 Indenture, dated as of August 3, 1998 (the "1998 Indenture"), by and between the Company and First Union National Bank, as trustee.
- 4.6 Loan and Security Agreement, dated December 18, 1998 (the "First Union Loan Agreement"), by and between First Union National Bank (the "Lender") and the Company.
- 4.6.1 Joinder Amendment, dated December 21, 1998 (the "Joinder Agreement"), by and among the Company, Congoleum Intellectual Properties, Inc., Congoleum Financial Corporation and the Lender.
- \*\*10.1 The CIT Financing Agreement (see Exhibit 4.1).
- \*\*10.2 First Amendment to the CIT Financing Agreement (see Exhibit 4.2).
- \*\*10.8 Joint Venture Agreement, dated as of December 16, 1992, by and among Resilient Holdings, Hillside, the Company (collectively, the "Congoleum Group"), Hillside Capital Incorporated ("Hillside Capital") and American Biltrite.
- \*\*10.9 Closing Agreement, dated as of March 11, 1993, by and among the Congoleum Group, Hillside Capital and American Biltrite.
- \*\*10.12 Stockholders Agreement, dated as of March 11, 1993 (the "Stockholders Agreement"), by and among the Congoleum Group, American Biltrite and Congoleum Holdings.
- \*\*\*10.12.1 First Amendment, dated February 8, 1995, to the Stockholders Agreement, by and among Hillside, American Biltrite and the Company.

- \*\*10.13 Personal Services Agreement, dated as of March 11, 1993 (the "Personal Services Agreement"), by and between American Biltrite and the Company.
- \*\*\*10.13.1 First Amendment, dated February 8, 1995, to Personal Services Agreement, by and between American Biltrite and the Company.
- \*\*\*\*\*10.13.2 Second Amendment, dated November 15, 1996, to Personal Services Agreement, by and between American Biltrite and the Company.
- \*\*\*\*\*10.13.3 Third Amendment, dated as of March 10, 1998, to Personal Services Agreement, by and between American Biltrite and the Company.
- \*\*10.14 Business Relations Agreement, dated as of March 11, 1993, by and between American Biltrite and the Company.
- \*\*\*\*\*10.14.1 First Amendment, dated August 19, 1997, to Business Relations Agreement, by and between American Biltrite and the Company.
- \*\*10.15 Tax Sharing and Indemnification Agreement, dated as of March 11, 1993, by and among Congoleum Holdings, Resilient Holdings, Hillside Capital and the Company.
- \*\*\*\*\*10.15.1 Tax Sharing Agreement, dated as of November 1, 1996, between American Biltrite and the Company.
- \*\*10.19 Commitment Letter, dated January 19, 1994 regarding Financing Agreement dated April 19, 1991, as amended, by and among CIT, BONYCC and the Company.
- \*\*\*10.20 Trademark Purchase Agreement, dated November 29, 1993, by and between the Company and The Amtico Company LTD ("Amtico Company").
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- 11.1 Statement regarding computation of earnings per common share.

Exhibit  
Number  
-----

Exhibit  
-----

- 13.1 Pages 20 through 41 of the Congoleum Annual Report to Shareholders for the year ended December 31, 1998.

21.1 Subsidiaries of the Company.

23.1 Consent of Ernst & Young LLP.

27.1 Financial Data Schedule.

- 
- \*\* Incorporated by reference to the exhibit bearing the same number filed with the Company's Registration Statement on Form S-1 (File No. 33-71836) declared effective by the Securities and Exchange Commission on January 25, 1994.
  - \*\*\* Incorporated by reference to the exhibit bearing the same number filed with the Company's Registration Statement on Form S-1 (File No. 33-87282) declared effective by the Securities and Exchange Commission on February 1, 1995.
  - \*\*\*\* Incorporated by reference to the exhibit bearing the same number filed with the Company's Annual Report on Form 10-K for the year ended December 31, 1995.
  - \*\*\*\*\* Incorporated by reference to the exhibit bearing the same number filed with the Company's Quarterly Report on Form 10-Q for the period ended June 30, 1996.
  - \*\*\*\*\* Incorporated by reference to the exhibit bearing the same number filed with the Company's Quarterly Report on Form 10-Q for the period ended June 30, 1998.
  - \*\*\*\*\* Incorporated by reference to the exhibit bearing the same number filed with the Company's Annual Report on Form 10-K for the fiscal period ended December 31, 1997.
  - \*\*\*\*\* Incorporated by reference to the exhibit bearing the same number filed with the Company's Annual Report on Form 10-K for the fiscal period ended December 31, 1996.

SCHEDULE II

CONGOLEUM CORPORATION  
VALUATION AND QUALIFYING ACCOUNTS  
(in thousands)

-----

<TABLE>  
<CAPTION>

	Balance at Beginning of Period -----	Additions -----			Balance at end of Period -----
		Charged to Costs/ Expenses (a) -----	Other Changes -----	Deductions (b) -----	
<S>	<C>	<C>	<C>	<C>	<C>
Year ended December 31, 1998:					
Allowance for doubtful accounts and cash discounts	\$ (3,294)	\$ --	\$ (39) (c)	\$ (3)	\$ (3,336)
Year ended December 31, 1997:					
Allowance for doubtful accounts and cash discounts	\$ (3,406)	\$ --	\$ 33 (c)	\$ 79	\$ (3,294)
Year ended December 31, 1996:					
Allowance for doubtful accounts and cash discounts	\$ (5,095)	\$ (600)	\$ --	\$2,289	\$ (3,406)

</TABLE>

- (a) Uncollectible accounts charged to bad debt expense.
- (b) Balances written-off, net of recoveries.
- (c) Represents reduction of the allowance for doubtful accounts and cash

discounts.

LOAN AND SECURITY AGREEMENT

Dated as of December 18, 1998

Among

CONGOLEUM CORPORATION

and

the other Borrowers named herein,

as Borrowers

and

FIRST UNION NATIONAL BANK,

as Lender

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LOAN AND SECURITY AGREEMENT dated as of this 18th day of December, 1998, among CONGOLEUM CORPORATION, a Delaware corporation ("Congoleum") and the other Borrowers listed on the signature pages hereto (individually (including Congoleum) a "Borrower" and collectively as "Borrowers") and FIRST UNION NATIONAL BANK, a national banking association ("Lender").

#### BACKGROUND

Borrowers have requested that Lender provide a revolving credit facility (the "Revolving Credit") in the amount of Thirty Million Dollars (\$30,000,000.00) to Borrowers to refinance Congoleum's existing revolving credit facility, to fund working capital and certain acquisitions. Lender has agreed to provide the Revolving Credit on the terms and conditions herein contained.

#### ARTICLE I

#### DEFINITIONS AND ACCOUNTING TERMS

SECTION 1.1 Certain Defined Terms. As used in this Agreement, the following terms shall have the following meanings (such meanings to be equally applicable to both the singular and plural forms of the terms defined):

"AAA" has the meaning given to such term in Section 8.7 hereof.

"Account" has the meaning given to such term in the New Jersey Uniform Commercial Code as in effect on the date hereof.

"Acquisition Advance" has the meaning given to such term in Section 2.1 hereof.

"Adjusted Base Rate" means the Base Rate minus the Applicable Margin. The Adjusted Base Rate shall change simultaneously with each change in the Base Rate and with each change in the Applicable Margin.

"Adjusted LIBOR" means LIBOR plus the Applicable Margin.

"Advance" has the meaning given to such term in Section 2.1 hereof.

"Affiliate" of a Person means (A) any other Person which directly or indirectly controls, or is controlled by, or is under common control with, such Person, (B) any director or officer (or, in the case of a Person which is not a corporation, any individual having analogous powers) of such Person or of a Person who is an Affiliate of such Person, and (C) any individual related to such Person or Affiliate by consanguinity or adoption within the third degree. For purposes of the preceding sentence, "control" of a

Person means (1) the possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of such Person, whether through the ownership of voting securities, by contract or otherwise and (2) in any case shall include direct or indirect ownership (beneficially or of record) of, or direct or indirect power to vote, 35% or more of the outstanding shares of any class of capital stock of such Person (or in the case of a Person that is not a corporation, 35% or more of any class of equity interest).

"Agreement" means this Loan and Security Agreement, as amended, modified, extended or restated from time to time.

"Applicable Margin" shall be calculated in accordance with the table and text below:

---

If the ratio of Total Senior Funded Debt to EBITDA is:	Then the Applicable Margin is:
	Base Rate Tranches      LIBOR Tranches

---

Greater than 4.00	0.00% per annum	1.50% per annum
Greater than 3.50 but less than or equal to 4.00	.25% per annum	1.25% per annum
Greater than 3.00 but less than or equal to 3.50	.50% per annum	1.00% per annum
Less than or equal to 3.00	.75% per annum	0.75% per annum

The calculation of the Applicable Margin pursuant to the above table shall be made each time Borrowers are required to submit a Compliance Certificate hereunder, based upon the immediately preceding twelve (12) month period, as reflected in the Compliance Certificate delivered by Borrowers and the Consolidated balance sheet as of the last day of such period and Consolidated statement of cash flows of Borrowers for such period. In the event the Applicable Margin changes, such change shall become effective, for the then outstanding principal balance of the Revolving Credit and all Advances thereafter made, as of the first day of the month immediately following the month in which the Compliance Certificate of Borrowers is delivered to Lender, except that Applicable Margin, once set or reset, shall remain in effect for not less than ninety (90) days.

"Arbitration Rules has the meaning given to such term in Section 8.7 hereof.

"Base Rate" means the higher of (A) the Prime Rate or (B) the Federal Funds Rate plus 1/2%. The Base Rate shall change simultaneously with each change in the Prime Rate or the Federal Funds Rate.

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"Base Rate Tranche" means any portion of the Revolving Credit to which the Adjusted Base Rate applies.

"Books and Records" means all books, records, tapes, information, data, stored material, computer media, passwords, access codes arising or related to a Borrower's business.

"Borrower" and "Borrowers" have the meanings given to such terms in the introductory paragraph hereof.

"Borrowing Base" at any time means (without duplication) the sum of (A) 85% of Borrowers' Eligible Accounts at such time, plus (B) 50% of Borrowers' Eligible Inventory at such time, plus (C) the lesser of (1) 85% of Borrowers'

Eligible Notes or (2) \$3,000,000.00, provided however that, Lender shall be permitted in its reasonable discretion to amend the foregoing definition of Borrowing Base.

"Business Day" means a day other than a Saturday, Sunday, or other day on which banks are authorized or required to close under the laws of New Jersey or under Federal law.

"Capital Asset" means any property or asset (real, personal or mixed, tangible or intangible) which is of a kind subject to an allowance for depreciation or amortization under GAAP.

"Capital Expenditures" means any expenditures made or cost incurred by a Borrower, whether paid or due and owing, for the acquisition, purchase, alteration or improvement of any Capital Asset and shall include, without limitation, all capital expenditures within the meaning of Section 263 of the Code and the regulations promulgated thereunder.

"Cash Collateral Account" has the meaning given to such term in Section 3.6 hereof.

"Cash Equivalents" means at any date: (A) demand deposits, time deposits or certificates of deposit at Lender or at any commercial bank organized under the laws of the United States of America or any state thereof, having combined capital and surplus of not less than \$500,000,000.00; (B) obligations backed by the full faith and credit of the United States of America or an agency thereof maturing not in excess of one year from the date of acquisition; and (C) commercial paper which is rated A-1 (or better) by Standard & Poor's Corporation or P-1 (or better) by Moody's Investor Services, Inc.

"CERCLA" means the Comprehensive Environmental Response, Compensation, and Liability Act, as amended from time to time.

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"Change in Control" means the occurrence of one or more of the following events: (A) any change (from the date hereof) in the Persons which, directly or indirectly, have the power to direct or cause the direction of the management or policies of Congoleum, whether through the ownership of voting securities, by contract or otherwise and (B) any change (from the date hereof) in the Persons which, directly or indirectly own (beneficially or of record) of, or directly or indirectly have the power to vote or to affect 35% or more of the outstanding shares of any class of capital stock of Congoleum.

"Chattel Paper" has the meaning given to such term in the New Jersey Uniform Commercial Code as in effect on the date hereof.

"Closing Date" means the date on which all of the conditions precedent set forth in Article IV are satisfied.

"Code" means the Internal Revenue Code of 1986, as amended from time to time.

"Collateral" means all property of Borrowers which serves as collateral for any of the Liabilities under Article III hereof, or otherwise.

"Commitment Fee" has the meaning given to such term in Section 2.5 hereof.

"Compliance Certificate" means a certificate of the chief executive officer or chief financial officer of Congoleum in substantially the form of Exhibit 6.2 attached hereto and made a part hereof as to each of the following (A) the absence of any Default or Event of Default on such date, or, if any Default or Event of Default then exists, the existence of each, with a full description thereof and a statement of the action taken or to be taken by Borrowers to cure or attempt to cure each such Default or Event of Default (provided that the acceptance by Lender of a Compliance Certificate stating that any Default or Event of Default has occurred shall not constitute a waiver of any such Default or Event of Default or remedy available as a result thereof), (B) that the representations and warranties herein and in the other Loan Documents are true and correct in all material respects as of such date (excluding representations and warranties which speak as of a particular date, which shall be true and correct in all material respects as of such earlier date), and (C) the compliance with the financial covenants and limitations set forth in Sections 6.5, 6.6, 6.7 and 6.8.

"Congoleum" has the meaning given to such term in the introductory paragraph hereof.

"Consents" has the meaning given to such term in Section 4.1 hereof.

"Consolidated" refers to the consolidation of the accounts of Borrowers and their Subsidiaries in accordance with GAAP, including principles of consolidation.

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"Consolidating" refers to the separate entity reporting and consolidation of the accounts of Borrowers and their Subsidiaries in accordance with GAAP.

"Controlled Group" means all trades or businesses which are under common control (as defined in ss.4001(b)(1) of ERISA) with a Borrower.

"Contingent Liabilities" means all liabilities that would, in accordance with GAAP, be classified as contingent liabilities of a Borrower.

"Credit Limit" at any time means the lesser of (A) Thirty Million Dollars (\$30,000,000.00) less any reduction in the unutilized principal of the Revolving

Credit in accordance with Section 2.1(D), or (B) the Borrowing Base.

"Credit Obligation" means any obligation either individually or in the aggregate in excess of \$5,000,000.00 for the payment of borrowed money or the installment purchase price of property or on account of a lease of property which, in accordance with GAAP, is capitalized, and shall also mean any obligation under a guaranty or suretyship agreement covering obligations of such type.

"Debt" means the sum of (A) the outstanding principal amount of the Revolving Credit, plus (B) the outstanding principal amount of any other long term indebtedness for borrowed money (including without limitation, any other Credit Obligation outstanding at any one time) in each case including, without limitation, current maturities of such Debt.

"Default" means the occurrence or non-occurrence of an event which but for the giving of notice, the passage of time or both would constitute an Event of Default.

"Default Rate" has the meaning given to such term in Section 2.6 hereof.

"Defined Benefit Pension Plan" means an employee pension benefit plan defined in Section 3(2) of ERISA (other than a Multiemployer Plan) covered by Title IV of ERISA as provided in Section 4021 of ERISA.

"Defined Contribution Plan" means an individual account plan as defined in ss.3(34) of ERISA.

"Delinquent Purchaser" means a Purchaser more than 50% of whose aggregate Account indebtedness to a Borrower is due for more than 90 days past the invoice date for such Account.

"Dispute" has the meaning given to such term in Section 8.7 hereof.

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"Document" has the meaning given to such term in the New Jersey Uniform Commercial Code as in effect on the date hereof.

"EBITDA" means, on any date of determination, net income of Borrowers and their Subsidiaries prior to income taxes, minus extraordinary gains, plus interest expense, depreciation, amortization, all as determined for Borrowers and their Subsidiaries on a Consolidated basis.

"Effective Date" means, for a LIBOR Tranche, the date a Borrower designates as the date on which a LIBOR Interest Period is to commence pursuant to Sections 2.1 or 2.4 hereof.

"Eligible Account" means any Account of a Borrower created in an arm's

length transaction in the ordinary course of such Borrower's business which meets all the following specifications at the time of determination of Eligible Accounts: (A) the Account is lawfully owned by such Borrower free and clear of all liens, security interests or prior assignments except as set forth in subsection (B) hereof, and such Borrower has the right of assignment thereof and the power to grant a security interest therein; (B) the Account is subject to a first priority security interest in favor of Lender; (C) the Account is valid and enforceable, representing the undisputed indebtedness of a Purchaser to such Borrower; (D) the Account is not subject to any defense, setoff, counterclaim, credit, allowance or adjustment, including without limitation, reserves for quality and special pricing; (E) the Purchaser has accepted the goods, the sale of which to such Purchaser has given rise to the Account; and no part of such goods have been returned, rejected, lost or damaged; (F) if the Account arises from the sale of goods by such Borrower, such sale was an absolute sale and not on consignment or on approval or on a sale-or-return basis nor subject to any other guaranty, repurchase or return agreements, and such goods have been shipped to the Purchaser; (G) if the Account arises from the performance of services, such services have actually been performed; (H) no notice of the death, bankruptcy, receivership, reorganization, or insolvency of the Purchaser owing such Account has been received by Lender or such Borrower; (I) the Purchaser is not a Subsidiary or Affiliate of any Borrower; (J) the Account is less than 90 days past the invoice date; (K) the original invoice creating such Account was delivered on the date the underlying goods or services were provided or within 15 days after such date; (L) the credit-worthiness of the Purchaser is reasonably acceptable to Lender; (M) the Account is not an International Account, unless such Account is an Eligible International Account, in which case, the Account shall not be deemed an International Account; (N) the Purchaser for such Account has not submitted a medium of payment therefor which has been returned uncollected for any reason; (O) the Purchaser for such Account is not otherwise in default pursuant to the terms underlying the agreement creating such Account; (P) such Account is not a contra Account; (Q) such Account is not owed by a Delinquent Purchaser or any Subsidiary or Affiliate of a Delinquent Purchaser; and (R) such Account is otherwise reasonably acceptable to Lender. In addition, not more than 25% of the aggregate Eligible Accounts and Eligible Notes at any one time shall be owing from any one Purchaser or affiliated Purchasers

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(excluding Eligible Accounts and Eligible Notes from L.D. Brinkman & Co. and Lasalle Bristol Corporation). With respect to Eligible Accounts and Eligible Notes from L.D. Brinkman & Co. and Lasalle Bristol Corporation, not more than 35% of the aggregate Eligible Accounts and Eligible Notes at any one time shall be owing from either such Purchaser or Affiliates of such Purchaser. Any Account, Instrument or portion of an Account or Instrument that does not comply with the limitations set forth in the preceding sentences shall not constitute an Eligible Account or Eligible Note, provided however that, to the extent a portion of such Account or Instrument does comply with the limitations set forth in the preceding sentence such portion shall be counted as an Eligible Account

or Eligible Note, but only to the extent that it does so comply.

"Eligible International Account" means an International Account of a Borrower either (A) secured by a letter of credit in the amount of the International Account issued by a bank acceptable to Lender, (B) insured under a foreign credit insurance policy acceptable to Lender with respect to such International Account in favor of such Borrower, (C) payable by a Purchaser that (1) maintains an office in Canada to which such Account is invoiced, or (2) maintains net assets in Canada at least five times as great as the aggregate of all Accounts arising from transactions between such Borrower and such Person, up to an aggregate amount not to exceed \$1,500,000.00, or (D) otherwise acceptable to Lender in its sole discretion, provided however that no International Account will be an Eligible International Account unless Lender has informed Borrowers in writing that such International Account will be accepted by Lender as an Eligible International Account hereunder.

"Eligible Inventory" means any item of Inventory of a Borrower meeting all the following specifications: (A) (1) it is lawfully owned by such Borrower, (2) is in the possession of such Borrower at a location specified on Exhibit 3.4 attached hereto, (3) to the extent such location is not owned by such Borrower, Lender has received a Landlord's Waiver or warehouseman's waiver or consent with respect to such location, (4) except as set forth in subsection (B) below, is subject to no mortgage, pledge, security interest, lien, or other encumbrances of any kind, and (5) such Borrower has the power to grant a security interest therein; (B) it is subject to a first priority perfected security interest in favor of Lender (provided however that, with respect to the initial Advance only, Lender shall have a first priority security interest which will become a first priority perfected security interest upon the filing of UCC-1 financing statements delivered to Lender on or before the Closing Date); (C) it is insured as required by Section 3.13 hereof pursuant to policies in full compliance with the requirements of such Section; (D) it is in good condition and repair; (E) it constitutes readily saleable finished goods or raw materials, excluding the packaging portion of raw materials; (F) is not in transit inventory; (G) it is not slow-moving, consignment or damaged inventory; and (H) it is otherwise acceptable to Lender in its reasonable discretion.

"Eligible Notes" means an Instrument payable to the order of a Borrower meeting all of the following specifications: (A) such instrument is lawfully owned by such Borrower free and clear of all liens, security interests or prior assignments except as set

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forth in subsection (B) hereof, and such Borrower has the right of assignment thereof and the power to grant a security interest therein; (B) the Instrument is subject to a first priority security interest in favor of Lender; (C) the Instrument is valid and enforceable, representing the undisputed indebtedness of a Purchaser to such Borrower; (D) the term of such Instrument is no greater than 180 days; (E) the credit-worthiness of the obligor is reasonably acceptable to

Lender; (F) the obligor has not submitted a medium of payment therefor which has been returned uncollected for any reason; (G) the Account evidenced by such Instrument has not been included as an Eligible Account; (H) the Account would otherwise constitute an Eligible Account, but for the requirements contained in subsections (J) and (K) of the definition of "Eligible Account"; (I) such Purchaser is not in default under such Instrument; and (J) such Instrument is otherwise reasonably acceptable to Lender. In addition, not more than 25% of the aggregate Eligible Accounts and Eligible Notes at any one time shall be owing from any one Purchaser or affiliated Purchasers (excluding Eligible Accounts and Eligible Notes from L.D. Brinkman & Co. and Lasalle Bristol Corporation). With respect to Eligible Accounts and Eligible Notes from L.D. Brinkman & Co. and Lasalle Bristol Corporation, not more than 35% of the aggregate Eligible Accounts and Eligible Notes at any one time shall be owing from either such Purchaser or Affiliates of such Purchaser. Any Account, Instrument or portion of an Account or Instrument that does not comply with the limitations set forth in the preceding sentences shall not constitute an Eligible Account or Eligible Note, provided however that, to the extent a portion of such Account or Instrument does comply with the limitations set forth in the preceding sentence such portion shall be counted as an Eligible Account or Eligible Note, but only to the extent that it does so comply.

"Employee Benefit Plan" has the meaning given to such term in ss.3(3) of ERISA.

"Environmental Law" means any federal, state, or local statute, law, ordinance, regulation, rule, standard, permit or requirement, including, but not limited to, those statutes, ordinances, laws, regulations, rules, standards, permits and requirements promulgated under the laws of the United States of America, concerning or relating to the generation, treatment, storage, transportation, disposal and release into the environment, cleanup and remediation of any "hazardous substance" as that term is defined in Section 101(14) of CERCLA.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended from time to time.

"Eurocurrency Reserve Requirement" means, for any LIBOR Tranche for any LIBOR Interest Period relating thereto, the daily average of the stated maximum rate (expressed as a decimal) at which reserves (including any marginal, supplemental, or emergency reserves) are required to be maintained during such LIBOR Interest Period under Regulation D by a member bank of the Federal Reserve System against "Eurocurrency liabilities" (as such term is used in Regulation D) but without benefit of or credit for proration, exemptions, or offsets that might otherwise be available to such

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member bank from time to time under Regulation D. Without limiting the effect of the foregoing, the Eurocurrency Reserve Requirement shall reflect any other

reserves required to be maintained by such member bank against (A) any category of liabilities which includes deposits by reference to which the LIBOR for LIBOR Tranches is to be determined or (B) any category of extension of credit or other assets that include LIBOR Tranches.

"Event of Default" has the meaning given to such term in Section 7.1 hereof.

"Exchange Notes" means Congoleum's 85/8% Senior Notes due August 1, 2008 which have been registered with the Securities and Exchange Commission.

"Exchange Note Documents" means the Indenture, the Exchange Notes and any other document delivered in connection with the Exchange Notes and/or the Exchange Offer.

"Exchange Offer" means Congoleum's offer to exchange an aggregate principal amount of up to \$100,000,000.00 of its Exchange Notes, for a like principal amount of the Senior Notes.

"Facility Fee" has the meaning given to such term in Section 2.5 hereof.

"Federal Funds Rate" means for each day, the rate per annum (rounded upwards, if necessary to the nearest 1/100 of 1%) which is the weighted average of the rates on overnight federal funds transactions arranged on such day by the federal funds brokers, computed and released by the Federal Reserve Bank of New York (or any successor).

"Fixed Charge Coverage Ratio" means the ratio of (A) EBITDA to (B) Fixed Charges, all as calculated for Borrowers and their Subsidiaries on a Consolidated basis for the immediately preceding four fiscal quarters.

"Fixed Charges" means the sum of (without duplication) (A) interest expense (without deduction of interest income) plus (B) dividends and distributions paid by a Borrower (other than a distribution or dividend paid to another Borrower), provided such dividend or distribution was permitted to be paid in accordance with Section 6.22 hereof.

"GAAP" means generally accepted accounting principles, applied in a consistent manner.

"Indenture" means the Indenture dated as of August 3, 1998 between Congoleum and Lender, as trustee, setting forth certain terms and conditions of the Exchange Notes.

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"Instrument" has the meaning given to such term in the New Jersey Uniform Commercial Code as in effect on the date hereof.

"Interest Rate" means Adjusted LIBOR, the Adjusted Base Rate or the Default Rate, as appropriate.

"International Account" means an Account which arises out of a transaction between a Borrower and a Purchaser who meets at least one of the following criteria: (A) the Purchaser is a non-United States government, governmental agency or government-controlled business, (B) the Purchaser is not subject to the jurisdiction of the court system of the United States or any state of the United States, (C) the Purchaser does not maintain in the United States an office to which such Account is invoiced, or (D) the Purchaser does not maintain net assets in the United States at least five times as great as the aggregate of all Accounts arising from transactions between such Borrower and such Person.

"Inventory" has the meaning given to such term in the New Jersey Uniform Commercial Code as in effect on the date hereof.

"L/C Fee" has the meaning given to such term in Section 2.12 hereof.

"Landlord's Waiver" has the meaning given to such term in Section 3.3 hereof.

"Lender" has the meaning given to such term in the introductory paragraph hereof.

"Letter of Credit" means any Letter of Credit issued by Lender pursuant to Section 2.12 hereof.

"Letter of Credit Cash Collateral Account" has the meaning given to such term in Section 2.11 hereof.

"Letter of Credit Liability" means, at any date of determination, the sum of (A) the maximum aggregate amount which is or at any time thereafter may become available for drawing under all Letters of Credit then outstanding plus (B) the aggregate amount of all drawings under Letters of Credit which have not theretofore been reimbursed by Borrowers. For purposes hereof, Letters of Credit on which a draw has not been received shall be deemed outstanding for a period of 30 Business Days after the expiration date thereof.

"Letter of Credit Sublimit" means Five Million Dollars (\$5,000,000.00).

"Liabilities" has the meaning given to such term in Section 3.1 hereof.

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"LIBOR" means, for each LIBOR Tranche, the rate per annum (rounded upwards, if necessary, to the nearest 1/16th of 1%) determined by Lender according to the following formula:

$$R = X / (1 - Y)$$

where R = LIBOR  
X = London Interbank Offered Rate for such LIBOR  
Tranche for the applicable LIBOR Interest Period  
Y = Eurocurrency Reserve Requirement for such LIBOR  
Tranche for the applicable LIBOR Interest Period

"LIBOR Interest Period" for a LIBOR Tranche means a period of time, beginning on an Effective Date, of 30 days, 60 days, 90 days or 180 days, in length selected by a Borrower by telephone or in writing (and if by telephone, confirmed by such Borrower the same day by facsimile), during which the Interest Rate for such LIBOR Tranche is Adjusted LIBOR. If a LIBOR Interest Period would otherwise end on a day that is not a Business Day, such LIBOR Interest Period shall be extended to the next Business Day, unless such Business Day would fall in the next calendar month, in which event such LIBOR Interest Period shall end on the immediately preceding Business Day.

"LIBOR Tranche" means any portion of the Revolving Credit to which Adjusted LIBOR applies having the same LIBOR Interest Period.

"Loan Documents" means this Agreement, the Note, the UCC financing statements and all other documents executed and delivered by Borrowers in connection with the Revolving Credit.

"London Business Day" means any Business Day on which commercial banks are open for international business (including dealing in Dollar deposits) in London, England, and Philadelphia, Pennsylvania.

"London Interbank Offered Rate" applicable to any elected LIBOR Interest Period for a LIBOR Tranche means the rate per annum (rounded upwards, if necessary, to the nearest 1/16th of 1%) quoted by the principal London branch of Lender two London Business Days prior to the first day of such LIBOR Interest Period for the offering from leading banks in the London interbank market of Dollar deposits in immediately available funds for a period, and in an amount, comparable to the LIBOR Interest Period and principal amount of the LIBOR Tranche which shall be made by Lender and/or be outstanding during such LIBOR Interest Period.

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"Multiemployer Plan" has the meaning given to such term in ss.3(37) of ERISA and regulations issued thereunder.

"Note" has the meaning given to such term in Section 2.1 hereof.

"Operating Account" has the meaning given to such term in Section 2.1 hereof.

"PBGC" means the Pension Benefit Guaranty Corporation.

"Permitted Acquisition" means the acquisition of substantially all of the assets or capital stock or other equity interests of a business which is engaged in substantially the same line of business as a Borrower or a business complementary to the business of a Borrower as reasonably determined by Lender.

"Permitted Encumbrances" means the liens, encumbrances and other title objections described in Section 6.4.

"Person" means an individual, corporation, partnership, trust or any other entity.

"Plan" means an Employee Benefit Plan maintained for employees of a Borrower or any member of its Controlled Group and covered by ERISA.

"Prime Rate" means the rate of interest which Lender announces from time to time to be its "prime rate" (which rate is not necessarily the lowest rate of interest which Lender charges any of its customers, but rather an index rate used by Lender to price many of its loans).

"Proceeds" has the meaning given to such term in the New Jersey Uniform Commercial Code as in effect on the date hereof.

"Prohibited Transaction" has the meaning given to such term in ss.406 of ERISA or regulations issued thereunder.

"Purchaser" means a buyer of goods from a Borrower or a customer for whom services have been rendered or materials furnished by a Borrower.

"Reimbursement Date" has the meaning given to such term in Section 2.12 hereof.

"Reorganization" has the meaning given such term in ss.4241 of ERISA.

"Reportable Event" has the meaning given to such term in ss.4043(c) of ERISA or regulations issued thereunder and, with respect to any such event, the requirement to file a notice of such event with the PBGC has not been waived by statute, regulation, rule or pronouncement issued by the PBGC.

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"Revolving Credit" has the meaning given to such term in the Background Section hereof.

"Security" has the meaning given to such term in the New Jersey Uniform Commercial Code as in effect on the date hereof.

"Senior Notes" means Congoleum's 85/8% Senior Notes due August 1, 2008 which have not been registered with the Securities and Exchange Commission.

"Subordinated Debt" means all indebtedness for borrowed money of a Borrower now or hereafter owed which indebtedness is subordinated to the Liabilities on terms and conditions acceptable to Lender.

"Subsidiary" of a Person (identified for purposes of this definition as "Z") means any Person, 50% or more of the voting capital stock (or other ownership interests) of which is owned, directly or indirectly, by Z.

"Tangible Assets" means all assets of Borrowers and their Subsidiaries on a Consolidated basis that would, in accordance with GAAP, be classified as tangible assets of Borrowers and their Subsidiaries on a Consolidated basis less any amount due from Subsidiaries or Affiliates not otherwise eliminated by such consolidation.

"Tangible Net Worth" means the amount by which Tangible Assets exceed Total Liabilities.

"Termination Date" means the earlier of (A) the date on which Lender's obligations to make Advances terminates pursuant to any provision of this Agreement, or (B) December 18, 2003

"Total Liabilities" means all liabilities of Borrowers and their Subsidiaries on a Consolidated basis that would, in accordance with GAAP, be classified as liabilities of Borrowers and their Subsidiaries on a Consolidated basis less any amount due from Subsidiaries or Affiliates not otherwise eliminated by such consolidation.

"Total Senior Funded Debt" means Debt minus Subordinated Debt.

"Withdrawal Liability" has the meaning given such term in ss.4201 of ERISA.

SECTION 1.2 Accounting Terms. All accounting terms not specifically defined herein shall be construed, and all financial data submitted pursuant to this Agreement shall be prepared, in accordance with GAAP; provided however that, each reference in Article VI, or in the definition of any term used in Article VI, to GAAP shall mean GAAP as in effect on the date hereof.

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## ARTICLE II

### THE REVOLVING CREDIT

SECTION 2.1 The Revolving Credit.

(A) Subject to the terms and conditions hereinafter provided, Lender shall (1) advance to Borrowers such sums as a Borrower may request (each such advance,

an "Advance") and (2) issue Letters of Credit for the account of Borrowers in accordance with Section 2.12 hereof, from time to time during the period from the date hereof through but not including the Termination Date, in an aggregate principal amount not to exceed the Credit Limit. It is agreed by Borrowers that Advances shall be used for working capital purposes and to fund, in part, the costs of the acquisition of certain assets or stock in connection with the Permitted Acquisitions and for no other purposes. The total Advances outstanding plus the Letter of Credit Liability shall not at any time exceed the Credit Limit. If the aggregate amount of the Advances outstanding at any time plus the Letter of Credit Liability exceeds the Credit Limit, Borrowers shall repay immediately the amount of the excess. Borrowers may borrow, repay and reborrow under the Revolving Credit until the Termination Date subject to the terms and conditions of this Agreement.

(B) Any requests for Advances which shall earn interest at the Adjusted Base Rate shall be submitted to Lender in writing or by facsimile copy by 2:00 p.m. of the Business Day of the requested Advance signed by an officer of Borrowers. Any requests for Advances which shall earn interest at Adjusted LIBOR shall be submitted to Lender in writing or by facsimile copy by 11:00 a.m. three London Business Days prior to the date of the requested Advance signed by an officer of Borrowers. Any request for an Advance to finance a Permitted Acquisition or a proposed acquisition (an "Acquisition Advance") shall be submitted to Lender in writing or by facsimile copy no later than ten Business Days prior to the date of the requested Acquisition Advance signed by an officer of Borrowers; provided however that, in the event such requested Acquisition Advance is for Ten Million Dollars (\$10,000,000.00) or more, such request must be submitted in writing or by facsimile copy no later than twenty (20) Business Days prior to the date of the requested Acquisition Advance signed by an officer of Borrowers. Such request shall set forth the date and amount of the requested Advance (which, if a LIBOR Tranche, shall be in the minimum amount of \$500,000.00), if a LIBOR Tranche is requested, the length of the proposed LIBOR Interest Period. Each request for an Advance shall constitute a representation that, at the time thereof and giving effect to the Advance requested thereby: (1) no Event of Default or Default has occurred and is continuing hereunder; (2) the representations and warranties contained herein are expressly reaffirmed and are correct in all material respects as of the date of such request (excluding representations and warranties which speak as of a particular date, which shall be true and correct in all material respects as of such earlier date); and (3) the sum of the outstanding Advances plus the requested Advance plus the

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Letter of Credit Liability will not exceed the Credit Limit. Each request for an Acquisition Advance shall also constitute a representation that: (a) such Permitted Acquisition or proposed acquisition will not cause an Event of Default or Default hereunder; and (b) after giving effect to such Acquisition Advance, the Credit Limit will exceed the sum of the outstanding Advances plus the requested Acquisition Advance plus the Letter of Credit Liability by at least \$10,000,000.00. Each request for an Acquisition Advance shall be accompanied by

a pro forma Compliance Certificate demonstrating that after giving effect to such Permitted Acquisition or proposed acquisition Borrowers shall be in compliance with the provisions hereof including without limitation Sections 6.6 through 6.9 hereof which shall be satisfactory in form and substance to Lender and shall provide such further information and backup as may be reasonably requested by Lender. Lender shall make any Advance to which Borrowers are entitled by depositing the amount thereof into an operating account which Borrowers shall maintain with Lender (the "Operating Account") prior to the Termination Date. Borrowers shall hold Lender harmless from any liability for any loss resulting from Lender's reliance on any writing or facsimile copy purportedly made by an officer of Borrowers, provided that Lender has acted in good faith in doing so. Lender's books and records shall be deemed conclusive evidence of whether or not a request was made and the terms thereof, absent bad faith or manifest error. If Borrowers submit a request for an Advance by facsimile copy, Borrowers shall deliver to Lender the original request (along with the Borrowing Base certificate, if any, required to be submitted therewith) to Lender no later than five (5) Business Days after submission of the facsimile copy.

(C) Borrowers shall pay interest on the principal amount of the Revolving Credit outstanding from time to time at the rates and at the times set forth in Section 2.4 hereof. On the Termination Date, Borrowers shall repay in full the aggregate principal amount of all Advances outstanding under the Revolving Credit, any drawings under Letters of Credit which have not been previously reimbursed by Borrowers, all accrued but unpaid interest thereon and any other amount owing in connection herewith. On the Termination Date, if there remain any unexpired Letters of Credit on such date, Borrowers shall deposit into the Letter of Credit Cash Collateral Account an amount equal to such Letter of Credit Liability, as determined by Lender.

(D) Borrowers shall have the right at any time and from time to time, upon at least five (5) Business Days prior written notice delivered by Borrowers to Lender, to terminate the Credit Limit in whole or reduce the Credit Limit in part, provided however that: (1) Borrowers shall simultaneously with such reduction pay to Lender (a) the amount by which the outstanding principal amount of the Advances plus the Letter of Credit Liability exceeds the Credit Limit as and if so reduced, with such repaid principal to be applied as determined by Lender against Base Rate Tranches and LIBOR Tranches, (b) all accrued and unpaid interest thereon, and (c) the accrued Commitment Fee relating thereto; (2) to the extent application of this subsection requires a payment of any LIBOR Tranches prior to the end of the applicable Interest Period(s), Borrower shall pay any prepayment compensation required under Section 2.10 hereof; and (3) while any Letters of Credit remain outstanding Borrower shall not be permitted to

terminate the Credit Limit in whole or reduce the Credit Limit below the aggregate amount of Letter of Credit Liability then outstanding except as

contemplated by Section 2.1(C). Any partial reduction of the Credit Limit shall be in the minimum amount of \$1,000,000.00 or in multiples of \$1,000,000.00 in excess thereof. Any termination or reduction of the Credit Limit hereunder shall be permanent.

(E) The joint and several obligation of Borrowers to repay the Advances outstanding under the Revolving Credit shall be evidenced by a promissory note, dated the date of this Agreement, payable to the order of Lender, in the principal amount of Thirty Million Dollars (\$30,000,000.00) or, if less, the principal amount of all Advances, and otherwise substantially in the form of Exhibit 2.1(E) attached hereto (the "Note").

SECTION 2.2 Place and Manner of Payments. All payments by Borrowers on account of principal, interest or any other sums due under any of the Loan Documents, shall be made without setoff or counterclaim to Lender at Lender's office located at its address specified in Section 8.2 hereof at or before 2:00 p.m. New Jersey time on the date due, in lawful money of the United States of America and in immediately available funds. Borrowers covenant and agree to maintain with Lender the Operating Account at all times during which the Revolving Credit remains outstanding. Borrowers agree to keep in the Cash Collateral Account (if required to be maintained hereunder) and/or the Operating Account an amount sufficient to make any and all payments of principal and interest on the Revolving Credit and any other amounts which become owing hereunder, as such payments become due. Borrowers hereby authorize Lender to charge the Cash Collateral Account (if required to be maintained hereunder) and/or the Operating Account in order to satisfy Borrowers' payment obligations hereunder, commencing with any and all payments due from and after December 31, 1998. Lender shall charge the Cash Collateral Account (if required to be maintained hereunder) and the Operating Account in order to satisfy Borrowers' payment obligations hereunder. Lender's failure to so charge the Cash Collateral Account (if required to be maintained hereunder) and/or the Operating Account in order to satisfy Borrowers' payment obligations hereunder shall not relieve Borrowers of their joint and several obligations to maintain a sufficient balance in the Cash Collateral Account (if required to be maintained hereunder) and/or the Operating Account to satisfy a payment obligation on the date such payment becomes due, and Borrowers shall continue to be obligated to make such payment. If the Cash Collateral Account (if required to be maintained hereunder) and the Operating Account contain insufficient funds to make any payment when due and payable to Lender hereunder, and such payment is not made by Borrowers in some other manner on the date such payment becomes due, such failure shall constitute an Event of Default hereunder. All payments received by Lender from Borrowers shall be applied in the following order: (A) to the payment of fees and other costs and expenses then due and owing from Borrowers, (B) to the payment of accrued and unpaid interest then due, (C) to the payment of any principal then due and owing under the Revolving Credit, (D) to the payment of any amounts outstanding under the Revolving Credit, and (E) to the Letter of Credit Cash Collateral Account.

SECTION 2.3 Computation of Interest. Interest on the amounts outstanding under the Revolving Credit shall be computed on the basis of a year of 365 or 366 days in the case of Base Rate Tranches and 360 days in the case of LIBOR Tranches for the actual number of days elapsed.

SECTION 2.4 Interest. Borrowers shall pay interest on Advances outstanding under the Revolving Credit as follows:

(A) Base Rate Tranches. Borrowers shall pay interest in arrears on the unpaid principal amount of each Base Rate Tranche at an annual rate equal to the Adjusted Base Rate, from the date on which such Base Rate Tranche is disbursed until such principal amount has been repaid in full, or converted to a LIBOR Tranche, (1) monthly on the last day of each month commencing with the last day of the first month following the Closing Date and (2) on the Termination Date.

(B) LIBOR Tranches. Borrowers shall pay interest in arrears on the unpaid principal amount of each LIBOR Tranche at Adjusted LIBOR (1) on the last day of each LIBOR Interest Period, provided that, if such LIBOR Interest Period is 180 days, Borrowers shall also pay interest on the 90th day of such LIBOR Interest Period, and (2) on the Termination Date.

(C) Conversions to LIBOR Tranches. By notifying Lender at least three London Business Days prior to an Effective Date and subject to the limitations set forth herein, Borrowers may convert into a LIBOR Tranche any Base Rate Tranche in an aggregate principal amount of Five Hundred Thousand Dollars (\$500,000.00). At the end of the applicable LIBOR Interest Period, the LIBOR Tranche will convert back to a Base Rate Tranche unless Borrowers notify Lender at least three London Business Days before the end of the existing LIBOR Interest Period that Borrowers are electing to continue the LIBOR Tranche as a LIBOR Tranche and is selecting a new LIBOR Interest Period.

(D) Restrictions With Respect to LIBOR Tranches. There shall be no more than 5 LIBOR Tranches at any one time.

SECTION 2.5 Fees. (A) Facility Fee. Borrowers shall pay to Lender an origination fee (the "Facility Fee") of \$50,000.00 on the Closing Date. The Facility Fee shall be deemed fully earned and non-refundable upon execution of this Agreement by Borrowers.

(B) Commitment Fee. Borrowers shall pay to Lender a commitment fee (the "Commitment Fee") on the daily unused amount of the Credit Limit (without reference to the Borrowing Base) for each day from and including the Closing Date to and including the Termination Date. The rate per annum shall be equal to .20% of such unused amount. The Commitment Fee shall be payable in arrears (1) on the last day of each quarter commencing on December 31, 1998, and the last day of each March, June, September and December thereafter, (2) on the date of any reduction of the Credit

Limit (to the extent accrued and unpaid on the amount of such reduction) and (3) on the Termination Date.

Late Charges; Default Rate.

(A) In the event that Borrowers fail to make any payment required hereunder or under any of the other Loan Documents within ten (10) days of the date such payment is due, Borrowers shall pay to Lender an amount equal to four percent (4%) of such late payment as a late charge to defer Lender's costs of collecting such late payments. Borrowers authorize Lender to charge the Cash Collateral Account (if required to be maintained hereunder), the Operating Account and/or any other account maintained by Borrowers with Lender for any late charge not otherwise paid by Borrowers.

(B) After the occurrence and during the continuance of any Event of Default, the Interest Rate then in effect on the Revolving Credit immediately shall be increased to the Base Rate plus four percent (4%) (such rate, the "Default Rate").

SECTION 2.7 Payment on Non-Business Days. Whenever any payment to be made hereunder or under the Note or Loan Documents shall be stated to be due on a day that is not a Business Day, such payment shall be made on the next succeeding Business Day, and, except as otherwise specifically provided herein, such extension of time shall in such case be included in the computation of payment of interest hereunder or under the Note, as the case may be.

SECTION 2.8 Reimbursement to Lender for Increased Costs Due to Capital Adequacy Requirements. If any law or regulation or the interpretation thereof by any court or administrative or governmental authority charged with the administration thereof, or compliance by Lender with any request or directive (whether or not having the force of law) of any such authority, applicable from time to time now or after the date hereof to banks in general, shall (A) impose, modify, deem applicable or result in the application of any capital maintenance, capital ratio or similar requirements against loan commitments or other facilities made by Lender and the result thereof shall be to impose upon Lender a fee or a requirement to increase any capital requirement applicable as a result of the making or maintenance of the Revolving Credit (which imposition of or increase in capital requirements may be determined by Lender's reasonable allocation of the aggregate of such capital impositions or increases), or (B) subject Lender to any tax, duty or other charge with respect to the Revolving Credit, the Note, or its obligation to advance the Revolving Credit, or change the basis of taxation of payments to Lender of the principal of or interest on the Revolving Credit or any other amounts due under this Agreement in respect of the Revolving Credit or its obligation to advance the Revolving Credit (except for changes in the rate of tax on the overall net income of Lender imposed by any jurisdiction in which Lender is obligated to pay taxes) to Borrowers, then, upon demand by Lender, Borrowers shall immediately pay to Lender from time to time as specified by Lender, such additional amounts or fees which shall be sufficient to compensate Lender for such impositions of or increases in

capital requirements or taxes from the date of such change, together with interest on each such amount from the date of the delivery of the certificate of Lender referred to in the following sentence until payment in full thereof at the Default Rate with respect to amounts or fees not paid when due. Upon the occurrence of any event referred to above, a certificate setting forth in reasonable detail the amounts necessary to compensate Lender as a result of an imposition of or increase in capital requirements or taxes submitted by Lender to Borrowers shall be conclusive, absent manifest error or bad faith, as to the amount thereof. For purposes of the application of this Section 2.8, and in calculating the amount necessary to compensate Lender for any imposition of or increase in capital requirements or taxes hereunder, Lender shall determine the applicability of this provision and calculate the amount payable to it hereunder in a manner consistent with the manner in which it shall apply and calculate similar compensation payable to it by other borrowers having provisions in their credit agreements comparable to this Section 2.8.

SECTION 2.9 Illegality. Notwithstanding any other provision in this Agreement, if the adoption of any applicable law, rule, or regulation, or any change therein, or any change in the interpretation or administration thereof by any governmental authority, central bank, or comparable agency charged with the interpretation or administration thereof, or compliance by Lender (or its lending office) with any request or directive (whether or not having the force of law) of any such authority, central bank, or comparable agency shall make it unlawful or impossible for Lender (or its lending office) to maintain the Revolving Credit, then upon notice to Borrowers by Lender, the Revolving Credit shall terminate.

SECTION 2.10 Prepayment.

(A) Borrowers may prepay the Base Rate Tranche in whole or in part at any time and from time to time without premium or penalty upon same Business Day notice to Lender prior to 10:00 a.m.

(B) Borrowers agree not to prepay any LIBOR Tranche prior to the expiration of its LIBOR Interest Period unless otherwise expressly required hereunder or after acceleration by Lender pursuant to Section 7.2. In the event that Borrowers prepay any LIBOR Tranche prior to the expiration of its LIBOR Interest Period, whether in violation of the previous sentence, or with the consent of Lender, or in compliance with the express requirement of this Agreement, or otherwise, Borrowers shall pay to Lender, upon the request of Lender, such amount or amounts as shall be sufficient (in the reasonable opinion of Lender) to compensate it for any loss, cost or expense which Lender determines is attributable to:

(1) any payment, prepayment, conversion or renewal of a LIBOR Tranche made by Lender on a date other than the last day of the applicable LIBOR Interest Period for such LIBOR Tranche (whether by

(2) any failure by Borrowers to borrow, convert into or renew a LIBOR Tranche to be made, converted into or renewed by Lender on the date specified therefor pursuant to a Borrower's prior election.

Without limiting the foregoing, such compensation shall include an amount equal to the excess, if any, of: (a) the amount of interest which otherwise would have accrued on the principal amount so paid, prepaid, converted or renewed or not borrowed, converted or renewed for the period from and including the date of the event described in clauses (1) or (2) above to, but excluding, the last day of the then current LIBOR Interest Period for such LIBOR Tranche which would have commenced on the date specified therefor in the relevant notice, at the applicable rate of interest for such LIBOR Tranche provided for herein; over (b) the amount of interest (as reasonably determined by Lender) Lender would have bid to New York dealers of London interbank dollar deposits for amounts comparable to such principal amount prepaid and maturities comparable to the remainder of such LIBOR Interest Period. A determination of Lender as to the amounts payable pursuant to this Section shall be conclusive absent manifest error or bad faith.

SECTION 2.11 Letter of Credit Cash Collateral Account. Cash collateral delivered to Lender pursuant to Sections 2.1 or 2.12 hereof shall be maintained in a deposit account of Borrowers to be established with Lender at the time such cash collateral is first created, over which Lender shall have sole control (the "Letter of Credit Cash Collateral Account"); provided that, so long as no Default or Event of Default has occurred and is continuing hereunder, Borrowers shall have the right to request, and Lender shall withdraw from the Letter of Credit Cash Collateral Account, the amount by which the balance in such account exceeds the Letter of Credit Liability which amount shall be deposited by Lender into the Operating Account. Borrowers hereby grant, bargain, convey and set over to Lender a security interest in and lien upon the Letter of Credit Cash Collateral Account and all cash and any other assets at any time hereafter contained therein as security for the payment and performance of all of Borrowers' obligations now or hereafter incurred hereunder, under the Note or otherwise in connection herewith. Borrowers shall take such action and execute and deliver such documents, including financing statements, as Lender may determine necessary or desirable to further the security interest hereby created. After the occurrence of an Event of Default and acceleration of the Revolving Credit as set forth in Section 7.2 hereof, or if Borrowers shall have failed to pay all amounts which have come due on or prior to such applicable due date, Lender shall apply all funds held in the Letter of Credit Cash Collateral Account in the manner provided in Section 2.2. On the Termination Date, all monies in the Letter of Credit Cash Collateral Account in excess of the amount required to repay Advances, the Letter of Credit Liability, and any other amount then owing hereunder shall be returned to Borrowers.

(A) Letters of Credit. In addition to a Borrower requesting that Lender make Advances pursuant to Section 2.1, a Borrower may request, in accordance with the provisions of this Section, that, on and after the date on which all of the conditions set forth in Section 4.1 are satisfied through but not including the Termination Date, subject to the terms and conditions hereof, Lender issue Letters of Credit for the account of such Borrower in an aggregate amount up to the Letter of Credit Sublimit; provided, that (1) in no event shall any Letter of Credit have an expiration date later than the Termination Date, and (2) no Borrower shall request any Letter of Credit if, after giving effect to such issuance, the Letter of Credit Liability would exceed the Letter of Credit Sublimit. The issuance of any Letter of Credit in accordance with the provisions of this Section shall require the satisfaction of each condition set forth in Sections 4.2 and 4.3.

(B) Evergreen Letters of Credit. Notwithstanding the provisions of Section 2.12(A), above, Lender hereby agrees to issue upon a Borrower's request, one or more Letter(s) of Credit which by its terms may be extended for additional periods of up to one (1) year each provided that (1) the expiration date of each such Letter of Credit (whether the initial expiration date or extended expiration date) would not be later than the Termination Date, and (2) renewal of such Letters of Credit, at Lender's discretion, shall be available upon written request from a Borrower to Lender at least sixty (60) days before the date upon which notice of renewal is otherwise required.

(C) Notice of Issuance or Amendment. Whenever a Borrower desires the issuance of a Letter of Credit or the amendment of a Letter of Credit, it shall deliver to Lender a written notice no later than 11:00 A.M. at least two (2) Business Days, or in each case such shorter period as may be agreed to by Lender in any particular instance, in advance of the proposed date of issuance. That notice shall specify (1) the proposed date of issuance (which shall be a Business Day), (2) the face amount of the Letter of Credit, (3) the expiration date of the Letter of Credit, (4) the purpose of the Letter of Credit and (5) the name and address of the beneficiary. On the proposed date of issuance of any Letter of Credit, Lender shall determine to the best of its knowledge whether the proposed Letter of Credit, when added to the then outstanding Letter of Credit Liability, would be within the Letter of Credit Sublimit and, when added to the then outstanding Letter of Credit Liability and Advances, would be within the Credit Limit. Unless both such criteria are satisfied, Lender shall not issue or cause to be issued the requested Letter of Credit. Borrowers shall hold Lender harmless for any miscalculations or other errors in making such determinations. In the event that, upon issuance of such proposed Letter of Credit, (a) the Letter of Credit Sublimit is exceeded, Borrowers shall immediately establish with Lender, if not already so established, and deposit into the Letter of Credit Cash Collateral Account the amount of such excess; and (b) the Credit Limit is exceeded, Borrowers shall immediately repay to Lender

the amount of such excess first for application against the Advances, together with accrued interest thereon and then for deposit into the Letter of Credit Cash Collateral Account. Prior to the date of issuance, Borrowers shall deliver to Lender an executed application for such Letter of Credit in the form customarily required by Lender for the issuance of letters of credit (the current version of such form is attached hereto

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as Exhibit 2.12), and specify a precise description of the documents and the verbatim text of any certificate to be presented by the beneficiary which, if presented by the beneficiary prior to the expiration date of the Letter of Credit, would require Lender to make payment under the Letter of Credit; provided, that Lender may require reasonable changes in any such documents and certificates; and provided, further, that no Letter of Credit shall require payment against a conforming draft to be made hereunder on the same Business Day that such draft is presented if such presentation is made after 11:00 A.M. on such Business Day. In determining whether to pay under any Letter of Credit, Lender shall be responsible only to determine that the documents and certificates required to be delivered under the Letter of Credit have been delivered and that they comply on their face with the requirements of that Letter of Credit.

(D) Payment of Amounts Drawn Under Letters of Credit. In the event of any request for drawing under any Letter of Credit by the beneficiary thereof, Lender shall notify Borrowers and Borrowers shall reimburse Lender on the day on which such drawing is honored in an amount in same day funds equal to the amount of such drawing; provided that (1) if sufficient funds are then in the Letter of Credit Cash Collateral Account to reimburse Lender in full for the amount of such drawing, Lender shall reimburse itself by debiting such amount necessary to reimburse Lender from the Letter of Credit Cash Collateral Account, (2) if the funds then in the Letter of Credit Cash Collateral Account are insufficient to reimburse Lender in full for the amount of such drawing, Lender shall debit the Letter of Credit Cash Collateral Account in the amount thereof and the unreimbursed balance of such drawing shall be reimbursed in accordance with clause (3) below, and (3) if there are no funds (or insufficient funds) then in the Letter of Credit Cash Collateral Account then unless Borrowers shall have notified Lender prior to 11:00 A.M. on the date of such drawing that Borrowers intend to reimburse Lender for the amount of such drawing with funds other than the proceeds of the Advances, Borrowers shall be deemed to have given notice to Lender requesting it to make an Advance in accordance with Section 2.1 on the day on which such drawing is honored (the "Reimbursement Date") in an aggregate amount equal to the amount of such drawing less the amount, if any, remitted to Lender pursuant to clause (2) above.

(E) Compensation. Borrowers agree to pay the following amounts to Lender:

(1) a fee equal to 0.75% per annum of the face amount of such Letter of Credit (the "L/C Fee");

(2) with respect to drawings made under any Letter of Credit, interest, payable on demand, on the amount paid by Lender in respect of each such drawing from the date of the drawing to the date such amount is reimbursed by Borrowers (including any such reimbursement out of the proceeds of Advances or out of the Letter of Credit Cash Collateral Account) at a rate equal to the Adjusted Base Rate for the period from the date of such drawing to and including the first Business Day after the date of such drawing and thereafter at a rate which is at all times equal to the Default Rate; and

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(3) with respect to the issuance, amendment, transfer, administration, cancellation or conversion of each Letter of Credit and each drawing made thereunder, processing charges in accordance with Lender's standard schedule for such charges in effect at the time of such issuance, amendment, transfer, administration, cancellation or drawing, as the case may be, or as otherwise agreed to by Lender.

(F) Obligations Absolute. The joint and several obligation of Borrowers to reimburse Lender for drawings made under the Letters of Credit issued by it shall be unconditional and irrevocable and shall be paid strictly in accordance with the terms of this Agreement under all circumstances including, without limitation, the following circumstances:

(1) any lack of validity or enforceability of any Letter of Credit;

(2) the existence of any claim, set-off, defense or other right which a Borrower may have at any time against a beneficiary or any transferee of any Letter of Credit (or any persons or entities for whom any such transferee may be acting), Lender, any Affiliate of Lender, or any other Person, whether in connection with this Agreement, the transactions contemplated herein or any unrelated transaction (including any underlying transaction between such Borrower and the beneficiary for which the Letter of Credit was procured);

(3) any draft, demand, certificate or any other document presented under any Letter of Credit proving to be forged, fraudulent, invalid or insufficient in any respect or any statement therein being untrue or inaccurate in any respect;

(4) payment by Lender under any Letter of Credit against presentation of a demand, draft or certificate or other document which does not comply with the terms of such Letter of Credit; provided, that such payment does not constitute willful misconduct or gross negligence on the part of Lender;

(5) any breach of this Agreement or any document delivered in connection herewith by any party hereto or thereto; and

(6) the fact that an Event of Default or an event which, but for the

giving of notice, the passage of time or both, would constitute an Event of Default shall have occurred and be continuing.

(G) Indemnification; Nature of Lender's Duties. In addition to amounts payable as elsewhere provided in this Section 2.12, each Borrower hereby agrees to protect, indemnify and save Lender harmless from and against any and all claims, demands, liabilities, damages, losses, costs, charges and expenses (including reasonable attorneys' fees and allocated costs of internal counsel) which Lender may incur or be subject to as a consequence, direct or indirect, to the extent not caused by the gross negligence, bad faith or willful misconduct of Lender, its directors, officers, employees, agents or attorneys, of (1) the issuance of any Letter of Credit, or (2) the

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failure of Lender to honor a drawing under any Letter of Credit as a result of any act or omission, whether rightful or wrongful, of any present or future de jure or de facto government or governmental authority. Without limiting the foregoing, Lender shall not have any obligation to ascertain whether the stated purpose of any requested Letter of Credit is permitted by this Agreement and shall not be liable for any Borrower's use of a Letter of Credit issued pursuant to the terms hereof in violation of Borrowers' covenants contained herein.

As among each Borrower on one hand and Lender on the other hand, each Borrower assumes all risks of the acts and omissions of, or misuse of the Letters of Credit issued by Lender by the respective beneficiaries of such Letters of Credit. In furtherance and not in limitation of the foregoing, Lender shall not be responsible for: (a) the form, validity, sufficiency, accuracy, genuineness or legal effect of any document submitted by any party in connection with the application for and issuance of such Letters of Credit, even if it should in fact prove to be in any or all respects invalid, insufficient, inaccurate, fraudulent or forged; (b) the validity or sufficiency of any instrument transferring or assigning or purporting to transfer or assign any such Letter of Credit or the rights or benefits thereunder or proceeds thereof, in whole or in part, which may prove to be invalid or ineffective for any reason; (c) failure of the beneficiary of any such Letter of Credit to comply fully with conditions required in order to draw upon such Letter of Credit, unless (i) such failure is material and substantive, and (ii) Lender's payment on such Letter of Credit constitutes gross negligence or willful misconduct; (d) errors, omissions, interruptions or delays in transmission or delivery of any messages, by mail, cable, telegraph, telex or otherwise, whether or not they be in cipher; (e) errors in interpretation of technical terms; (f) any loss or delay in the transmission or otherwise of any document required in order to make a drawing under any such Letter of Credit or of the proceeds thereof; (g) the misapplication by the beneficiary of any such Letter of Credit; or (h) any consequences arising from causes beyond the control of Lender. None of the above shall affect, impair, or prevent the vesting of any of Lender's rights or powers hereunder.

In furtherance and extension and not in limitation of the specific provisions hereinabove set forth, any action taken or omitted by Lender under or in connection with the Letters of Credit issued by it or the related certificates, if (i) taken or omitted in good faith and (ii) substantially in accordance with the terms thereof, shall not put Lender under any resulting liability to Borrowers.

#### SECTION 2.13 Special Provisions for LIBOR Tranches.

(A) Unavailability of Funds and Indeterminate Interest Rates. If on or before the date Lender is to make any LIBOR Tranche or on or before any Effective Date (1) Lender determines in good faith that it is unable to obtain funds at LIBOR for the elected LIBOR Interest Period for any reason, including, but not limited to the unavailability of funds at such rate, any change in existing law, any new law, the length of such LIBOR Interest Period, or otherwise or (2) Lender determines in good faith that

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no adequate means exists to determine LIBOR for such LIBOR Interest Period, then, at Lender's option, Borrowers shall be deemed to have requested an Advance at the Adjusted Base Rate or shall be required to elect a LIBOR Interest Period of a length for which Lender may obtain funds at the rate the adjustment of which determines LIBOR.

(B) Changes Affecting Ability to Maintain Funds. If, during any LIBOR Interest Period, any change in existing law, any new law, or any other factor beyond the control of Lender prevents Lender in its good faith determination from maintaining funds at the rate the adjustment of which determines LIBOR for such LIBOR Interest Period and requires Lender to cease so maintaining funds actually so maintained prior to termination of such LIBOR Interest Period, then on the date of such required cessation, Borrowers shall be required to specify a different Interest Rate for such LIBOR Interest Period or, in the alternative, to elect an Interest Period of a length for which Lender may maintain funds at the rate the adjustment of which determines LIBOR. In addition, within five days after Lender notifies Borrowers of such required conversion, Borrowers shall reimburse Lender for any loss or expense Lender has certified in writing to Borrowers that Lender has incurred as a result of any such required cessation.

SECTION 2.14 Ineligible LIBOR Interest Periods. If, on any date Lender is to make a LIBOR Tranche or on any Effective Date, the period of time from such date or such Effective Date to the Termination Date or final repayment date is less than a LIBOR Interest Period which Borrowers could otherwise elect, Borrowers will elect a LIBOR Tranche whose LIBOR Interest Period will end on or before the Termination Date or the final repayment date, as necessary. If an appropriate LIBOR Interest Period is not available, then the Advance shall be made at the Adjusted Base Rate.

SECTION 2.15 Availability of Rate Quotations. Notwithstanding anything herein to the contrary, if Lender reasonably determines (which determination shall be conclusive) that quotations of interest rates for the relevant deposits referred to in the definition used to calculate LIBOR are not being provided in the relevant amounts or for the relevant maturities for purposes of determining the rate of interest on a LIBOR Tranche as provided in this Agreement, then Lender shall forthwith give notice thereof to Borrowers. From and after the date on which such notice is given, (A) the obligation of Lender to make LIBOR Tranches shall be suspended; and (B) Borrowers shall repay in full the then outstanding principal amount of each LIBOR Tranche, together with accrued interest thereon, on the last day of the then current Interest Period applicable to such LIBOR Tranche by remitting sufficient funds to Lender or by conversion to a Base Rate Tranche.

### ARTICLE III

#### COLLATERAL

SECTION 3.1 Security Interests. As security for the performance of this Agreement, and/or any of the other Loan Documents, the payment of principal and interest under the Revolving Credit and the payment of all other liabilities of each Borrower to Lender,

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whether absolute or contingent, matured or unmatured, direct or indirect, sole, joint, several, or joint and several, similar or dissimilar, related or unrelated to the Loan Documents, due or to become due or heretofore or hereafter contracted or acquired, including without limitation, obligations of any Borrower as surety under any guaranty or suretyship agreement given or to be given by such Borrower to Lender for the debt of others (the "Liabilities"), each Borrower hereby grants, pledges, and assigns to Lender a security interest in the following assets of such Borrower now owned or hereafter acquired including, without limitation, all of the following, (A) Accounts (including but not limited to Eligible Accounts), (B) Inventory (including, but not limited to, Eligible Inventory) of such Borrower and any intellectual property rights of such Borrower (including, but not limited to, patents, trademarks and tradenames or licenses thereto) to the extent necessary for the Lender to dispose of such Inventory, (C) Documents, (D) Instruments (including, but not limited to, Eligible Notes), (E) any lockbox established in accordance with Section 3.6 hereof, (F) the Operating Account, the Cash Collateral Account, the Letter of Credit Cash Collateral Account and any other account maintained by such Borrower with Lender and all cash held therein, (G) its Books and Records, and (H) all Proceeds and products of the foregoing, including, insurance thereon, now owned or hereafter acquired by such Borrower.

SECTION 3.2 Financing Statements. Each Borrower will join with Lender in executing such financing statements and continuation statements (in form reasonably satisfactory to Lender) under the Uniform Commercial Code as Lender

may specify, and will pay the cost of filing the same in such public offices as Lender shall designate. Each Borrower agrees to take whatever action Lender reasonably requests to perfect and to continue perfection of Lender's security interest in the Collateral.

SECTION 3.3 Landlord's Waiver. Each Borrower shall cause the owners of the locations identified on Exhibit 3.4 to execute and deliver to Lender an instrument (in form satisfactory to Lender) by which each such owner waives its right to distrain on any of the Collateral, and by which such owner grants to Lender the right (but not the obligation) to cure any default by such Borrower under the applicable lease (the "Landlord's Waiver").

SECTION 3.4 Places of Business; Location of Collateral.

(A) Each Borrower represents that the properties listed on part A of Exhibit 3.4 attached hereto serves as such Borrower's chief place of business, chief executive office, and the place where it keeps its Books and Records, and that all of the Inventory serving as Collateral hereunder are kept at the locations listed on part B of Exhibit 3.4 attached hereto.

(B) Each Borrower will notify Lender prior to (1) any change in the location of the chief place of business or chief executive office of such Borrower, (2) any change in the place where such Borrower keeps its Inventory or its Books and Records, (3) the establishment of any new or the discontinuance of any existing place of business, and

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(4) the establishment of any new or the discontinuance of any location where Inventory or Books and Records are kept.

SECTION 3.5 Lender's Rights With Respect to Accounts. With respect to any Account that is Collateral hereunder, Lender shall have the right at any time and from time to time without notice to Borrowers to: (A) endorse in the name of a Borrower all proceeds of the Accounts payable to such Borrower that come to Lender which, if the Cash Collateral Account has been established, will then be deposited into the Cash Collateral Account or, if the Cash Collateral Account has not been established, will then be deposited into the Operating Account; (B) upon the occurrence and during the continuance of a Default or an Event of Default, notify Purchasers under a Borrower's Accounts that such Accounts have been assigned to Lender, (C) upon the occurrence and during the continuance of a Default or an Event of Default, forward invoices to Purchasers directing them to make payments to Lender, collect all Accounts of a Borrower in Lender's or such Borrower's name, and take control of any cash or non-cash proceeds of a Borrower's Accounts which will then be deposited into the Cash Collateral Account; (D) upon the occurrence and during the continuance of a Default or an Event of Default, compromise, extend, or renew any Account of a Borrower or deal with such Borrower's Accounts as Lender may deem advisable; (E) make exchanges, substitutions, or surrenders of Collateral; and (F) upon the occurrence and

during the continuance of a Default or an Event of Default, take control of any cash or non-cash proceeds of any Collateral which cash proceeds will be deposited into the Cash Collateral Account.

### SECTION 3.6 The Lockbox; The Cash Collateral Account.

(A) Notwithstanding anything to the contrary contained herein, Lender may require Borrowers to execute and deliver to Lender an irrevocable "Lockbox Agreement" in Lender's standard form under which Borrowers will agree to indicate on all invoices and other correspondence with customers and Purchasers to make all payments to Borrowers in care of a post office box which will be under the exclusive control of Lender and further under which each Borrower will appoint Lender, as such Borrower's true and lawful attorney-in-fact to receive all incoming mail, open all such mail, remove all collections and remittances therefrom in payment of or on account of any Borrower's Accounts and use Lender's reasonable efforts to forward all other mail so received to such Borrower's place of business. Borrowers agree to pay to Lender promptly when billed Lender's standard fees for opening a lockbox account with Lender. Each Borrower hereby grants, bargains, conveys and sets over to Lender a security interest in and lien upon such lockbox and all cash and any other assets at any time hereafter contained therein. All cash and other assets in such accounts shall be deposited in the Cash Collateral Account.

(B) Notwithstanding anything to the contrary contained herein, Borrowers hereby agree upon the request of Lender to establish a restricted access account which will be under the exclusive control of Lender (the "Cash Collateral Account") into which

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each Borrower shall deposit all payments of any of its Accounts; provided that, so long as no Default or Event of Default has occurred and is continuing hereunder and there are no Advances outstanding hereunder, Borrowers shall have the right to request, and Lender shall withdraw from the Cash Collateral Account, any balance in such account which balance shall be deposited into the Operating Account. Borrowers hereby grant, bargain, convey and set over to Lender a security interest in and lien upon such Cash Collateral Account and any other account established by a Borrower with Lender or any affiliate thereof, and all cash and any other assets at any time hereafter contained therein. For purposes of determining whether a requested Advance may be made in accordance with Section 2.1 hereof only, the total outstanding principal under the Revolving Credit shall be reduced each Business Day by an amount equal to any and all amounts deposited into the Cash Collateral Account, provided however that, if any checks deposited into the Cash Collateral Account are returned unpaid or otherwise dishonored and as a result of such dishonor the total outstanding principal including the amount of any such dishonored check exceeds the Credit Limit, Borrowers shall repay immediately the amount of the excess. Amounts deposited into the Cash Collateral Account shall be applied to amounts outstanding hereunder each Business Day. Borrowers shall pay Lender interest at

the Base Rate on the average daily uncollected funds deposited into the Cash Collateral Account. Such interest on the average daily uncollected funds shall be due at the end of each month.

### SECTION 3.7 Accounts.

(A) With respect to any Borrower's Account, such Borrower represents that: (1) such Account is not evidenced by a judgment, an Instrument or Chattel Paper or secured by a letter of credit (except (a) such judgment as has been assigned to Lender, (b) such Instrument or Chattel Paper as has been endorsed and delivered to Lender and (c) such letter of credit as has been assigned and delivered to Lender) and represents a bona fide completed transaction; (2) the amount shown on such Borrower's Books and Records and on any list, invoice or statement furnished to Lender is owing to such Borrower; (3) the title of such Borrower to the Account and, except as against the Purchaser, to any goods represented thereby is absolute; (4) the Account has not been transferred to any other person, and, at the time such Account is created, no person except such Borrower has any claim thereto or, with the sole exception of the Purchaser therefor, to the goods represented thereby; (5) no partial payment against any Account has been made by anyone; and (6) no set-off or counter-claim to such Account exists, and no agreement has been made with any person under which any deduction or discount may be claimed.

(B) Each Borrower will promptly, and in any event within two (2) Business Days of the creation thereof, notify Lender if any Account arises out of contracts with the United States or any department, agency or instrumentality thereof, furnish Lender with copies of each such contract and execute any instruments and take any steps reasonably required by Lender in order that all moneys due and to become due under

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any such contract shall be assigned to Lender and notice given under the Federal Assignment of Claims Act.

(C) Each Borrower will (1) furnish Lender upon Lender's request with all information received by such Borrower affecting the financial standing of any Purchaser; (2) if requested by Lender, mark such Borrower's records concerning each of its Accounts in a manner satisfactory to Lender so as to show that each Account has been assigned to Lender; (3) if requested by Lender, furnish Lender with satisfactory evidence of the shipment and receipt of any goods and the performance of any services represented by any Accounts; and (4) furnish Lender with such other information as Lender may from time to time reasonably request.

SECTION 3.8 Letters of Credit. Each Borrower represents and warrants to Lender that it has delivered to Lender and covenants that it will deliver to Lender promptly on receipt all originals of letters of credit securing its Accounts now in its possession or hereafter acquired, each properly assigned and/or endorsed over to Lender, which letters of credit shall be held by Lender as security

hereunder. Each Borrower shall remain solely responsible for the observance and performance of all of its covenants and obligations under all such letters of credit, and Lender shall not be required to observe or perform any such covenants or obligations.

SECTION 3.9 Inventory. Each Borrower represents and agrees that (A) such Borrower is the absolute owner of its Inventory, subject only to the security interests created hereby and Permitted Encumbrances; and (B) such Borrower will sell its Inventory only in the ordinary course of business; and (C) if any Inventory is or becomes represented by a Document, Lender may require that such Document be in such form as to permit Lender or anyone to whom Lender may negotiate the same to obtain delivery to it of the Inventory represented thereby.

SECTION 3.10 Condition of Inventory. Each Borrower will promptly, and in any event within two (2) Business Days after a Borrower becomes aware of the occurrence thereof, notify Lender of any event of deterioration, loss or depreciation of value of any substantial portion of its Inventory and the amount of such deterioration, loss or depreciation.

SECTION 3.11 Expenses of Lender. Borrowers will reimburse Lender on demand for all expenses (including the reasonable fees and expenses of legal counsel for Lender) in connection with the enforcement of Lender's rights to take possession of the Collateral and the proceeds thereof and to hold, collect, render in material compliance with applicable Environmental Laws and regulations, prepare for sale, sell and dispose of the Collateral.

SECTION 3.12 Notices. If notice of sale, disposition or other intended action by Lender with respect to the Collateral is required by the Uniform Commercial Code or other applicable law, any notice thereof sent to Borrowers at the address specified in Section 8.2 hereof or such other address of Borrowers as may from time to time be

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shown on the records of Lender at least ten days prior to such action, shall constitute reasonable notice to Borrowers.

SECTION 3.13 Insurance; Discharge of Taxes, etc. Lender shall have the right at any time and from time to time, with or without notice to Borrowers, to (A) obtain insurance covering any of the Collateral if a Borrower fails to do so, (B) discharge taxes, liens, security interests or other encumbrances at any time levied or placed on any of the Collateral and (C) pay for the maintenance and preservation of any of the Collateral. Borrowers will reimburse Lender, on demand, with interest at the Default Rate for any payment Lender makes, or any expense Lender incurs under this authorization. Each Borrower assigns to Lender, as its interest may appear, all right to receive the proceeds of insurance covering the Collateral, directs any insurer to pay all such proceeds directly to Lender and authorizes Lender to endorse in the name of such Borrower any

draft for such proceeds.

SECTION 3.14 Waiver and Release by Borrowers. Each Borrower (A) waives protest of all commercial paper at any time held by Lender on which such Borrower is in any way liable, notice of nonpayment at maturity of any and all Accounts of such Borrower and, except where required hereby or by law, notice of action taken by Lender, and (B) releases Lender from all claims for loss or damage caused by any failure to collect any Account or by any act or omission on the part of Lender or its officers, agents and employees, except gross negligence and willful misconduct.

SECTION 3.15 Access to Inventory. Each Borrower shall permit Lender's representatives to have access to its Inventory from time to time, as requested by Lender, for purposes of audit, examination, inspection, and appraisal thereof and verification of such Borrower's records pertaining thereto. Except after the occurrence and during the continuance of a Default or an Event of Default, Lender shall give a Borrower at least 72 hours telephone notice before exercising the rights granted in the preceding sentence and such audit, examination, inspection, appraisal or verification shall be conducted, to the extent taking place on such Borrower's premises, during normal business hours. Upon demand by Lender, each Borrower shall assemble its Inventory which constitutes Collateral hereunder and make it available to Lender at such Borrower's place of business. At the request of Lender, after the occurrence and during the continuance of an Event of Default, each Borrower shall provide warehousing space in its own premises to Lender for the purpose of taking Inventory into the custody of Lender without removal thereof from such premises and will erect such structures and post such signs as Lender may require in order to place such Inventory under the exclusive control of Lender.

SECTION 3.16 Records and Reports. Each Borrower shall keep accurate and complete records of its Accounts (and the collection thereof), Chattel Paper, Instruments, Documents and Inventory and furnish Lender such information about its Accounts, Chattel Paper, Instruments, Documents, and Inventory as Lender may reasonably request. Lender shall have the right to conduct periodic examinations and verifications of each Borrower's Books and Records, which examination may include,

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without limitation, verifications of Accounts by contacting Purchasers. Each Borrower agrees to make its Books and Records available to Lender at such Borrower's principal place of business for purposes of such examination. Provided there does not exist a Default or an Event of Default, Lender agrees to give a Borrower at least 72 hours notice of such examination (which notice need not be in writing) and to conduct such examination during normal business hours. Borrowers shall reimburse Lender for the reasonable costs and expenses (whether internal or external) of any such examination. Borrowers shall reimburse Lender for the costs and expenses (whether internal or external) of any such examination which, prior to the occurrence and during the continuance of an

Event of Default hereunder, shall not exceed \$500.00 per auditor per day and \$3,000.00 in the aggregate per annum.

SECTION 3.17 Further Assurances. From time to time each Borrower will execute and deliver to Lender such additional instruments as Lender may reasonably request to effectuate the purposes of this Agreement and to assure to Lender, as secured party, a security interest in the Collateral. Each Borrower hereby irrevocably appoints Lender as such Borrower's attorney-in-fact (A) to take any action Lender deems necessary to perfect or maintain perfection of any security interest granted to Lender herein or in connection herewith, including the execution of any document on such Borrower's behalf, and (B) to take any other action to effectuate the rights granted in this Article III, which power of attorney is coupled with an interest and irrevocable until all of the Liabilities are paid in full. Until all of the Liabilities are paid in full, Lender may, at any time and from time to time, send to any Purchaser a verification form, make such calls or otherwise contact Purchasers of a Borrower as are necessary or desirable, in Lender's sole discretion, to verify Accounts and the balance due.

SECTION 3.18 Application of Proceeds of Collateral. All proceeds of Collateral shall be applied (A) to the costs of preservation and, after the occurrence of an Event of Default, liquidation of such Collateral and Lender's exercise of its rights under Articles III and VII hereof, then (B) to any unpaid fees due hereunder, then (C) to any unpaid interest due hereunder or under the Note, then (D) to the principal payable hereunder or under the Note, then (E) to all other Liabilities.

SECTION 3.19 Continuing Collateral. Lender shall be under no obligation to proceed first against any part of the Collateral before proceeding against any other part of the Collateral. It is expressly agreed that all of the Collateral stands as equal security for all Liabilities and Lender shall have the right to proceed against or sell any and/or all of the Collateral in any order, or simultaneously, as it, in its sole discretion, shall determine.

#### ARTICLE IV

#### CONDITIONS OF LENDING

SECTION 4.1 Conditions Precedent to Lender's Obligations. The obligations of Lender hereunder are subject to the conditions precedent that, on or before the day the initial Advance under the Revolving Credit is to be made or the initial Letter of Credit is

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to be issued, Lender shall have received all of the following, in form and substance satisfactory to Lender:

(A) a copy, certified in writing by a Secretary or Assistant Secretary of

each Borrower, of (1) resolutions of the Board of Directors of such Borrower evidencing approval of the Loan Documents by such Borrower and the matters contemplated thereby, (2) each document evidencing other necessary action and governmental approvals, if any, with respect to the Loan Documents, and (3) such Borrower's charter documents and by-laws;

(B) a favorable opinion of independent counsel for Borrowers on such matters and in form and substance acceptable to Lender;

(C) a written certificate by the Secretary or an Assistant Secretary of each Borrower as to the names and signatures of the officers of such Borrower authorized to sign the Loan Documents to which such Borrower is a party and the other documents or certificates of such Borrower to be executed and delivered pursuant thereto and to request Advances or the issuance of Letters of Credit;

(D) recent certificates, issued by the Secretary of State of the State of the state of incorporation of each Borrower, stating that such Borrower is a corporation duly incorporated and in good standing under the laws of such state;

(E) recent certificates, issued by the Secretaries of State of each state in which each Borrower does business, stating that such Borrower is in good standing as a foreign corporation under the laws of such state;

(F) a field audit of the Collateral (performed by auditors selected by Lenders) satisfactory to Lender;

(G) the Note duly executed by each Borrower;

(H) the UCC financing statements required by Lender duly executed by Borrowers;

(I) copies of all real property leases under which a Borrower is lessee or lessor;

(J) the Landlord's Waivers required by Section 3.3 hereof;

(K) a copy of each and every authorization, permit, consent and approval of and other action by, and notice to and filing with (collectively, "Consents"), every governmental authority and regulatory body which is required to be obtained or made by each Borrower for the due execution, delivery and performance of this Agreement and the other Loan Documents, or a certificate of an officer of each Borrower and such supporting evidence as Lender may request that no such Consents are required;

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(L) a pro forma Compliance Certificate as of the Closing Date using Borrowers' results for the twelve (12) month period ending September 30, 1998;

(M) evidence of the completion of the transactions contemplated by the Exchange Offer;

(N) the financial information required by Section 5.4 hereof relating to Borrowers;

(O) a certificate of insurance confirming that each Borrower has procured insurance policies covering worker's compensation, public liability and completed operations, protecting such Borrower against any liability for loss or damage to persons or property in any way occurring during the progress of the work or in any way arising from the work, whether under the Worker's Compensation Law or otherwise, and whether injury shall be to employees or to persons other than employees. Lender shall be named an additional insured on the liability insurance policy, and the aforesaid certificate shall confirm Lender's status as an additional insured and contain the agreement of the insurer to give not less than thirty (30) days notice to Lender prior to cancellation of such policies or material change in the coverage thereof;

(P) copies of an all-risk hazard insurance policy or policies on a full replacement cost basis (with no co-insurance) (including flood insurance, if applicable) for the full insurable value of all Collateral with a standard lender loss payee clause in favor of Lender as its interest may appear, in an amount or amounts and with a company or companies reasonably satisfactory to Lender, and which contains the agreement of the insurer to give not less than thirty (30) days notice to Lender prior to cancellation of such policies or material change in the coverage thereof;

(Q) evidence of liability, errors and omissions, business interruption, and product liability insurance in amounts as are customary in each Borrower's industry and are reasonably acceptable to Lender, with a company or companies reasonably satisfactory to Lender, with a long form endorsement in favor of Lender, and which contains the agreement of the insurer to give not less than thirty (30) days notice to Lender prior to cancellation of such policies or material change in the coverage thereof;

(R) a lien search prepared by a search company acceptable to Lender showing no perfected liens against any of the assets of Borrowers, excluding liens for which termination statements have been received by Lender;

(S) a payoff letter from the lender for Congoleum's existing revolving credit facility;

(T) such evidence as Lender may reasonably require that each Borrower and its business and the transactions contemplated hereby are in material compliance with all applicable federal, state and local environmental laws, ordinances, rules and regulations;

(U) evidence that Borrowers have paid or has made arrangements satisfactory to Lender to pay all fees, costs and expenses incurred in connection with the transactions contemplated hereby including, without limitation, the Facility Fee, the audit fees, lien search fees, filing fees and the fees and expenses of Lender's counsel;

(V) results satisfactory to Lender of (1) an examination of the Collateral and Books and Records conducted by Lender; (2) inquiries conducted by Lender of Borrowers' trade and bank creditors and Purchasers; and (3) any other due diligence conducted by Lender with respect to Borrowers;

(W) each other document required by Article III hereof as to the Collateral and any other documents or condition which Lender may reasonably request;

(X) an executed Borrowing Base certificate in the form attached hereto as Exhibit 4.1;

(Y) documents necessary to open the Operating Account and, if required by Lender, the Cash Collateral Account;

(Z) a letter from Borrowers' certified public accountants addressed to Lender acknowledging and agreeing that Lender may rely on financial statements required under Section 6.2(A)(1) in administering the Revolving Credit;

(AA) originals of all of each Borrower's letters of credit (drawn on a bank other than Lender), if any, supporting any Account, each properly endorsed and/or assigned to Lender; and

(BB) such other documents as Lender may reasonably require.

SECTION 4.2 Additional Conditions Precedent. The obligations of Lender hereunder are subject to the further conditions precedent that:

(A) the representations and warranties contained in this Agreement and in the other Loan Documents shall be correct and accurate in all material respects on and as of the date of each Advance or issuance as though made on and as of such date (excluding representations and warranties which speak as of a particular date, which shall continue to be true and correct in all material respects as of such date);

(B) no Default or Event of Default shall have occurred and be continuing or will result from the making of any Advance or issuance of any Letter of Credit;

(C) there shall have occurred no material adverse change in the financial condition, assets, nature of the assets, operations or prospects of a Borrower; and

(D) there shall be no litigation pending or, to the best of any Borrower's

knowledge, threatened which has not previously been disclosed to Lender in writing

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and which, if adversely determined, is reasonably likely to have a material adverse effect on the financial condition, assets, operations or prospects of a Borrower.

SECTION 4.3 Conditions to Issuance of Letters of Credit. The obligation of Lender to issue any Letter of Credit hereunder is subject to the prior or concurrent satisfaction of all of the following conditions:

(A) On or before the date of issuance of the Letter of Credit, each of the conditions set forth in Section 4.1 shall have been satisfied or waived;

(B) On or before the date of issuance of each Letter of Credit, Lender in respect of such Letter of Credit shall have received in accordance with the provisions of Section 2.12, a notice requesting the issuance of such Letter of Credit, an executed application for such Letter of Credit in the form customarily required by Lender for the issuance of letters of credit, all other information specified in Section 2.12, and such other documents as Lender may reasonably require in connection with the issuance of such Letter of Credit;

(C) On the date of issuance of each Letter of Credit, all conditions precedent described in Section 4.2 shall be satisfied to the same extent as though the issuance of such Letter of Credit were the making of an Advance, and each request by a Borrower to Lender to issue a Letter of Credit shall constitute a representation by Borrowers that at the time thereof (1) all conditions precedent described in Section 4.2 have been satisfied and (2) the sum of the proposed Letter of Credit plus the Letter of Credit Liability plus the Advances then outstanding would not exceed the Credit Limit; and

(D) On or before the date of issuance of such Letter of Credit, Borrowers shall have paid the fees therefor required under Section 2.12.

## ARTICLE V

### REPRESENTATIONS AND WARRANTIES

In addition to all other representations and warranties set forth in this Agreement (including, without limitation, those in Article III hereof), each Borrower represents and warrants as follows:

SECTION 5.1 Existence. Each Borrower is a corporation, duly formed, validly existing, and in good standing under the laws of the State of Delaware. Each Borrower has all requisite power and authority to conduct its business as presently conducted and to own its properties and is duly qualified as a foreign corporation in good standing in all other jurisdictions in which its failure so

to qualify could have a material adverse effect on its financial condition or business.

SECTION 5.2 Authorization. The execution, delivery, and performance by each Borrower of each Loan Document to which it is a party has been duly authorized by all

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necessary corporate action, and does not and will not violate any provision of law or of the certificate of incorporation or by-laws of such Borrower or result in a material breach of or constitute a default under any agreement, indenture, or instrument to which such Borrower is a party or by which such Borrower, or any of its properties, may be bound.

SECTION 5.3 Validity of Documents. Each Loan Document when duly executed and delivered by the parties thereto will constitute the valid and legally binding obligation of each Borrower, enforceable against each such Borrower in accordance with its terms, except as such enforceability may be limited by bankruptcy, insolvency, or other similar laws affecting the enforcement of creditors' rights generally, by limitations on the availability of equitable remedies and by equitable principles.

SECTION 5.4 Financial Information. The financial information and statements of Borrowers, including without limitation annual financial statements of Borrowers, previously delivered to Lender (excluding projections delivered to Lender), are complete and correct in all material respects and accurately reflect the financial positions and results of operations of Borrowers as of the dates and for the periods indicated, in accordance with GAAP (subject with respect to quarterly or interim statements to year-end adjustments and the absence of footnotes). Since the date of such statements, there has been no material adverse change in such financial position which has not been disclosed to Lender in writing.

SECTION 5.5 Litigation. Except as disclosed on Exhibit 5.5 attached hereto as of the date hereof, there are no actions, suits, or proceedings pending or, to the knowledge of Borrowers, threatened, against a Borrower or any of its properties before any court or governmental department, commission, board, bureau, agency, or instrumentality (domestic or foreign) that, if determined adversely to such entity, would have a material adverse effect on the financial condition or operations of such Borrower or which relate to its entering into the Loan Documents, or the consummation of the transactions contemplated thereby.

SECTION 5.6 Contingent Liabilities. As of the date hereof, there are no suretyship agreements, guarantees, or other Contingent Liabilities of a Borrower that are not included on the financial statements mentioned in Section 5.4 hereof or otherwise disclosed in this Agreement other than suretyship agreements and guarantees given to Lender.

SECTION 5.7 Taxes. Each Borrower has filed all tax returns and reports required to be filed before the date hereof and has paid all taxes, assessments, and charges imposed upon it or its property, or that it is required to withhold and pay over, to the extent that they were required to be paid before the date hereof.

SECTION 5.8 Encumbrances. Except as disclosed on Exhibit 5.8 attached hereto, the property and assets of each Borrower are not subject to any mortgage, pledge, security, interest, lien, or other encumbrance except for Permitted Encumbrances.

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SECTION 5.9 Consents. Except for the filing of the UCC financing statements contemplated by Section 3.2 hereof, no authorization, consent, approval, license, exemption by or filing or registration with any court or governmental department, commission, board (including the Board of Governors of the Federal Reserve System), bureau, agency, or instrumentality, domestic or foreign, or other Person is or will be necessary for the valid execution, delivery, or performance by Borrowers of the Loan Documents.

SECTION 5.10 ERISA. Each Borrower and other members of its Controlled Group maintain only those Defined Benefit Pension Plans and Defined Contribution Plans listed on Exhibit 5.10 attached hereto. Except as otherwise disclosed on Exhibit 5.10 attached hereto, no Borrower is obligated to contribute to any Multiemployer Plans and no Borrower has any Withdrawal Liability with respect to any Multiemployer Plan of which such Borrower or any member of its Controlled Group had previously been a member. All such Defined Benefit Pension Plans and Defined Contribution Plans, as of the date hereof, meet the minimum funding standards of Section 302 of ERISA and Section 412 of the Code without regard to any funding waiver and no non-exempt Prohibited Transaction has occurred with respect to any such plan which is reasonably likely to have a material adverse effect on the financial condition or results of operations of a Borrower. No Defined Benefit Pension Plan sponsored by a Borrower or any member of its Controlled Group has any amount of "unfunded benefit liabilities" (as such term is defined in 4001(a)(18) of ERISA) which is reasonably likely to have a material adverse effect on the financial condition or results of operations of a Borrower. Except as set forth on Exhibit 5.10 attached hereto, no trust was established in connection with any such Defined Benefit Pension Plan pursuant to ss.4049 of ERISA. No liability (whether or not such liability is being litigated) has been asserted against a Borrower or any Controlled Group member in connection with any Defined Benefit Pension Plan by the PBGC or by a trustee appointed pursuant to ss.4042(b) or (c) of ERISA which is reasonably likely to have a material adverse effect on the financial condition or results of operations of a Borrower, and no lien has been attached and, to the best of each Borrower's knowledge, no person has threatened to attach a lien on any property of a Borrower or any Controlled Group member as a result of any failure by such Borrower to comply with the Code or ERISA with respect to any Defined Benefit Pension Plan. Each such Defined Benefit Pension Plan and Defined Contribution

Plan, as most recently amended, including, without limitation, amendments to any trust agreement, group annuity, or insurance contracts, or other governing instrument, is the subject of a favorable determination letter by the Internal Revenue Service with respect to its qualification under ss.401(a) of the Code or an application for such determination within the applicable remedial amendment period has been filed and, to the best of each Borrower's knowledge, such plans are in material compliance, both in form and in operation, with the requirements of the Code and ERISA. All Plans maintained by a Borrower or any member of its Controlled Group are in material compliance in all respects (A) in operation with the requirements of the Code and the regulations thereunder and ERISA, and (B) in form with those requirements of the Code and the regulations thereunder and ERISA which must be met on the date hereof.

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There is not now, and has not been, any violation of the Code or the regulations thereunder or ERISA that creates a material liability for any Borrower with respect to the filing of applicable reports, documents, and notices regarding the Plans of a Borrower or any member of its Controlled Group with the Secretary of Labor, the Secretary of the Treasury, the PBGC or any other governmental entity or the furnishing of such documents to the participants or beneficiaries of such Plans. No Borrower nor any member of its Controlled Group has any unfunded liabilities of unfunded and uninsured "employee welfare benefit plans" (as defined in ss.3(1) of ERISA) which are reasonably likely to have a material adverse effect on the financial condition or results of operations of a Borrower. There is not now, and has not been, any violation of the "continuation coverage requirements" applicable to "group health plans" under ss.4980B of the Code and the regulations thereunder and Part 6 of Subtitle B of Title I of ERISA that creates a material liability with respect to any Employee Benefit Plan of a Borrower or of any member of its Controlled Group to which such continuation coverage requirements apply.

SECTION 5.11 Subsidiaries and Affiliates; Fictitious Name. No Borrower has any Subsidiaries or Affiliates as of the date hereof other than as listed on Exhibit 5.11 attached hereto and, except as set forth on Exhibit 5.11 attached hereto, does not trade under any fictitious names.

SECTION 5.12 Licenses, Permits, etc. Each Borrower is in possession of and operating in material compliance with all franchises, grants, authorizations, licenses, permits, easements, consents, certificates and orders required for the conduct of its business as now conducted, and all of them are valid and in full force and effect, except where the failure to possess any such franchise, grant, authorization, license, permit, easement, consent, certificate or order would not have a material adverse effect on the financial condition or operations of such Borrower.

SECTION 5.13 Compliance with Laws Generally. Each Borrower is in material compliance with all laws, rules, regulations, and orders of all federal, state, and governmental agencies and courts which are applicable to it, to the conduct

of its business, or to the ownership and use of its properties, except where the failure to be in such compliance would not have a material adverse effect on the financial condition or operations of such Borrower.

SECTION 5.14 Environmental Matters. To the extent necessary for the conduct of its business, each Borrower is in possession of and in material compliance with all required permits relating to the discharge or release of liquids, gases or solids into the air, water, and soil except as set forth on Exhibit 5.14 attached hereto. No Borrower refines, processes, generates, stores, recycles, transports, disposes of, or releases into the environment any "hazardous substance" as that term is defined in Section 101(14) of CERCLA or any hazardous or toxic substances as those terms are used in any state or local environmental statute or regulation except in material compliance with all Environmental Laws. Except as set forth on Exhibit 5.14 attached hereto, no Borrower has received notice from any governmental agency that it is a potentially responsible

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party in any proceeding under CERCLA or any similar state or local environmental statute or regulation, received any notice of violation, citation, complaint, request for information, order, directive, compliance schedule, notice of any claim, proceeding, or litigation from any party concerning such Borrower's compliance with any Environmental Law.

SECTION 5.15 Patents, etc. Each Borrower possesses all patents, trademarks, copyrights, tradenames, trade secrets, and other intellectual property rights, or licenses therefor, that are required to conduct its business as presently conducted without, to the best of any Borrower's knowledge, conflict with the rights or claimed rights of others.

SECTION 5.16 Debt and Credit Arrangements. Except as set forth on Exhibit 5.16 as of the date hereof, no Borrower has any Debt and is not a party to any credit agreement, guaranty, capital lease or other investments, agreements and arrangements presently in effect providing for or relating to extensions of credit in respect of which such Borrower is in any manner directly or contingently obligated, except to the extent such Borrower is obligated to pay for goods and services obtained or acquired in the ordinary course of business under customary trade terms.

SECTION 5.17 Regulation U, Etc. The Revolving Credit will not constitute a violation of Regulation T, U or X of the Board of Governors of the Federal Reserve System. No part of the proceeds of the Revolving Credit will be used for any purposes which violate or are inconsistent with the provisions of any of such regulations.

SECTION 5.18 Labor Matters. As of the date hereof, there are no existing, or to the knowledge of Borrowers, threatened, or contemplated, strikes, slowdowns, picketing or work stoppages by any employees against a Borrower, any lockouts by a Borrower of any of its employees or any labor trouble or other occurrence,

event or condition of a similar character.

SECTION 5.19 Outstanding Judgments or Orders. Each Borrower has satisfied all judgments against it to the extent outstanding and not stayed pending appeal for more than thirty (30) days, and no Borrower is in default with respect to any judgment, writ, injunction, decree, rule or regulation of any court, arbitrator or commission, board bureau, agency or instrumentality, domestic or foreign, pertaining to it.

SECTION 5.20 No Defaults on Other Agreements. No Borrower is in default in the performance, observance or fulfillment of any of the material obligations, covenants or conditions contained in any agreement or instrument to which it is a party which has not been waived in writing or cured which would have a material adverse effect on the financial condition or operations of a Borrower or any Loan Document.

SECTION 5.21 Full Disclosure. No representation or warranty by a Borrower in this Agreement and no information in any statement, certificate, schedule or other document furnished or to be furnished to Lender pursuant hereto, or in connection with the transactions contemplated hereby, contains or will contain any untrue statement of

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a material fact, or omits or will omit to state a material fact necessary to make the statements contained herein or therein not misleading. Except as disclosed in this Agreement and the Exhibits attached hereto, there is no fact known to Borrowers which has not been disclosed to Lender in writing which materially adversely affects the financial condition or operations of a Borrower or any Loan Document.

## ARTICLE VI

### COVENANTS

In addition to all other covenants set forth in this Agreement, each Borrower covenants that so long as any of the Liabilities shall remain unpaid unless Lender shall otherwise consent in writing:

SECTION 6.1 Use of Proceeds. The proceeds of the Revolving Credit will be used as set forth in the Background Section hereof.

SECTION 6.2 Financial Information.

(A) In addition to the reports which Borrowers are obligated to deliver pursuant to Article III hereof, Borrowers will furnish to Lender:

(1) as soon as available, and in any event within ninety (90) days

after the close of each fiscal year of Borrowers, (a) a Consolidated and Consolidating balance sheet of Borrowers and their Subsidiaries as of the close of each such fiscal year together with related statements of operations, retained earnings and changes in financial position for such fiscal year, audited and unqualifiedly certified by independent certified public accountants reasonably acceptable to Lender and (b) a copy of Congoleum's Annual Report on Form 10K for such fiscal year;

(2) as soon as available, and in any event no later than forty-five (45) days after the end of each fiscal quarter, (a) an unaudited Consolidated and Consolidating balance sheet of Borrowers and their Subsidiaries as of the close of each such fiscal quarter together with related statements of operations, retained earnings and changes in financial position for such fiscal quarter and (b) a copy of Congoleum's Quarterly Report on Form 10Q for such fiscal quarter (if required to be filed);

(3) as soon as available prior to the end of each fiscal year but in no event later than thirty (30) days prior to the end of each such fiscal year, a budget by quarter of projected revenues and expenses, for the next fiscal year;

(4) as soon as available, and in any event no later than the fifteenth day of each month, (a) an aging report of the Accounts of each Borrower showing the names of Purchasers, the amounts owed by them respectively, and the invoice dates for each such Account, (b) a monthly calculation of Accounts which are not Eligible

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Accounts, (c) a monthly reconciliation report reconciling the last two monthly Accounts aging reports provided to Lender, (d) a monthly inventory report, all of which shall be in form and detail reasonably satisfactory to Lender and (e) a completed Borrowing Base certificate in the form attached hereto as Exhibit 4.1, provided however that, the failure to deliver the foregoing reports, certificates or calculations by the fifteenth of a month shall not constitute an Event of Default hereunder in the event that Borrowers deliver such report or calculation within three (3) days of notice of such failure from Lender;

(5) in the event that, at any time and for so long as, the Credit Limit does not exceed the outstanding Advances and the Letter of Credit Liability by more than \$10,000,000.00, Borrowers shall be obligated to deliver a completed Borrowing Base certificate in the form attached hereto as Exhibit 4.1 by Tuesday of each week, provided further that Lender in its sole discretion shall have the right at any time to increase the frequency of Borrowers' delivery of Borrowing Base certificates;

(6) as soon as available, and in any event no later than the fifth Business Day after the filing thereof, a copy of any document (other than those otherwise required to be delivered hereunder) filed by Congoleum with the

(7) promptly upon the request of Lender, a list containing the name, address and telephone number of all current Purchasers; and (8) promptly upon the request of Lender, any other information reasonably requested by Lender.

(B) All data will be prepared according to GAAP.

(C) Each statement required to be delivered in accordance with Section 6.2(A) (1) and (2) above shall be accompanied by a completed Compliance Certificate of the chief executive officer or chief financial officer of Congoleum in substantially the form of Exhibit 6.2 attached hereto.

SECTION 6.3 Insurance. In addition to the requirements of Article III hereof, each Borrower will at all times carry insurance, in form and amount reasonably satisfactory to Lender, and underwritten by financially sound and reputable insurers reasonably satisfactory to Lender, against fire (with extended coverage and, if required by the location of any of such Borrower's premises on a flood plain, flood coverage), liability, business interruption, errors and omissions, product liability and all other hazards specified by Lender and will furnish to Lender a copy of all such insurance policies which shall insure the interest of Lender in accordance with a standard lender's loss payable clause as to all non-liability policies. All insurance policies will name Lender as an additional insured and contain provisions (A) that with respect to Lender, the insurance policies may be cancelled only for nonpayment of premiums by a Borrower after not less than 30 days notice of intent to cancel provided to Lender and (B) that the insured will make payment to Lender as its interest may appear under any such policy

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notwithstanding any defense which such insurer may have against any of the other insureds on such policy.

SECTION 6.4 Encumbrances. No Borrower will create, incur, assume, or suffer to exist any mortgage, pledge, lien, or other encumbrance of any kind upon, or any security interest in, any of its property or assets (including, but not limited to, the Collateral), whether now owned or hereafter acquired, except for the following (collectively, "Permitted Encumbrances"): (A) liens for taxes not yet delinquent; (B) statutory inchoate liens in connection with workmen's compensation, unemployment insurance, or other social security obligations; (C) mechanic's, workman's, materialman's, landlord's, carrier's, or other similar liens arising in the ordinary course of business with respect to obligations that are not due; (D) liens listed on Exhibit 5.8 attached hereto; (E) liens in favor of Lender; and (F) liens in respect of "Acquired Indebtedness" (as such term is defined in the Indenture on the date hereof) provided that (1) such liens do not apply to the Accounts, Inventory or Documents of the entity acquired, and (2) the transaction in which such Acquired Indebtedness is incurred is a Permitted Acquisition; and (G) "Permitted Liens" as such term is

defined in the Indenture on the date hereof. No Borrower will agree with any Person to restrict its ability to grant mortgages, pledges, liens, or other encumbrances upon, or security interests in, any of its property or assets, except for the restrictions contained in the Indenture.

SECTION 6.5 Minimum Tangible Net Worth.

(A) From the Closing Date to December 30, 1999, Borrowers will not permit

(1) the sum of

(a) Tangible Net Worth, plus

(b) to the extent deducted in determining Tangible Net Worth, the good will associated with Permitted Acquisitions consummated during the fiscal year ending December 31, 1999 not to exceed \$4,000,000.00 in the aggregate, plus or minus

(c) any change in Tangible Net Worth resulting from changes in additional minimum pension liability recognized after December 31, 1997 under FASB Statement No. 87 subject to the limitation contained in subsection (D) hereof, to be less than

(2) the sum of

(a) \$20,000,000.00 minus

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(b) any repurchase or redemption of stock of a Borrower during the fiscal year ending December 31, 1999 subject to the limitation contained in subsection (D) hereof.

(B) From December 31, 1999 through December 30, 2000, Borrowers will not permit:

(1) the sum of

(a) Tangible Net Worth, plus

(b) to the extent deducted in determining Tangible Net Worth, the good will associated with Permitted Acquisitions consummated during the fiscal year ending December 31, 1999 not to exceed \$4,000,000.00 in the aggregate, plus or minus

(c) any change in Tangible Net Worth resulting from changes in additional minimum pension liability recognized after December 31, 1997 under FASB Statement No. 87 subject to the limitation contained in subsection (D) hereof to be less than

(2) the sum of

(a) \$20,000,000.00 plus

(b) 50% of Borrowers' net income (but with no reduction for net losses) earned in the fiscal year ending December 31, 1999 plus

(c) 100% of the proceeds from the sale of any capital stock in any Borrower (to any Person other than another Borrower) during the fiscal year ending December 31, 1999 plus

(d) 100% of the proceeds from the sale of any fixed assets of any Borrower during the fiscal year ending December 31, 1999 subject to the limitations contained in subsection (D) hereof, minus

(e) any repurchase or redemption of stock of a Borrower during the fiscal year ending December 31, 1999 subject to the limitation contained in subsection (D) hereof.

(C) From and after December 31, 2000, Borrowers will not permit the sum of

(1) (a) Tangible Net Worth commencing as of the end of any fiscal year ending from and after December 31, 1999 through the day preceding the end of the following fiscal year, plus or minus

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(b) any change in Tangible Net Worth resulting from changes in additional minimum pension liability recognized after December 31, 1997 under FASB Statement No. 87 subject to the limitation contained in subsection (D) hereof

to be less than

(2) the sum of

(a) the Tangible Net Worth required as of the end of the preceding fiscal year (which, in the case of the fiscal year ending December 31, 1999 through December 30, 2000 shall be the sum of subsections (B) (2) (a) through (B) (2) (e) and thereafter shall be the sum of subsections (C) (2) (a) through (C) (2) (e) as of the end of the preceding fiscal year) plus

(b) 50% of Borrowers' net income (but with no reduction for net losses) earned in the fiscal year ending on the first date of the period being measured plus

(c) 100% of the proceeds from the sale of any capital stock in any Borrower (to any Person other than another Borrower) during the fiscal year

ending on the first date of the period being measured plus

(d) 100% of the proceeds from the sale of any fixed assets of any Borrower during the fiscal year ending on the first date of the period being measured subject to the limitation contained in subsection (D) hereof, minus

(e) any repurchase or redemption of stock of a Borrower during the fiscal year ending on the first date of the period being measured subject to the limitation contained in subsection (D) hereof

(D) The aggregate reduction of Tangible Net Worth pursuant to subsection (B) (2) (e) and (C) (2) (e) shall not exceed \$5,000,000.00. Proceeds from the sale of any fixed assets of any Borrower during the fiscal year ending on the first day of the period being measured shall be disregarded for the purpose of the aggregate increase of Tangible Net Worth pursuant to subsection (B) (2) (d) and (C) (2) (d) to the extent the aggregate amount thereof is less than \$100,000.00. The aggregate change in Tangible Net Worth pursuant to subsection (B) (1) (b) and (C) (1) (b) shall not exceed \$5,000,000.00.

SECTION 6.6 Fixed Coverage Charge Ratio. Borrowers shall maintain a Fixed Coverage Charge Ratio at all times of greater than 2.50:1.00.

SECTION 6.7 No Losses. Borrowers shall not suffer losses for any two consecutive fiscal years.

SECTION 6.8 Capital Expenditures. Borrowers' Capital Expenditures shall not exceed: (A) \$25,000,000.00 in the fiscal year ending December 31, 1999 and (B)

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\$20,000,000.00 in any fiscal year ending thereafter, provided however that in the event Capital Expenditures in the fiscal year ending December 31, 1999 are less than \$25,000,000.00, Borrowers may expend such excess in the immediately following fiscal year and provided further that, Borrowers may expend an additional \$20,000,000 in the aggregate on Capital Expenditures (in excess of the annual limitations set forth in subsection (A) and (B) above) from January 1, 1999 to the Termination Date.

SECTION 6.9 Fiscal Year. Each Borrower shall at all times maintain its fiscal year ending on December 31, unless otherwise required by government regulation.

SECTION 6.10 Accounting Methods. Without the prior written consent of Lender, no Borrower shall change its accounting methods except as otherwise permitted or required by GAAP.

SECTION 6.11 Taxes. Each Borrower shall pay when due all taxes, assessments, and charges imposed upon it or its properties by any governmental entity or which it is required to withhold or pay over unless the same is being contested by such Borrower in good faith by proper proceedings and for which proper reserves or

other provisions have been made in accordance with GAAP.

SECTION 6.12 Guarantees, etc. Except for obligations existing on the date hereof set forth on Exhibit 6.12, no Borrower shall become liable on the obligation of another Person or otherwise incur any consensual Contingent Liability except by endorsement of negotiable instruments for deposit or collection in the usual course of business, except for guarantees or suretyship agreements given to Lender and except for guarantees by one Borrower of indebtedness of another Borrower provided such indebtedness is permitted to be incurred in accordance with Section 6.16 hereof.

SECTION 6.13 Loans and Investments. No Borrower shall make any loans or investments (including without limitation loans to officers or loans to or investments in Affiliates or Subsidiaries) except for (A) investments in (1) Cash Equivalents, (2) direct obligations of, or obligations fully guaranteed by, the United States of America, and (3) obligations of Lender, (B) investments in or loans to another Borrower, (C) Permitted Acquisitions, and (D) "Permitted Investments" as such term is defined in the Indenture on the date hereof.

SECTION 6.14 Compliance with Laws. Each Borrower shall comply in all material respects with all laws and regulations applicable to it in the operation of its business except where the failure to so comply would not have a material adverse effect on the financial conditions or operations of a Borrower.

SECTION 6.15 Environmental Matters.

(A) To the extent necessary for the conduct of its business, each Borrower will obtain and comply in all material respects with all permits, licenses, registrations, and approvals required by Environmental Laws relating to the discharge or release of

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liquids, gases or solids into the environment. To the extent that such are applicable to the conduct of its business, each Borrower will comply in all material respects with all laws, rules, regulations and governmental orders and directives relating to the generation, treatment, storage, transportation, disposal and release into the environment and cleanup of any hazardous or toxic waste or substance which is subject to the provisions of CERCLA, or any similar state or local environmental statute or regulation at all premises owned or operated by such Borrower. Each Borrower will comply in all material respects with all laws, rules, regulations, and governmental orders and directives relating to the cleanup of hazardous or toxic substances at all premises owned or operated by it unless the same is being contested by such Borrower in good faith by proper proceedings and for which proper reserves or other provisions have been made in accordance with GAAP.

(B) Each Borrower will promptly notify Lender if it receives, and in any event no later than the fifth Business Day after any Borrower's receipt of, (1)

any notice from any governmental agency that it is a potentially responsible party in any proceeding under CERCLA or any similar state or local environmental statute or regulation, (2) any notice of any claim, proceeding, litigation, order, directive, citation, or request for information concerning environmental conditions, or notice of any alleged violation of any environmental statute, ordinance, regulation, or permit condition against such Borrower or related to any location owned, used or occupied by such Borrower at any time, or (3) any written notice or information concerning any potentially materially adverse environmental condition, including, but not limited to, any spilling, leaking, discharge, release, or threat of release of any hazardous or toxic waste or substance above regulatory limits at any location owned, used or occupied by such Borrower at any time.

(C) Each Borrower shall comply in all material respects with any notice or directive from any governmental authority, whether state, federal, or local, regarding the removal or discharge of any hazardous substance on any of its properties within such period as may be required therein unless the same is being contested by such Borrower in good faith and, upon request of Lender shall provide a bond or title insurance endorsement reasonably satisfactory to Lender insuring Lender's continued lien on the Collateral affected by such notice or directive.

(D) Each Borrower hereby indemnifies and agrees to defend and hold harmless Lender, its parent corporation, subsidiaries, successors, assigns, officers, directors, shareholders, employees, agents and counsel from and against any and all claims, actions, causes of action, liabilities, penalties, fines, damages, judgments, losses, suits, expenses, legal or administrative proceedings, interest, costs and expenses (including court costs and reasonable attorneys', consultants' and experts' fees) arising out of or in any way relating to (1) the presence of any substance which is or becomes regulated under any Environmental Law whether now or hereafter enacted, on, about, beneath or arising from any property used or occupied by a Borrower; (2) the failure of a Borrower to comply with any Environmental Law; (3) a Borrower's breach of

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any of the representations and warranties or covenants contained herein relating to any Environmental Law; (4) any notice of violation, citation, complaint, request for information, order, directive, compliance schedule, notice of claim, consent decree, action, litigation or proceeding brought or instituted by any governmental authority or any third party under or in connection with any Environmental Law or based on the presence of any substances described in (1) above against a Borrower or related to any location owned, used or occupied by a Borrower at any time; and (5) the imposition or recording of a lien against any property of or occupied by a Borrower pursuant to any Environmental Law, unless, in each case, due to the gross negligence or willful misconduct of Lender. IT IS INTENDED THAT THE INDEMNITY PROVIDED IN THIS SECTION SHALL SURVIVE THE REPAYMENT OF THE LIABILITIES.

SECTION 6.16 Maintenance of Property. Each Borrower will maintain all of its property (subject to ordinary wear and tear) in good condition and repair except for property which is no longer useful or necessary to the conduct of the business of such Borrower.

SECTION 6.17 Inspection by Lender. Each Borrower will permit representatives of Lender to inspect, examine and/or audit the Collateral, any of its other property and/or its Books and Records and to make extracts therefrom at Borrowers' expense and at all reasonable times, provided however that except after the occurrence and during the continuance of a Default or an Event of Default, Lender shall give a Borrower at least 72 hours telephone notice before exercising the rights granted in the preceding clause and such audit, examination or inspection shall be conducted, to the extent taking place on a Borrower's premises, during normal business hours.

SECTION 6.18 Limitations on Borrowing. No Borrower will incur or otherwise permit to exist any obligation for the payment of borrowed money, whether as borrower or guarantor, except (A) Debt owed to Lender in connection herewith, (B) trade debt incurred by such Borrower in the ordinary course of business, (C) the Debt set forth on Exhibit 5.16, (D) Debt owed to another Borrower, (E) Debt not to exceed \$5,000,000.00 in the aggregate, and (F) the Debt represented by the Exchange Notes and any refinancing thereof provided that any Debt incurred to refinance the Exchange Notes (1) has a maturity date that is not earlier than August 1, 2008, (2) is not subject to any sinking fund or principal repayment which begins prior to the Termination Date, (3) has an interest rate less than or equal to 8 5/8% per annum, and (4) is in an aggregate principal amount not in excess of the aggregate principal amount and accrued interest outstanding under the Exchange Notes on the date of the proposed refinancing thereof.

SECTION 6.19 Reports. Borrowers will furnish the following to Lender:

(A) as soon as possible and in any event within 5 days after a Borrower becomes aware of the occurrence of any Default or Event of Default a written statement of Borrowers signed by the chief executive officer or chief financial officer of Borrowers setting forth details of such Default or Event of Default, stating whether or not the same is continuing and, if so, the action proposed to be taken with respect thereto;

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(B) as soon as possible and in any event within 5 days after a Borrower receives knowledge thereof, notice in writing of all actions, suits, or proceedings before any court or governmental department, commission, board, bureau, agency, or instrumentality, domestic or foreign, directly affecting a Borrower which, if adversely determined, is reasonably likely to have a material adverse effect on the financial condition, assets, operations or prospects of such Borrower;

(C) as soon as possible and in any event within 5 days after a Borrower

becomes aware of the occurrence of a significant material adverse change in the business, properties, operations, or condition (financial or otherwise) of a Borrower, a written statement of Borrowers signed by the chief executive or chief financial officer of Borrowers setting forth details of such significant material adverse change and the action proposed to be taken with respect thereto;

(D) as soon as possible and in any event within 5 days after a Borrower receives knowledge thereof, notice in writing of any strike, walkout, boycott or other material labor dispute involving a Borrower;

(E) if requested by Lender, furnish to Lender copies, with such duplicate copies as Lender may request, of any invoice applicable to a Borrower's Accounts; and

(F) such other information respecting the business properties, operations, and condition (financial or otherwise) of a Borrower as Lender may at any time and from time to time reasonably request.

#### SECTION 6.20 ERISA.

(A) Each Borrower and all members of its Controlled Group will comply in all material respects with the provisions of ERISA and the Code with respect to any Defined Benefit Pension Plan and Defined Contribution Plan including the timely filing of required annual reports and the payment of PBGC premiums except where the failure to so comply would not have a material adverse effect on the financial condition, assets, operations or prospects of a Borrower.

(B) Each Borrower will furnish to Lender, promptly after the filing thereof with the United States Secretary of Labor and the PBGC and, in any event within five Business Days of the filing thereof, copies of each annual or other report with respect to each Defined Benefit Pension Plan and Defined Contribution Plan maintained by such Borrower or any member of its Controlled Group.

(C) Each Borrower will cause to be made all contributions required to amortize any accumulated funding deficiency (as defined in ss.412(a) of the Code and the regulations thereunder and ss.302(a) of ERISA), unless waived, with respect to any pension plan (as defined in ss.3(2) of ERISA), other than a Multiemployer Plan, which is subject to Part 3 of the Subtitle B of Title I of ERISA or Section 412 of the Code and the

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regulations thereunder and which is maintained by such Borrower or any member of its Controlled Group.

(D) As soon as possible (and in any event within 10 days) after a Borrower knows (1) that any Reportable Event has occurred with respect to any Defined

Benefit Pension Plan maintained by a Borrower or any member of its Controlled Group, (2) that any Defined Benefit Pension Plan maintained by a Borrower or any member of its Controlled Group is to be terminated in a distress termination (within the meaning of 4041(c) of ERISA), (3) that the PBGC has instituted or will institute proceedings under Title IV of ERISA to terminate any Defined Benefit Pension Plan maintained by a Borrower or any member of its Controlled Group, (4) that a Borrower has incurred Withdrawal Liability from a Multiemployer Plan maintained by a Borrower or any member of its Controlled Group, or (5) that any Multiemployer Plan to which a Borrower or any member of its Controlled Group has made contributions is in Reorganization, such Borrower will furnish a statement to Lender setting forth the details as to such Reportable Event, distress termination, termination proceedings, Withdrawal Liability, or Reorganization, and the action that any such Borrower proposes to take with respect thereto, together with a copy of any notice of such Reportable Event or distress termination given to the PBGC by such Borrower, or a copy of any notice of termination proceedings, Withdrawal Liability, or Reorganization received by a Borrower or any member of its Controlled Group.

(E) Each Borrower will furnish to Lender as soon as possible (and in any event within 10 days) after receipt thereof a copy of any notice that such Borrower or any member of its Controlled Group receives from the PBGC or the Internal Revenue Service or from the sponsor of any Multiemployer Plan that sets forth or proposes any action to be taken or determination made by the PBGC or the Internal Revenue Service with respect to any Defined Benefit Pension Plan, Defined Contribution Plan or Multiemployer Plan which action or determination would have a material adverse effect on the financial condition, assets, operations or prospects of a Borrower.

(F) Each Borrower will promptly notify Lender of and, in any event, no later than ten days after a Borrower becomes aware of, any taxes, penalties, interest charges and other material financial obligations that have been assessed or imposed or, to such Borrower's knowledge, threatened to be assessed or imposed against such Borrower or any member of its Controlled Group by the Internal Revenue Service, the PBGC or any other governmental entity with respect to any Plan or Multiemployer Plan maintained by such Borrower or a member of its Controlled Group.

(G) Each Borrower will promptly notify Lender and, in any event, within ten days of the adoption by such Borrower or any member of its Controlled Group of any Defined Benefit Pension Plan or Defined Contribution Plan or any obligation to contribute to any Multiemployer Plan by such Borrower or any member of its Controlled Group.

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(H) No Borrower will permit (1) with respect to any Employee Benefit Plan, any non-exempt Prohibited Transaction or Prohibited Transactions under ERISA or the Code resulting in liability of such Borrower or any of its Controlled Group members in excess of \$100,000 in the aggregate or (2) with respect to any

Defined Benefit Pension Plan, any Reportable Event under ERISA, if upon termination of the Plan or Plans with respect to which one or more such Reportable Events has occurred there is or would be any liability of such Borrower or any of its Controlled Group members to the PBGC in excess of \$100,000 in the aggregate. No Borrower will voluntarily take or fail to take any action which would result in any Withdrawal Liability becoming due.

(I) No Borrower will fail to make required minimum contributions, or permit any other Controlled Group member to fail to make required minimum contributions with respect to a Defined Benefit Pension Plan maintained by such Borrower or any member of its Controlled Group, resulting in a lien (as provided in ss.302(f) of ERISA) against such Borrower or any of its Controlled Group members.

(J) No Borrower will permit the adoption of a plan amendment which results in significant underfunding (as defined in ss.307 of ERISA) of a Defined Benefit Pension Plan maintained by such Borrower or any member of its Controlled Group which requires such Borrower or any of its Controlled Group members to provide security.

(K) No Borrower will permit the unfunded liabilities of unfunded and uninsured "employee welfare benefit plans" (as defined in ss.3(1) of ERISA) of such Borrower and of any members of its Controlled Group to exceed, in the aggregate \$100,000.

(L) No Borrower will acquire or permit the acquisition by any of its Controlled Group members, of any trade or business which maintains a Defined Benefit Pension Plan that immediately prior to or after giving effect to such acquisition has an unfunded benefit liability (as defined in ss.4001 of ERISA) that exceeds \$100,000 or acquire or permit the acquisition, by such Borrower or any of its Controlled Group members, of any trade or business which has incurred either directly or indirectly an unfunded benefit liability that exceeds \$100,000 under any Defined Benefit Pension Plan.

SECTION 6.21 Mergers, etc. No Borrower will directly or indirectly without the prior written consent of Lender, (A) merge or consolidate with any other Person other than another Borrower, (B) except for the sale of Inventory in the ordinary course of business, sell or lease or otherwise transfer all or any substantial part of its assets to any Person other than another Borrower, (C) acquire whether through purchase or exchange of equity or assets or otherwise, all or any substantial part of the assets of any other Person or any equity interest in any other Person, excluding (1) investments permitted under Section 6.11 hereof, and (2) Permitted Acquisitions, or (D) create any Subsidiary, excluding Subsidiaries listed on Exhibit 5.11 or Subsidiaries created in connection with a Permitted Acquisition, so long as such Subsidiary becomes a Borrower hereunder by execution of a joinder agreement satisfactory in form and substance to Lender and delivers to Lender any document required to be delivered by a Borrower in accordance herewith.

SECTION 6.22 Dividends, etc. No Borrower will make or declare any dividend or distribution of any kind or redeem or repurchase any of its stock (excluding dividends or distributions, redemptions or repurchases paid to another Borrower), provided however that any Borrower may declare a dividend on its stock or repurchase or redeem any of its stock, during the term of this Agreement, if (A) such dividend, purchase or redemption is lawful in all respects, (B) no Default or Event of Default hereunder has occurred and is continuing or would result from such purchase, declaration or redemption or making of such dividend, and (C) prior to such purchase, redemption or payment of such dividend Borrowers shall deliver a Compliance Certificate indicating that no Default or Event of Default would exist upon consummation of such redemption or making such purchase or dividend. No Borrower will, without the prior written consent of Lender, permit or effect (1) any change in the capitalization or capital structure of such Borrower, including the issuance of any new, additional or different type or class of stock, (2) any modification, reduction or retirement of any existing class or type of stock, or (3) the alteration or modification of the voting rights of any stock.

SECTION 6.23 Nature of Business. No Borrower will make any material change in the nature of its business as conducted on the date hereof.

SECTION 6.24 Disposal of Assets. Except for the sale of Inventory in the ordinary course of business, replacement of Equipment and the disposal of obsolete Equipment, no Borrower will dispose of any assets except as otherwise permitted by Section 3.7 of the Indenture as in effect on the date hereof.

SECTION 6.25 Patents, etc. Each Borrower will maintain all of its material patents, trademarks, copyrights, trade secrets and other intellectual property rights, and licenses therefor, if any, in full force and effect except where the failure to maintain any such patent, trademark, copyright, trade secret or other intellectual property right or license therefor would not have a material adverse effect on the financial condition or operations of a Borrower.

SECTION 6.26 Indemnification. Each Borrower hereby indemnifies and agrees to protect, defend, and hold harmless Lender and its directors, officers, employees, agents, attorneys and shareholders from and against any and all losses, damages, expenses or liabilities of any kind or nature and from any suits, claims, or demands, including all reasonable counsel fees incurred in investigating, evaluating, or defending such claims, suffered by any of them and caused by, relating to, arising out of, resulting from, or in any way connected with this Agreement, the Note, any other Loan Document and any transaction contemplated herein or therein including, but not limited to, claims based upon any act or omission by Lender in connection with this Agreement, the Note or any Loan Document and any transaction contemplated herein or therein to the extent not caused by the gross negligence, bad faith or willful misconduct of Lender or its directors, officers, employees, agents or attorneys. If a Borrower shall have knowledge of any claim or liability hereby indemnified against, it shall promptly and, in any event, within ten days after any Borrower acquires knowledge thereof, give written notice to Lender. THIS COVENANT SHALL SURVIVE THE PAYMENT OF THE

INDEBTEDNESS CREATED BY THIS AGREEMENT, THE NOTE OR THE LOAN DOCUMENTS.

SECTION 6.27 RICO. No Borrower shall engage in any conduct or fail to take any action which will, or would, under the facts and circumstances relative thereto, violate the Racketeer Influenced and Corrupt Organization Act as amended by the Comprehensive Act of 1984, 18 U.S.C. ss.ss.1961-68.

SECTION 6.28 Licenses, Permits. Each Borrower will maintain the validity, force and effect of, and operate in material compliance with, all franchises, grants, authorizations, licenses, permits, easements, consents, certificates and orders required for the conduct of its business except where the failure to maintain any such franchise, grant, authorization, license, permit, easement, consent, certificate or order would not have a material adverse effect on the financial condition or operations of a Borrower.

SECTION 6.29 Transaction with Affiliates. Except for the transactions pursuant to the agreements described on Exhibit 6.29 attached hereto and except for transactions otherwise permitted under Sections 6.13 or 6.18 hereof, no Borrower will enter into any transaction with any director, officer or member of any Borrower or any Subsidiary or Affiliate of any Borrower for less than full value or on terms or conditions not less favorable to such Borrower than could be obtained in an arm's length transaction with a third party.

SECTION 6.30 Primary Operating Accounts. While any of the Liabilities remain outstanding or Lender has any obligation to make Advances under the Revolving Credit, each Borrower shall keep its primary operating accounts at Lender.

SECTION 6.31 Payments or Amendments of Credit Obligations. Without the prior written consent of Lender, no Borrower will make any material amendment of the Indenture.

SECTION 6.32 Restrictive Agreements. No Borrower will enter into any agreement which restricts such Borrower's rights to make payments hereunder, make payments on the Senior Notes, pay dividends, grant liens or incur indebtedness.

SECTION 6.33 Sale-Leasebacks. No Borrower shall at any time enter into or suffer to remain in effect any transaction to which such Borrower is a party involving the sale, transfer or other disposition by such Borrower of any property (now owned or hereafter acquired), with a view directly or indirectly to the leasing back of any part of the same property or any other property used for the same or a similar purpose or purposes, or agree, become or remain liable (contingently or otherwise) to do any of the foregoing.

SECTION 6.34 Year 2000 Compliance. The advent of the year 2000 shall not and will not materially adversely affect the performance of any Borrower's information technology. Without limiting the generality of the foregoing, on or

before June 30, 1999, the hardware and software utilized by each Borrower are designed to be used prior to,

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during and after calendar year 2000 A.D. and such hardware and software will operate during each such time period without error relating to date data, specifically including any error relating to, or the conduct of, date data which represents or references different centuries or more than one century, the hardware and software utilized by each Borrower will not abnormally end or provide invalid or incorrect results as a result of date data, and the hardware and software utilized by each Borrower have been designed to ensure year 2000 A.D. compatibility, including date data, century recognition, leap year, calculations which accommodate same century and multicentury formulas and date values and date data interface values that reflect the century.

## ARTICLE VII

### DEFAULT

SECTION 7.1 Events of Default. Each of the following shall be an event of default ("Event of Default"):

(A) If Borrowers shall fail to pay when due any interest, principal, or any other Liabilities;

(B) If any representation or warranty made by a Borrower in any Loan Document or in any certificate, agreement, instrument, statement, or report contemplated by or made or delivered pursuant to or in connection with any thereof, or if any information furnished to Lender pertaining to the Revolving Credit shall prove to have been incorrect or false in any material respect when made or reaffirmed;

(C) If a Borrower shall fail to pay any Credit Obligation owing by it, or any interest or premium thereon, when due, whether owed to Lender or any other Person and whether such Credit Obligation shall become due by scheduled maturity, by required prepayment, by acceleration, by demand, or otherwise, or shall fail to perform any term, covenant, or agreement on its part to be performed under any agreement or instrument evidencing or securing or relating to any such Credit Obligation when required to be performed, if the effect of such failure is to accelerate, or to permit the holder or holders of such Credit Obligation to accelerate, the maturity of such Credit Obligation, whether or not such failure to perform shall be waived by the holder or holders of such Credit Obligation, unless such waiver has the effect of terminating the right of such holder or holders to accelerate the maturity of such Credit Obligation as a result of such failure;

(D) If any Borrower shall be adjudicated bankrupt or insolvent, or admit in writing its inability to pay its debts as they mature, or make an assignment

for the benefit of its creditors; or if any Borrower shall apply for or consent to the appointment of any receiver, trustee, or similar officer for it or for all or any substantial part of its property; or any such receiver, trustee, or similar officer shall be appointed without the

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application or consent of a Borrower and shall continue undischarged for a period of 90 days; or if any Borrower shall institute (by petition, application, answer, consent, or otherwise) any bankruptcy, insolvency, reorganization, arrangement, readjustment of debt, dissolution, liquidation, or similar proceeding relating to it under the laws of any jurisdiction; or if such proceeding shall be instituted (by petition, application, or otherwise) against any Borrower and an order for relief shall be entered in such proceeding or such proceeding shall remain undismissed for a period of 90 days; or if any judgment, writ, warrant of attachment or execution or similar process shall be issued or levied against property of any Borrower for all or a portion of the property which represents a substantial portion of the property of such Borrower, and such judgment, writ, or similar process shall not be released, vacated, or fully bonded within 30 days after its issue or levy;

(E) If (1) any Reportable Event, or any failure of compliance required by Section 6.20 hereof that Lender reasonably determines in good faith creates a reasonable possibility of the termination of any Defined Benefit Pension Plan of any Borrower or of the appointment by the appropriate United States District Court of a trustee to administer any such Defined Benefit Pension Plan of any Borrower, shall have occurred and be continuing 30 days, or (2) any such Defined Benefit Pension Plan shall be terminated, or (3) the plan administrator of any such Plan shall file with the PBGC a notice of intention to terminate such Defined Benefit Pension Plan, or (4) the PBGC shall institute proceedings to terminate any such Defined Benefit Pension Plan or to appoint a trustee to administer any such Defined Benefit Pension Plan and such proceedings shall remain undismissed or unstayed for 30 days and if, in any of the cases described in the foregoing clauses (1) through (4), Lender further reasonably determines in good faith that the amount of the unfunded guaranteed benefits (within the meaning of Title IV of ERISA) resulting upon termination of such Defined Benefit Pension Plan would have a material adverse effect on the business, properties, operation, or condition (financial or otherwise) of a Borrower if a lien against the assets of such Borrower were to result under ERISA;

(F) If an event of default (as therein defined) shall occur under any other Loan Document;

(G) If an event of default (as therein defined) shall occur under any of the Exchange Note Documents or the Exchange Notes unless such event of default shall be waived by the requisite holders of the Exchange Notes if and only if such waiver has the effect of eliminating the right of the holders of the Exchange Notes to accelerate the maturity of the Exchange Notes;

(H) The occurrence of a Change in Control;

(I) If any Borrower shall fail to observe and perform in any material respect any of the terms, covenants, promises and agreements on its part to be observed and performed under this Agreement not set forth elsewhere in this Section;

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(J) If there occurs a material adverse change to the financial condition, assets, nature of the assets or operations of a Borrower;

(K) Any execution shall have been levied against any part of the Collateral and shall continue unstayed and in effect for a period of ten (10) days;

(L) The dissolution, termination or liquidation of a Borrower; or

(M) If the security interests granted to Lender hereunder and the other Loan Documents no longer constitute a first lien on any part of the Collateral.

SECTION 7.2 Remedies. If any Event of Default other than those described in Section 7.1(D) shall occur and be continuing, then upon notice from Lender to Borrowers, and if any Event of Default described in Section 7.1(D) shall occur then automatically:

(A) the Revolving Credit and the obligation of Lender to make Advances or the issue Letters of Credit hereunder shall terminate;

(B) the Revolving Credit shall be due and payable immediately without presentment, demand, protest, or further action of any kind, all of which are hereby waived;

(C) Lender may exercise all of the rights and remedies of a secured party under the Uniform Commercial Code or any other applicable law with respect to the Collateral;

(D) with respect to any Inventory of Borrowers serving as Collateral hereunder, Lender may require each Borrower to assemble its Inventory and make it available to Lender at a place designated by Lender which is reasonably convenient to it and to such Borrower;

(E) Lender may exercise its rights under any Loan Document (including this Agreement);

(F) subject to the terms of the Indenture, Lender shall have and is hereby granted a right of set-off, a lien upon and a security interest in all property of each Borrower now or at any time hereafter in Lender's possession in any capacity whatsoever, including, without limitation, any balance or share of any

deposit, trust or agency account, as security for all liabilities of Borrowers to Lender;

(G) Lender may exercise its rights with respect to the Operating Account, the Cash Collateral Account an the Letter of Credit Cash Collateral Account and apply the proceeds of such accounts against the Liabilities in such order as Lender shall elect; and

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(H) Lender may exercise any other rights and remedies available to Lender whether available at law, in equity, or otherwise.

## ARTICLE VIII

### ADDITIONAL PROVISIONS

SECTION 8.1 No Waiver, Cumulative Remedies. No failure or delay on the part of Lender in exercising any right, power, or remedy hereunder shall operate as a waiver thereof; nor shall any single or partial exercise of any such right, power, or remedy preclude any other or further exercise thereof or the exercise of any other right, power, or remedy hereunder. No waiver of any provision hereof shall be effective unless the same shall be in writing and signed by Lender. The remedies herein provided are cumulative and not exclusive of any remedies provided by law.

SECTION 8.2 Notices. All notices, requests, demands and other communications under this Agreement shall be in writing and shall be given to each party hereto by overnight delivery service at its address specified below or at such other address as shall be designated by such party in a notice to each other party complying with the terms of this Section 8.2:

If to Borrowers:

Congoleum Corporation  
3705 Quakerbridge Road, Suite 211  
P.O. Box 3127  
Mercerville, New Jersey 08619  
Attention: Howard N. Feist III

If to Lender:

First Union National Bank  
370 Scotch Road  
Pennington, NJ 08534  
Attention: Leanne Castagna

All notices, requests, demands and other communications provided for hereunder shall be effective when delivered or received at the aforesaid addresses.

SECTION 8.3 Set-off. Subject to the terms of the Indenture, Lender shall have a right of set-off against, a lien upon, and a security interest in all property of a Borrower now or at any time in the possession of Lender in any capacity whatever, including, but not limited to such Borrower's interest in any deposit account, as security for the Liabilities, including without limitation, the obligations of such Borrower under the Loan Documents and to reimburse Lender for any returned checks.

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SECTION 8.4 Costs and Expenses. Borrowers agree to pay on demand (A) all reasonable costs and expenses of Lender in connection with the preparation, execution, delivery and administration of the Loan Documents and in connection with any request for an amendment, modification, or waiver of any of the provisions of any thereof (including the reasonable fees and out-of-pocket expenses of counsel with respect thereto); (B) all filing, recording, and similar fees and charges; (C) all costs and expenses, if any, of Lender in connection with the enforcement of any Loan Document (including the reasonable fees and out-of-pocket expenses of legal counsel with respect thereto) after the occurrence of a Default or an Event of Default; and (D) all costs and expenses, if any, of Lender in connection with the enforcement of Lender's right to take possession of the Collateral after the occurrence of a Default or an Event of Default and the proceeds thereof and to hold, collect, prepare for sale, render in compliance with federal, state or local environmental statutes, ordinances, regulations, orders, directives, and permits, sell and dispose of the Collateral (including the reasonable fees and out-of-pocket expenses of legal counsel with respect thereto).

SECTION 8.5 Governing Law. This Agreement and the other Loan Documents shall be governed in all respects by the law of the State of New Jersey, the jurisdiction in which the Loan Documents have been executed and delivered, and for all purposes shall be construed in accordance with such law.

SECTION 8.6 Survival of Agreements and Representations. All agreements, representations and warranties made herein shall survive the delivery of this Agreement and the Note.

SECTION 8.7 Arbitration. Upon demand of any party hereto whether made before or after the institution of any judicial proceeding, any claim or controversy arising out of or relating to the Loan Documents between parties hereto (a "Dispute") shall be resolved by binding arbitration conducted under and governed by the Commercial Finance Dispute Arbitration Rules (the "Arbitration Rules") of the American Arbitration Association (the "AAA") and the Federal Arbitration Act. Disputes may, include, without limitation, tort claims, counterclaims, a dispute as to whether a matter is subject to arbitration, claims brought as class actions, or claims arising from documents executed in the future. A judgment upon the award may be entered in any court having jurisdiction. Notwithstanding the foregoing, this arbitration provision does not apply to disputes under or related to swap agreements. All arbitration proceedings shall

be conducted in the city in which the office of Lender first stated above is located. A hearing shall begin within 90 days of demand for arbitration and all hearings shall be conducted within 120 days of demand for arbitration. These time limitations may not be extended unless a party shows cause for extension and then for a total of no more than 60 days. The expedited procedures set forth in Rule 51 et seq. of the Arbitration Rules shall be applicable for claims for less than \$1,000,000.00. Arbitrators shall be licensed attorneys selected from the Commercial Finance Dispute Arbitration Panel of the AAA. The parties do not waive applicable federal or state substantive law except as provided herein. The parties hereto agree that they shall not have a remedy of punitive or

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exemplary damages against the other in any Dispute and hereby waive any right or claim to punitive or exemplary damages they have now or which may arise in the future in connection with a Dispute, whether the Dispute is resolved judicially or by arbitration.

SECTION 8.8 Preservation and Limitation of Remedies. Notwithstanding the foregoing binding arbitration provisions, the parties agree to preserve, without diminution, certain remedies that any party may exercise before or after an arbitration proceeding is brought. The parties shall have the right to proceed in any court of proper jurisdiction or by self-help to exercise or prosecute the following remedies, as applicable: (A) all rights of foreclosure against any real or personal property or other security by exercising a power of sale or under applicable law by judicial foreclosure including a proceeding to confirm the sale; (B) all rights of self-help including peaceful occupation of real property and collection of rents, set-off and peaceful possession of personal property; and (C) obtaining provisional or ancillary remedies including injunctive relief, sequestration, garnishment, attachment, appointment of a receiver and filing of an involuntary bankruptcy proceeding. Any claim or controversy with regard to any party's entitlement to such remedies is a Dispute.

SECTION 8.9 JURY TRIAL WAIVER. AFTER CONSULTATION WITH COUNSEL, WITH KNOWLEDGE OF THE CONSEQUENCES AND BY AGREEING TO BINDING ARBITRATION, EACH BORROWER AND LENDER HEREBY IRREVOCABLY WAIVES ALL RIGHTS TO DEMAND A JURY TRIAL AND AGREE THAT ALL SUITS WILL BE HEARD BY A JUDGE ONLY. Any and all judicial proceedings brought by Lender against a Borrower with respect to this Agreement may be brought in: (A) any court of competent jurisdiction in the State of New Jersey; and (B) any Federal district court having subject matter jurisdiction and being located in the State of New Jersey. Each Borrower hereby accepts, for itself and its properties, the non-exclusive jurisdiction of the aforesaid courts and agrees to be bound by any judgments rendered by such courts in connection with this Agreement. No Borrower will move to transfer any such proceeding to any different court. Any such process may be mailed by registered or certified mail to Borrowers at the address referred to in Section 8.2 hereof. Each Borrower agrees that service by mail at the address referred to in Section 8.2 hereof will constitute sufficient notice. Service will be considered complete upon

delivery. Nothing herein limits the right of Lender to bring proceedings against a Borrower in the courts of any other jurisdiction.

SECTION 8.10 Binding Effect; Assignment. The Loan Documents shall be binding upon and inure to the benefit of each Borrower, Lender, and their respective successors and assigns, except that no Borrower shall have the right to assign or delegate its respective rights or obligations under any of such documents.

SECTION 8.11 Headings. Article, Section and subsection headings used in this Agreement are for convenience only and shall not affect the construction of this Agreement.

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SECTION 8.12 Time of the Essence. Whether or not elsewhere herein expressly stated, all dates and times for performance herein set forth shall be of the essence of this Agreement.

SECTION 8.13 Sole Discretion of Lender. It is understood and agreed that, except as expressly provided otherwise in this Agreement, Lender shall have, with respect to all matters herein which must be approved by or be acceptable or satisfactory to Lender or which may be determined by or consented to by Lender, including, but not limited to, any conditions, provisions, agreements, contracts, documents, surveys, reports, legal opinions, and title requirements, the sole and absolute discretion to determine the acceptability thereof to Lender.

SECTION 8.14 Amendments. Any of the provisions of this Agreement may be waived, modified or amended only by written agreement or agreements entered into by Borrowers and Lender, except that no such waiver, modification or amendment shall extend to or affect any obligation not expressly waived, modified or amended, or impair any right of Lender related to such obligation.

SECTION 8.15 Usury. Nothing herein contained or in the Note, or any other Loan Document nor any transaction related thereto shall be construed or shall so operate either presently or prospectively to require Borrowers (A) to pay interest at a rate greater than is now lawful in such case to contract for, but shall require payment of interest only to the extent of such lawful rate, or (B) to make any payment or do any act contrary to law, but if any provision herein or therein contained shall otherwise so operate to invalidate this Agreement, the Note, or any other Loan Document, in whole or in part, then such provision only shall be held for naught as though not herein or therein contained and the remainder of this Agreement, the Note, and the other Loan Documents shall remain operative and in full force and effect. Any interest paid in excess of the lawful rate shall be refunded to Borrowers. Such refund shall be made by application of the excessive amount of interest paid against any sums outstanding under this Agreement and shall be applied in such order as Lender may determine. If the excessive amount of interest paid exceeds the sums outstanding hereunder, the portion exceeding the said sums outstanding shall be

refunded in cash by Lender. Any such crediting or refund shall not cure or waive any default by Borrowers hereunder or under the Note or any other Loan Document. Borrowers agree, however, that in determining whether or not any interest payable exceeds the highest rate permitted by law, any non-principal payment (except payments specifically stated in this Agreement to be "interest"), including without limitation prepayment premiums, shall be deemed, to the extent permitted by law, to be an expense, fee, premium or penalty rather than interest.

SECTION 8.16 Participations. Each Borrower acknowledges and agrees that Lender may sell a participation interest or participating interests in the Revolving Credit. After such sale and provided Lender shall notify Borrowers thereof, Borrowers shall, at the option of Lender, have a direct obligation to the purchaser under such sale to the extent of the participation interest purchased. Borrower acknowledges that Lender may share

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with any participant or prospective participant, any and all information obtained by Lender in connection with the Revolving Credit, including without limitation information delivered to Lender by Borrower, and Borrower consents thereto. Borrowers agree to cooperate with Lender in connection with any reasonable request made by Lender with respect to any such sale or prospective sale.

SECTION 8.17 Entire Agreement. This Agreement, the Exhibits attached hereto and the Loan Documents constitute the entire understanding among the parties with respect to the subject matter hereof, and supersedes any and all contemporaneous and prior agreements between the parties hereto with respect to the subject matter hereof.

SECTION 8.18 No Joint Venture. The parties expressly agree that the relationship of Lender to each Borrower is that of lender only, and Lender is not a partner or co-venturer of any Borrower.

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IN WITNESS WHEREOF, the parties hereto, intending to be legally bound, have caused this Agreement to be executed by their respective officers thereunto duly authorized, as of the date first above written.

CONGOLEUM CORPORATION

By: \_\_\_\_\_  
Name:

Title:

FIRST UNION NATIONAL BANK

By:

-----

Name:

Title:

JOINDER AGREEMENT

THIS JOINDER AGREEMENT ("Joinder Agreement") dated as of December 21, 1998 among CONGOLEUM CORPORATION ("CONGOLEUM Corp."), CONGOLEUM INTELLECTUAL PROPERTIES, INC. ("Intellectual"), CONGOLEUM FINANCIAL CORPORATION ("Financial"; Congoleum Corp., Intellectual and Financial shall be referred to collectively as "Borrowers") and FIRST UNION NATIONAL BANK ("Lender"). All terms capitalized but not defined herein shall have the meanings given to such terms in the Loan Agreement (as such term is hereinafter defined).

BACKGROUND

A. Corporation and Lender entered into a certain Loan and Security Agreement ("Loan Agreement") dated as of December 18, 1998 pursuant to which Lender made available to the Borrowers the revolving credit facility described therein.

NOW, THEREFORE, the parties agree as follows, intending to be legally bound.

1. Intellectual and Financial, each individually, hereby: (a) shall be, become and is a Borrower under, in accordance with and subject to the terms and conditions of the Loan Agreement; (b) joins in and agrees to be bound by and to perform in accordance with the terms of the Loan Agreement; (c) confirms that Borrowers are jointly and severally liable to Lender for all the Liabilities; (d) hereby pledges, transfers, assigns and delivers and grants to Lender a lien on and security interest in and to the Collateral; and (e) confirms the truth and accuracy of the representations and warranties in the Loan Agreement as of the date hereof insofar as they relate to it.

2. Intellectual and Financial, each individually, hereby agrees to deliver to Lender within twenty (20) days of the execution hereof such UCC-1 financing statements and other documents and agreements as Lender may request to perfect its interest in the Collateral owned by them. Borrowers hereby agree that failure to deliver such agreements within twenty (20) days of execution hereof shall constitute an Event of Default under the Loan Agreement.

IN WITNESS WHEREOF, the parties hereto, intending to be legally bound, have caused this Joinder Agreement to be executed by their respective officers thereunto duly authorized, as of the date first above written.

CONGOLEUM CORPORATION

CONGOLEUM INTELLECTUAL  
PROPERTIES, INC.

By: \_\_\_\_\_

By: \_\_\_\_\_

Howard N. Feist III  
Sr. Vice President - Finance

Name:  
Title:

CONGOLEUM FINANCIAL CORPORATION

FIRST UNION NATIONAL BANK

By: \_\_\_\_\_  
Name:  
Title:

By: \_\_\_\_\_  
Name:  
Title:

Exhibit 11.1 - Computation of Earnings Per Common Share

CONGOLEUM CORPORATION  
 COMPUTATION OF EARNINGS PER COMMON SHARE  
 (AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)

	Years Ended December 31,		
	1998	1997	1996
	----	----	----
Basic Earnings Per Common Share:			
Income before extraordinary item	\$9,853	\$7,020	\$12,097
Extraordinary item - early retirement of debt, net of income tax benefit	(2,413)	(279)	0
	-----	-----	-----
Net income	\$7,440	\$6,741	\$12,097
	=====	=====	=====
Weighted average common shares outstanding	9,038	9,837	9,997
	=====	=====	=====
Income per common share before extraordinary item	\$1.09	\$0.72	\$1.21
Extraordinary item	(0.27)	(0.03)	0.00
	-----	-----	-----
Net income per common share	\$0.82	\$0.69	\$1.21
	=====	=====	=====
Diluted Earnings Per Common Share:			
Income before extraordinary item	\$9,853	\$7,020	\$12,097
Extraordinary item - early retirement of debt, net of income tax benefit	(2,413)	(279)	0
	-----	-----	-----
Net income	\$7,440	\$6,741	\$12,097
	=====	=====	=====
Weighted average common shares outstanding	9,038	9,837	9,997
Effect of assumed exercise of dilutive stock options (1)	0	2	10
	-----	-----	-----

Weighted average common and common equivalent shares	9,038 =====	9,839 =====	10,007 =====
Income per common share before extraordinary item	\$1.09	\$0.72	\$1.21
Extraordinary item	(0.27) -----	(0.03) -----	0.00 -----
Net income per common share	\$0.82 =====	\$0.69 =====	\$1.21 =====

(1) Computed based on the Treasury Stock method.

Congoleum Corporation  
Selected Financial Data  
(in thousands, except per share amounts)

<TABLE>  
<CAPTION>

	For the years ended December 31,				
	1998	1997	1996	1995	1994
<S>	<C>	<C>	<C>	<C>	<C>
Income Statement Data:					
Net sales .....	\$259,126	\$252,526	\$269,451	\$263,147	\$265,784
Cost of sales .....	181,997	180,093	182,585	186,382	175,059
Selling, general and administrative expenses .....	56,839	57,094	61,597	55,228	56,315
Income from operations .....	20,290	15,339	25,269	21,537	34,410
Interest expense, net .....	(5,758)	(5,258)	(6,369)	(6,708)	(6,968)
Other income, net .....	984	974	1,095	1,135	1,184
Income before taxes and extraordinary item .....	15,516	11,055	19,995	15,964	28,626
Provision for income taxes .....	5,663	4,035	7,898	6,529	11,131
Income before extraordinary item .....	9,853	7,020	12,097	9,435	17,495
Extraordinary item .....	(2,413)	(279)	--	--	--
Net income .....	\$ 7,440	\$ 6,741	\$ 12,097	\$ 9,435	\$ 17,495
Income per common share before extraordinary item .....	\$ 1.09	\$ 0.72	\$ 1.21	\$ 0.94	\$ 1.75
Extraordinary Item .....	(0.27)	(0.03)	--	--	--
Net income per common share, basic and diluted .....	\$ 0.82	\$ 0.69	\$ 1.21	\$ 0.94	\$ 1.75
Average shares outstanding .....	9,038	9,839	10,007	10,022	10,000
Balance Sheet Data (at end of period):					
Total assets .....	\$231,865	\$196,581	\$219,798	\$206,842	\$204,822
Total debt .....	99,526	76,594	87,750	90,000	90,000
Stockholders' equity .....	37,853	31,783	33,667	22,602	19,410

</TABLE>

Congoleum Corporation  
Management's Discussion and Analysis of  
Financial Condition and Results of Operations

Results of Operations

The Company's business is cyclical and is affected by the same economic factors that affect the remodeling and housing industries in general, including the availability of credit, consumer confidence, changes in interest rates, market demand and general economic conditions.

In addition to external economic factors, the Company's results are sensitive to sales and manufacturing volume, competitors' pricing, consumer preferences for flooring products, raw material costs and the mix of products sold. The manufacturing process is capital intensive and requires substantial investment in facilities and equipment. The cost of operating these facilities

generally does not vary in direct proportion to production volume and, consequently, operating results fluctuate disproportionately with changes in sales volume.

Year ended December 31, 1998 as compared to year ended December 31, 1997

Net sales for the year ended December 31, 1998 were \$259.1 million as compared to \$252.5 million for the year ended December 31, 1997, an increase of \$6.6 million or 2.6%. Increases in sales to the manufactured housing industry and to home centers from 1997 to 1998 were partly offset by a decline in sales of lower-end products to the specialty retail channel. Price reductions occurred in certain products and markets which resulted in an aggregate decrease in prices of 1.2%.

Gross profit for the year ended December 31, 1998 was \$77.1 million compared to \$72.4 million in 1997, an increase of \$4.7 million or 6.5%, as a result of higher sales and improved gross profit margins. Gross profit margins improved from 28.7% of net sales in 1997 to 29.8% of net sales in 1998 due to declines in raw material costs, an increase in manufacturing productivity and a higher margin mix of sales.

Selling, general and administrative expenses were \$56.8 million for the year ended December 31, 1998 as compared to \$57.1 million for the year ended December 31, 1997, a decrease of \$0.3 million or 0.4%. As a percent of net sales, selling, general and administrative expenses declined from 22.6% in 1997 to 21.9% in 1998. Expense control initiatives have succeeded in reducing these costs on an overall basis despite increased spending related to Year 2000 compliance. In addition, the sales channels where the Company has experienced the most sales growth require relatively less sales and marketing support than the specialty retail channel.

Income from operations was \$20.3 million (7.8% of net sales) for the year ended December 31, 1998, compared to \$15.3 million (6.1% of net sales) for the year ended December 31, 1997, an increase of \$5.0 million or 32.3%, primarily due to the increase in sales and gross profit margins.

Interest expense increased from \$6.8 million in 1997 to \$7.4 million in 1998 primarily due to a higher amount of interest being capitalized rather than expensed in connection with capital expenditures in 1997.

During 1998, the Company issued \$100 million in ten-year 8 5/8% Senior Notes (priced to yield 8.70%). Most of the proceeds were used to retire the Company's existing 9% Senior Notes due in 2001. In connection with this transaction, the Company recorded an extraordinary charge of \$2.4 million (net of tax benefit) for the prepayment premium and write-off of deferred financing costs. In 1997, the Company had recorded an extraordinary charge of \$0.3 million for similar costs in connection with open market purchases of \$11.2 million of the 9% Senior Notes.

Before the extraordinary charges, income in 1998 was \$9.9 million, as compared to \$7.0 million in 1997, an increase of \$2.8 million or 40.4%. Income per common share before extraordinary item increased 51.4%, from \$.72 in 1997 to \$1.09 in 1998.

Net income increased from \$6.7 million, or \$.69 per share, in 1997, to \$7.4 million, or \$.82 per share, in 1998. Weighted average number of common and equivalent shares outstanding decreased in 1998 to 9.0 million from 9.8 million in 1997, primarily due to the purchases of its stock in the fourth quarter of 1997.

=====  
Year ended December 31, 1997 as compared to year ended December 31, 1996

Net sales for the year ended December 31, 1997 were \$252.5 million as compared to \$269.5 million for the year ended December 31, 1996, a decrease of \$17.0 million or 6.3%. The decline in sales was due to a number of factors, including reduced sales volume of higher priced sheet goods, an inventory reduction by the Company's largest distributor, lower average selling prices for certain products, and a decline in shipments to Color Tile, Inc., a major retailer which ceased operations in mid-1997. In addition, the Company's largest production line was shut down for refurbishment for four months, which limited its ability to pursue certain sales initiatives.

Gross profit for the year ended December 31, 1997 was \$72.4 million, or

28.7% of sales, compared to \$86.9 million, or 32.2% of sales for the previous year, a decline of \$14.5 million or 16.7%. The decline in gross profit was due to higher raw material costs, a less profitable mix of products sold, and manufacturing inefficiencies experienced preparing for the shutdown of a major production line.

Selling, general and administrative expenses were \$57.1 million for the year ended December 31, 1997 as compared to \$61.6 million for the year ended December 31, 1996, a decline of \$4.5 million, or 7.3%. This decrease was due to declines in sales-related costs and incentive compensation, combined with an overall program of cost control. As a percent of sales, selling, general and administrative expenses declined to 22.6% in 1997 from 22.9% in 1996.

Income from operations was \$15.3 million (6.1% of sales) for the year ended December 31, 1997, down from \$25.3 million (9.4% of sales) for 1996, a decrease of 39.5%. This decline reflects the lower sales and gross profit, partly offset by reduced selling, general and administrative expenses discussed above.

Interest expense decreased from \$8.2 million in 1996 to \$6.8 million in 1997 as a result of lower average debt outstanding and a greater amount of interest capitalized in connection with capital expenditures in 1997. The provision for income taxes declined from 39.5% of income before income taxes in 1996 to 36.5% of income before income taxes in 1997 as a result of the lower income level, which reduced the average effective statutory rate, and lower effective state income tax rates.

The Company recorded an extraordinary charge of \$0.3 million or \$.03 per share in 1997 for premiums and writeoff of deferred financing costs in connection with the open market purchase of \$11.2 million of its 9% Senior Notes.

Net income for the year ended December 31, 1997 was \$6.7 million, down 44.6% from \$12.1 million in 1996. Net income per share in 1997 was \$.69, compared to \$1.21 in 1996.

#### Liquidity and Capital Resources

Cash and equivalents, including short-term investments at December 31, 1998, were \$50.3 million, an increase of \$31.3 million from December 31, 1997. Working capital was \$68.5 million, up from \$39.0 million one year earlier. The ratio of current assets to current liabilities at December 31, 1998 was 2.4 to one, compared to 1.9 to one a year earlier. The ratio of debt to total capital at December 31, 1998 was .43, compared to .39 at December 31, 1997. Net cash provided by operations during the year ended December 31, 1998 was \$24.0 million, up from \$11.0 million in 1997. Capital expenditures in 1998 totaled \$9.4 million. The Company is currently planning capital expenditures of \$18 million to \$20 million in 1999 and \$20 million to \$25 million in 2000.

During 1998, the Company issued \$100 million of 8 5/8% Senior Notes maturing August 1, 2008 priced at 99.505 to yield 8.70%. Proceeds of the offering were used to redeem all \$76.6 million of its 9% Senior Notes, plus accrued interest and prepayment premium, to pay certain fees and expenses in connection with the offering, and for working capital and general corporate purposes. In connection with this offering, the Company recorded an extraordinary after-tax charge of \$2.4 million in the third quarter of 1998.

During 1998, the Company entered a new five-year revolving credit facility which provides for borrowings up to \$30 million which replaced its then-existing \$30 million line of credit facility. Interest ranges from 0-1% below prime, or 0.75% to 1.5% over LIBOR, depending on the Company's ratio

of debt to EBITDA. This financing agreement contains certain covenants which include the maintenance of minimum net worth, income, and fixed charge coverage levels. It also includes restrictions on the incurrence of additional debt and limitations on capital expenditures. Borrowings under this facility are collateralized by inventory and receivables. At December 31, 1998, based on the level of receivables and inventory, the Company had a borrowing base available of \$25.6 million, of which \$3.4 million was utilized for outstanding letters of credit.

In 1998, the Company's Board of Directors approved a new plan to repurchase up to \$5 million of the Company's Common Stock. As of December 31,

1998, the Company had repurchased 24,190 shares of its Common Stock for an aggregate cost of \$0.2 million pursuant to this plan.

In 1996, the Company began the initial planning of a comprehensive initiative to address the impact of the Year 2000 on its information and equipment systems. The Company organized a Year 2000 oversight team to develop a strategy of evaluation, implementation, testing and contingency planning to address the Company's Year 2000 readiness. The evaluation phase involved performing a complete, company-wide inventory to identify all internal, general purpose and production hardware and software systems, as well as any embedded logic devices used to control equipment or facilities, that required modification to become Year 2000 compliant. In addition to the Company's internal assessment, the Company communicated with all its distributors and all key third-party suppliers of goods and services to determine their states of Year 2000 readiness, implementation of Year 2000 compliant systems and related contingency plans.

In the second quarter of 1997, the Company began the implementation and testing phase of replacing or modifying system hardware, software, and devices. As of January 1999, the Company has completed work on 86% of the systems identified as requiring modification. The Company anticipates that substantially all of its systems will be Year 2000 compliant by the end of the first quarter of 1999.

Costs directly associated with achieving Year 2000 compliance, including modifying computer software or converting to new programs, consist of payments to third parties as well as an allocation of the payroll and benefits of its employees based on the amount of their time devoted to this activity. These costs are expensed as incurred. Costs for new hardware are capitalized in accordance with the Company's fixed asset policy, and any equipment retired is written off.

The following table summarizes the Company's direct Year 2000 compliance expenditures (actual and planned) by year:

(In thousands)	1997	1998	1999
	----	----	----
Expenses paid to third parties	\$52	\$330	\$108
Allocated payroll costs	174	386	67
Capital expenditures	5	206	--

In addition to work undertaken explicitly to achieve Year 2000 compliance, the Company has replaced or upgraded a number of systems in the ordinary course of business where the replacement or upgrade will, in addition to its primary benefits, also provide Year 2000 compliance. The nature of these costs, and their accounting treatment, is the same as described above. The following table summarizes the Company's actual or planned expenditures on systems improvements undertaken for reasons unrelated to the Year 2000, but also serving to achieve Year 2000 compliance:

(In thousands)	1997	1998	1999
	----	----	----
Expenses paid to third parties	\$13	\$76	\$111
Allocated payroll costs	48	37	48
Capital expenditures	92	144	126

The costs of achieving Year 2000 compliance, and of improving the Company's systems, are being funded through operating cash flow. With respect to embedded logic devices used to monitor or control equipment or facilities, the Company has completed a survey of all locations and identified 12 devices which must be modified or replaced. The Company expects to complete modification or replacement of these devices by the end of the second quarter of 1999 at an estimated aggregate cost of \$0.2 million.

Although the Company believes it has taken all of the necessary steps to ensure that the Company will be Year 2000 compliant, there can be no assurances that the Company will be able to complete all of the modifications in the required time frame, that all third parties will be Year 2000

compliant, or that unforeseen Year 2000 issues will not arise. Management currently believes the worst case scenario with any reasonable probability is that a small number of vendors, who are not critical to the operation of the Company's business, will be unable to supply materials for a short time after

January 1, 2000, and that minor additional systems modifications not identified during evaluation or testing will be identified and corrected in a matter of days. The Company does not anticipate any disruption of service to its customers.

The Company is currently preparing contingency plans for the various potential disruptions that could occur in spite of its own efforts and representations from its distributors and suppliers.

Collective bargaining agreements with hourly employees at the Company's facilities expire in 2001 and 2003. In the past five years, there have been no strikes by employees at the Company, and the Company believes that its employee relations are satisfactory.

The Company has recorded what it believes are adequate provisions for environmental remediation and product-related liabilities, including provisions for testing for potential remediation of conditions at its own facilities. While the Company believes its estimate of the future amount of these liabilities is reasonable, that such amounts will not have a material adverse impact on the Company's financial position, and that they will be paid over a period of five to ten years, the timing and amount of such payments may differ significantly from the Company's assumptions. Although the effect of future government regulation could have a significant effect on the Company's costs, the Company is not aware of any pending legislation which could have a material adverse effect on its financial position. There can be no assurances that the costs of any future government regulations could be passed along to its customers.

The Company is subject to federal, state and local environmental laws and regulations and certain legal and administrative claims are pending or have been asserted against the Company. Among these claims, the Company is a named party in several actions associated with waste disposal sites, asbestos-related claims, and general liability claims (more fully discussed in "Legal Proceedings" in Part I Item 3. and "Environmental Regulation" in Part I Item 1. of the Company's Annual Report on Form 10-K for the year ended December 31, 1998). These actions include possible obligations to remove or mitigate the effects on the environment of wastes deposited at various sites, including Superfund sites and certain of the Company's owned and previously owned facilities. The contingencies also include claims for personal injury and/or property damage. The exact amount of such future cost and timing of payments are indeterminable due to such unknown factors as the magnitude of cleanup costs, the timing and extent of the remedial actions that may be required, the determination of the Company's liability in proportion to other potentially responsible parties, and the extent to which costs may be recoverable from insurance. The Company has recorded provisions in its financial statements for the estimated probable loss associated with all known general, environmental and asbestos-related contingencies.

The Company records a liability for environmental remediation, asbestos-related claim costs, and general liability claims when a cleanup program or claim payment becomes probable and the costs can be reasonably estimated. As assessments and cleanups progress, these liabilities are adjusted based upon progress in determining the timing and extent of remedial actions and the related costs and damages. The extent and amounts of the liabilities can change substantially due to factors such as the nature or extent of contamination, changes in remedial requirements and technological improvements. Estimated insurance recoveries related to these liabilities are reflected in other noncurrent assets (see Note 15 of Notes to Financial Statements).

Although the outcome of these matters could result in significant expenses or judgments, management does not believe based on present facts and circumstances that their disposition will have a material adverse effect on the financial position the Company.

The Company's principal sources of capital are net cash provided by operating activities and borrowings under its Financing Agreement. The Company believes these sources will be adequate to fund working capital requirements, debt service payments and planned capital expenditures through the foreseeable future.

<S>	<C>	<C>
ASSETS		
Current assets:		
Cash and cash equivalents .....	\$ 50,344	\$ 11,069
Short-term investments .....	--	7,900
Accounts and notes receivable, less allowance for doubtful accounts and cash discounts of \$3,336 and \$3,294 as of December 31, 1998 and 1997, respectively .....	15,880	14,512
Inventories .....	45,192	44,434
Prepaid expenses and other current assets .....	3,022	2,965
Deferred income taxes .....	3,046	3,041
Total current assets .....	117,484	83,921
Property, plant, and equipment, net .....	87,954	88,401
Goodwill, net .....	11,819	12,251
Deferred income taxes .....	1,863	2,636
Other noncurrent assets .....	12,745	9,372
Total assets .....	\$231,865	\$196,581
=====		
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable .....	\$ 14,399	\$ 13,440
Accrued liabilities .....	31,209	28,793
Accrued income taxes .....	317	918
Deferred income taxes .....	3,058	1,752
Total current liabilities .....	48,983	44,903
Long-term debt .....	99,526	76,594
Other liabilities .....	23,501	22,305
Noncurrent pension liability .....	12,130	11,038
Accrued postretirement benefit obligation .....	9,872	9,958
Total liabilities .....	194,012	164,798
=====		
STOCKHOLDERS' EQUITY		
Class A common stock, par value \$0.01; 20,000,000 shares authorized; 4,658,000 shares issued; 4,258,610 and 4,282,800 shares outstanding as of December 31, 1998 and 1997, respectively .....	47	47
Class B common stock, par value \$0.01; 4,755,000 shares authorized, issued and outstanding as of December 31, 1998 and 1997 .....	47	47
Additional paid-in capital .....	49,574	49,574
Retained deficit .....	(5,380)	(12,820)
Minimum pension liability adjustment .....	(2,302)	(1,122)
Common stock held in treasury, at cost; 399,390 shares and 375,200 shares at December 31, 1998 and 1997, respectively .....	(4,133)	(3,943)
Total stockholders' equity .....	37,853	31,783
Total liabilities and stockholders' equity .....	\$231,865	\$196,581

</TABLE>

The accompanying notes are an integral part of the financial statements.

25

Congoleum Corporation  
Statement of Operations  
(in thousands, except per share amounts)

<S>	For the years ended December 31,		
	1998	1997	1996
Net sales .....	\$259,126	\$252,526	\$269,451
Cost of sales .....	181,997	180,093	182,585
Selling, general and administrative expenses .....	56,839	57,094	61,597
Income from operations .....	20,290	15,339	25,269
Other income (expense):			
Interest income .....	1,607	1,539	1,784
Interest expense .....	(7,365)	(6,797)	(8,153)

Other income .....	1,249	1,287	1,436
Other expense .....	(265)	(313)	(341)
-----			
Income before income taxes and extraordinary item ..	15,516	11,055	19,995
Provision for income taxes .....	5,663	4,035	7,898
-----			
Income before extraordinary item .....	9,853	7,020	12,097
Extraordinary item - early retirement of debt, net of income tax benefit .....	(2,413)	(279)	--
-----			
Net income .....	\$ 7,440	\$ 6,741	\$ 12,097
=====			
Income per common share before extraordinary item ..	\$ 1.09	\$ .72	\$ 1.21
Extraordinary item .....	(.27)	(.03)	--
-----			
Net income per common share, basic and diluted .....	\$ .82	\$ .69	\$ 1.21
=====			
Weighted average number of common and equivalent shares outstanding .....	9,038	9,839	10,007
=====			

</TABLE>

The accompanying notes are an integral part of the financial statements.

26

Congoleum Corporation  
Statements of Changes in Stockholders' Equity  
(dollars in thousands, except share amounts)

	Common Stock par value \$0.01		Additional Paid-in Capital	Retained Deficit	Accumulated Other Comprehensive Income/(Loss) Adjustment*	Treasury Stock	Total	Comprehensive Income
	Class A	Class B						
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Balance, December 31, 1995 .....	\$ 47	\$ 53	\$55,172	\$ (31,658)	\$ (1,012)	--	\$22,602	
Purchase of treasury stock .....						\$ (49)	(49)	
Minimum pension liability adjustment, net of tax benefit of \$603 .....					(983)		(983)	\$ (983)
Net income .....				12,097			12,097	12,097
Net comprehensive income .....								\$11,114
-----								
Balance, December 31, 1996 .....	47	53	55,172	(19,561)	(1,995)	(49)	33,667	
Purchase of treasury stock .....						(3,894)	(3,894)	
Purchase and retirement of Class B stock .....		(6)	(5,624)				(5,630)	
Exercise of stock options .....			26				26	
Minimum pension liability adjustment, net of tax of \$658 .....					873		873	\$873
Net income .....				6,741			6,741	6,741
Net comprehensive income .....								\$ 7,614
-----								
Balance, December 31, 1997 .....	47	47	49,574	(12,820)	(1,122)	(3,943)	31,783	
Purchase of treasury stock .....						(190)	(190)	
Minimum pension liability adjustment, net of tax benefit of \$678 .....					(1,180)		(1,180)	\$ (1,180)
Net income .....				7,440			7,440	7,440
Net comprehensive income .....								\$ 6,260
-----								
Balance, December 31, 1998 .....	\$ 47	\$ 47	\$49,574	\$ (5,380)	\$ (2,302)	\$ (4,133)	\$37,853	

\*Entire amount relates to minimum pension liability adjustment.

</TABLE>

The accompanying notes are an integral part of the financial statements.

27

Congoleum Corporation  
Statements of Cash Flows  
(dollars in thousands)

<TABLE>  
<CAPTION>

	For the years ended December 31,		
	1998	1997	1996
<S>	<C>	<C>	<C>
Cash flows from operating activities:			
Net income .....	\$ 7,440	\$ 6,741	\$ 12,097
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation .....	9,848	9,102	8,696
Amortization .....	893	992	1,087
Loss on early retirement of debt, including write-off of deferred financing fees .....	3,809	252	--
Deferred income taxes .....	2,074	93	994
Loss on disposition of assets .....	--	331	16
Changes in certain assets and liabilities:			
Accounts and notes receivable .....	(1,368)	3,216	(3,297)
Inventories .....	(758)	3,016	568
Prepaid expenses and other current assets .....	(2,299)	(1,294)	1,026
Accounts payable .....	959	(6,495)	(1,151)
Accrued liabilities .....	1,854	(4,781)	4,200
Other liabilities .....	1,515	(156)	(1,094)
Net cash provided by operating activities .....	23,967	11,017	23,142
Cash flows from investing activities:			
Capital expenditures, net .....	(9,440)	(19,523)	(12,817)
Purchase of short-term investments .....	(15,000)	(40,200)	(45,000)
Maturities of short-term investments .....	22,900	49,800	27,500
Net cash used by investing activities .....	(1,540)	(9,923)	(30,317)
Cash flows from financing activities:			
Issuance of long-term debt .....	99,505	--	--
Debt issuance costs .....	(3,310)	--	--
Payments to reduce long-term debt .....	(76,594)	(11,156)	(2,250)
Premium payments on early retirement of debt .....	(2,563)	--	--
Purchase of treasury stock .....	(190)	(3,894)	(49)
Purchase and retirement of Class B stock .....	--	(5,630)	--
Exercise of stock options .....	--	26	--
Net cash provided (used) by financing activities ...	16,848	(20,654)	(2,299)
Net increase (decrease) in cash .....	39,275	(19,560)	(9,474)
Cash and cash equivalents:			
Beginning of year .....	11,069	30,629	40,103
End of year .....	\$ 50,344	\$ 11,069	\$ 30,629

</TABLE>

The accompanying notes are an integral part of the financial statements.

Congoleum Corporation  
Notes to Financial Statements  
(dollars in thousands, except per share amounts)

1. Summary of Significant Accounting Policies:

Nature of Business and Basis of Presentation - Congoleum Corporation (the "Company" or "Congoleum") manufactures and sells resilient sheet and tile flooring products primarily to wholesale distributors and major retailers in the United States and Canada.

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.

Revenue Recognition - Revenue is recognized when products are shipped. Net sales are comprised of the total sales billed during the period less the sales value of goods returned, trade discounts and customers' allowances.

Cash and Cash Equivalents - All highly liquid debt instruments with a maturity of three months or less at the time of purchase are considered to be cash equivalents. The carrying amount reported in the balance sheets for cash and cash equivalents approximates its fair value.

Short-Term Investments - The Company invests in highly liquid debt instruments with strong credit ratings. Investments with a maturity greater than three months, but less than one year at the time of purchase are considered to be short-term investments. The carrying amount of the investments approximates fair value due to their short maturity. The Company maintains cash and cash equivalents and short-term investments with certain financial institutions. The Company performs periodic evaluations of the relative credit standing of those financial institutions that are considered in the Company's investment strategy.

Inventories - Inventories are stated at the lower of cost or market. The LIFO (last-in, first-out) method of determining cost is used for substantially all inventories.

Property, Plant, and Equipment - Property, plant, and equipment are recorded at cost and are depreciated over their estimated useful lives (30 years for buildings, 15 years for building improvements, production equipment and heavy-duty vehicles, 3 to 10 years for light-duty vehicles and office furnishings and equipment) on the straight-line method for financial reporting and accelerated methods for income tax purposes. Costs of major additions and betterments are capitalized; maintenance and repairs which do not improve or extend the life of the respective assets are charged to operations as incurred. When an asset is sold, retired or otherwise disposed of, the cost of the asset and the related accumulated depreciation are removed from the respective accounts and any resulting gain or loss is reflected in operations.

Debt Issue Costs - Costs incurred in connection with the issuance of long-term debt have been capitalized and are being amortized over the life of the related debt. Such costs, at December 31, 1998 and 1997 amounted to \$3,170 and \$1,547, respectively, net of accumulated amortization of \$140 and \$2,603, respectively, and are included in other noncurrent assets.

Goodwill - The excess of purchase cost over the fair value of net assets acquired (goodwill) is being amortized on a straight-line basis over 40 years. At each balance-sheet date, the Company evaluates the recoverability of its goodwill using certain financial indicators, such as historical and future ability to generate income from operations. Accumulated amortization amounted to \$5,273 and \$4,841 at December 31, 1998 and 1997, respectively.

The Company periodically evaluates goodwill to ensure it is fully recoverable from projected undiscounted cash flows of the related business operations. There have been no impairment adjustments to goodwill through December 31, 1998.

Environmental Remediation Liabilities - The Company

Congoleum Corporation  
Notes to Financial Statements (continued)  
(dollars in thousands, except per share amounts)

is subject to federal, state and local environmental laws and regulations. The Company records a liability for environmental remediation claims when a cleanup program or claim payment becomes probable and the costs can be reasonably estimated. The recorded liabilities are not discounted for delays in future payments (see Notes 4, 6, and 15).

Income Taxes - The provision for income taxes is based on earnings reported in the financial statements under an asset and liability approach in accordance with SFAS No. 109, "Accounting for Income Taxes," that requires the recognition of deferred tax assets and liabilities for the difference between the tax bases of assets and liabilities and their reported amounts for financial statement purposes.

Reclassifications - For comparative purposes, certain amounts have been reclassified to conform to the current-year presentation.

Income Per Share - Effective October 1, 1997, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share." This statement establishes new standards for computing and presenting earnings per

share. Earnings per share data for prior periods have been restated to conform to SFAS 128. The effect of the restatement on prior periods was immaterial. Due to the immaterial effect of common stock equivalents there is no difference between basic and fully diluted earnings per share for any period presented.

Changes in Accounting Principles - During 1998, the Accounting Standards Executive Committee ("AcSEC") issued Statement of Position ("SOP") 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." This statement requires certain costs of internally developed software to be capitalized for years beginning after December 15, 1998. The Company will adopt SOP 98-1 effective January 1, 1999. The adoption of this SOP would not have had a material impact in 1998.

In June 1997, the Financial Accounting Standards Board issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." This statement establishes standards for the way that companies report information about operating segments and is effective for financial statements for the year ended December 31, 1998 for the Company. The Company believes that it operates in one segment, flooring products.

Effective January 1, 1997, the Company adopted the American Institute of Certified Public Accountants ("AICPA") SOP 96-1, "Environmental Remediation Liabilities," which provides authoritative guidance on the recognition, measurement, display and disclosure of environmental remediation liabilities. Adoption of this standard did not have a material effect on the Company's financial position, results of operations or liquidity.

## 2. Inventories:

A summary of the major components of inventories is as follows:

	December 31, 1998	December 31, 1997
-----		
Finished goods .....	\$36,018	\$34,914
Work-in-process .....	3,106	3,160
Raw materials and supplies .....	6,068	6,360
-----		
Total inventories .....	\$45,192	\$44,434
=====		

If the FIFO (first-in, first-out) method of inventory accounting (which approximates current cost) had been used, inventories would have been approximately \$1,251 and \$340 lower than reported at December 31, 1998 and 1997, respectively. The carrying value of certain LIFO inventories was reduced by market valuation reserves of \$300 and \$229 at December 31, 1998 and 1997, respectively.

## 3. Property, Plant, and Equipment:

A summary of the major components of property, plant, and equipment is as follows:

	December 31, 1998	December 31, 1997
-----		
Land .....	\$ 2,930	\$ 2,930
Buildings and improvements .....	35,759	33,259
Machinery and equipment .....	138,782	132,414
Construction-in-progress .....	4,072	3,819
-----		
	181,543	172,422
Less accumulated depreciation .....	(93,589)	(84,021)
-----		
Total property, plant, and equipment, net .....	\$ 87,954	\$ 88,401
=====		

Interest is capitalized in connection with the construction of major facilities and equipment. The capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset's estimated useful life. Capitalized interest cost was \$325 and \$823 for 1998 and 1997,

respectively.

The amount of approved but unexpended capital appropriations at December 31, 1998 was \$13,334, substantially all of which is planned to be expended during 1999.

#### 4. Accrued Liabilities:

Accrued liabilities consists of the following:

	December 31, 1998	December 31, 1997
-----		
Accrued warranty, marketing and sales promotion .....	\$18,174	\$17,244
Employee compensation and related benefits .....	6,377	5,766
Interest .....	3,599	2,935
Environmental remediation and product-related liabilities .....	1,040	1,035
Other .....	2,019	1,813
-----		
Total accrued liabilities .....	\$31,209	\$28,793
=====		

#### 5. Long-Term Debt:

Long-term debt consists of the following:

	December 31, 1998	December 31, 1997
-----		
8 5/8% Senior Notes due 2008 .....	\$99,526	--
9% Senior Notes due 2001 .....	--	\$76,594
=====		

On August 3, 1998, the Company issued \$100 million of 8 5/8% Senior Notes maturing August 1, 2008 priced at 99.505 to yield 8.70%. The Senior Notes are redeemable at the option of the Company, in whole or in part, at any time on or after August 1, 2003 at a predetermined redemption price (ranging from 104% to 100%), plus accrued and unpaid interest to date of redemption. The Indenture under which the notes were issued includes certain restrictions on additional indebtedness and uses of cash, including dividend payments.

Proceeds of the offering were used to redeem all of the outstanding 9% Senior Notes, including accrued interest and prepayment premium, to pay certain fees and expenses in connection with the offering, and for working capital and general corporate purposes. In connection with this offering, the Company recorded an extraordinary charge of \$2.4 million, net of \$1.4 million of income tax benefits, to write off debt issuance costs and premiums associated with the repurchase of the 9% Senior Notes.

During 1997 and 1996, the Company repurchased \$11,156 and \$2,250, respectively, of its 9% Senior Notes. In connection with the repurchase in 1997, the Company recorded an extraordinary charge of \$279, net of \$160 of income tax benefits, to write off the portion of the debt issuance cost and premiums associated with the repurchased 9% Senior Notes. Such write-offs were immaterial to the financial statements for 1996 and were included in other expenses.

The fair value of the Company's long-term debt is based on the quoted market prices for publicly traded issues. The estimated fair value of the 8 5/8% Senior Notes was approximately \$98,500 at December 31, 1998. The estimated fair value of the 9% Senior Notes was \$77,743 at December 31, 1997.

The Company has a revolving credit facility which expires in 2003 that provides for borrowings up to \$30,000 with interest varying based on the Company's ratio of debt to EBITDA, as defined. This agreement provides for a commitment fee based on the average daily unused portion of the commitment equal to one-fifth of one percent per annum. This financing agreement contains certain covenants which include the maintenance of minimum net worth, income, and fixed charge coverage levels. It also includes restrictions on the incurrence of additional debt and limitations on capital expenditures. Borrowings under this facility are collateralized by inventory and receivables. There were no

=====  
borrowings outstanding under this facility at December 31, 1998, however, the facility provides for standby letters of credit which totaled \$3,380 at December 31, 1998.

6. Other Liabilities:

Other liabilities consists of the following:

	December 31,	
	1998	1997
-----		
Environmental remediation and product-related liabilities .....	\$16,198	\$13,981
Accrued workers' compensation claims .....	4,987	4,425
Other .....	2,316	3,899
-----		
Total other liabilities .....	\$23,501	\$22,305
=====		

7. Research and Development Costs:

Total research and development costs charged to operations amounted to \$3,819, \$3,718 and \$4,552 for the years ended December 31, 1998, 1997 and 1996, respectively.

8. Operating Lease Commitments and Rent Expense:

The Company leases certain office facilities and equipment under leases with varying terms.

Future minimum lease payments of significant, noncancelable operating leases having initial or remaining lease terms in excess of one year as of December 31, 1998 are as follows:

Years Ending	
-----	
1999 .....	\$1,867
2000 .....	1,527
2001 .....	653
2002 .....	484
2003 .....	479
Thereafter .....	40
-----	
Total minimum lease payments .....	\$5,050
=====	

Rent expense was \$2,368, \$1,902 and \$1,772 for the years ended December 31, 1998, 1997 and 1996, respectively.

9. Retirement Plans:

Retirement benefits are provided for substantially all employees under Company-sponsored defined benefit pension plans. The plans are noncontributory and generally provide monthly lifetime payments, normally commencing at age 65. Benefits under the plans are based upon the provisions of negotiated labor contracts and years of service. It is the Company's policy to make contributions to these plans sufficient to meet the minimum funding requirements of applicable laws and regulations plus such additional amounts, if any, as the Company's actuarial consultants advise to be appropriate.

Net periodic pension cost includes the following components:

	For the years ended December 31,		
	1998	1997	1996
-----			
Service cost .....	\$ 1,134	\$ 1,144	\$ 1,113
Interest cost .....	3,898	3,863	3,743
Expected return on plan assets .....	(4,070)	(3,614)	(3,579)
Amortization of transition			
-----			

amount .....	76	76	76
Amortization of prior service benefit .....	(242)	(242)	(242)
Recognized actuarial loss .....	2	290	142
-----			
Net periodic pension cost .....	\$ 798	\$ 1,517	\$ 1,253
=====			

Weighted-average rate assumptions as of December 31 were as follows:

	1998	1997	1996
-----			
Discount rate .....	6.75%	7.00%	7.00%
Rate of compensation increase .....	5.00%	5.50%	5.50%
Expected long-term rate of return on assets .....	9.00%	9.00%	9.00%
=====			

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Congoleum Corporation  
Notes to Financial Statements (continued)  
(dollars in thousands, except per share amounts)

The following table sets forth the components of the change in projected benefit obligation and fair value of plan assets during 1998 and 1997 as well as funded status of the plans at December 31, 1998 and 1997:

	December 31,	
	1998	1997
-----		
Accumulated benefit obligation at end of year .....	\$ 59,451	\$ 57,285
=====		
Change in projected benefit obligation:		
Projected benefit obligation		
at beginning of year .....	\$ 58,000	\$ 56,182
Service cost .....	1,134	1,144
Interest cost .....	3,898	3,863
Actuarial loss .....	1,629	1,202
Benefits paid .....	(4,309)	(4,391)
-----		
Projected benefit obligation at the end of the year .....	\$ 60,352	\$ 58,000
=====		
Change in plan assets:		
Fair value of plan assets		
at beginning of year .....	\$ 46,405	\$ 40,655
Actual return on assets .....	3,100	7,579
Employer contributions .....	1,730	2,562
Benefit paid .....	(4,309)	(4,391)
-----		
Fair value of plan assets at end of year .....	\$ 46,926	\$ 46,405
=====		
Funded status .....	\$ (13,426)	\$ (11,595)
Unrecognized transition amount .....	9	85
Unrecognized prior service benefit .....	(1,978)	(2,221)
Unrecognized net actuarial loss .....	7,006	4,409
-----		
Net amount recognized .....	\$ (8,389)	\$ (9,322)
=====		
Amounts recognized in the financial statements consist of:		
Accrued benefit liability (including current amount of \$864 and \$1,140, respectively) .....	\$ (12,759)	\$ (11,926)
Intangible asset .....	746	837

Deferred tax asset .....	1,322	645
Accumulated other comprehensive income .....	2,302	1,122
-----		
Net amount recognized .....	\$ (8,389)	\$ (9,322)
=====		

For the year ended December 31, 1997, one of the plan's assets exceeded the projected benefit obligation. At December 31, 1997 the projected benefit obligation, accumulated benefit obligation, and assets were \$31,242, \$30,527 and \$31,336, respectively.

The Company also has two 401(k) defined contribution retirement plans that cover substantially all employees. Eligible employees may contribute up to 15% of compensation with partially matching Company contributions. The charge to income relating to the Company match was \$1,529, \$1,316 and \$1,363 for the years ended December 31, 1998, 1997 and 1996, respectively.

10. Postretirement Benefits Other Than Pensions:

Net periodic postretirement benefits cost is as follows:

	For the years ended December 31,		
	1998	1997	1996
Service cost .....	\$ 139	\$ 139	\$ 141
Interest cost .....	480	505	484
Amortization of prior service benefit .....	(409)	(409)	(447)
Amortization of net loss .....	60	99	90
-----			
Net periodic benefits cost .....	\$ 270	\$ 334	\$ 268
=====			
Weighted average discount rate .....	6.75%	7.0%	7.0%
=====			

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Congoleum Corporation  
Notes to Financial Statements (continued)  
(dollars in thousands, except per share amounts)

The change in benefit obligation and the actuarial and recorded liabilities for these postretirement benefits, none of which have been funded in 1998 and 1997, were as follows:

	December 31, 1998	December 31, 1997
-----		
Change in benefit obligation:		
Benefit obligation at end of prior year .....	\$ 7,552	\$ 7,490
Service cost (with interest) .....	139	139
Interest cost .....	480	505
Actuarial (gain) loss .....	(256)	16
Benefits paid .....	(539)	(598)
-----		
Benefit obligation at end of year .....	\$ 7,376	\$ 7,552
=====		
Funded status .....	\$ (7,376)	\$ (7,552)
Unrecognized net (gain) loss .....	(96)	220
Unrecognized prior service benefit .....	(2,815)	(3,224)
-----		
Accrued postretirement benefit cost .....	(10,287)	(10,556)
Less current portion .....	415	598
-----		
Noncurrent postretirement benefit obligations .....	\$ (9,872)	\$ (9,958)

The annual rate of increase in the per capita cost of covered health care benefits was assumed to be 8.1% in 1998; the rate was assumed to decrease gradually to 5.0% over the next 8 years and remain level thereafter. An increase of one percentage point in the assumed health care cost trend rates for each future year would increase the aggregate of the service and interest cost components of net periodic postretirement benefits cost by \$53 for the year ended December 31, 1998, and would increase the accumulated postretirement benefit obligations by \$605 at December 31, 1998.

11. Income Taxes:

The provision for income taxes is comprised of the following:

	For the years ended December 31,		
	1998	1997	1996
Current:			
Federal .....	\$2,866	\$3,980	\$5,591
State .....	45	246	711
Deferred:			
Federal .....	2,353	(213)	1,348
State .....	399	22	248
Provision for income taxes .....	\$5,663	\$4,035	\$7,898

The following is a reconciliation of the statutory federal income tax rate to the Company's effective tax rate expressed as a percentage of income before income taxes:

	For the years ended December 31,		
	1998	1997	1996
Statutory federal income tax rate .....	34.0%	34.0%	35.0%
State income taxes, net of federal benefit .....	1.9	1.6	3.5
Goodwill .....	1.0	1.4	0.8
Other .....	(0.4)	(0.5)	0.2
Effective tax rate .....	36.5%	36.5%	39.5%

Deferred taxes are recorded using enacted tax rates based upon differences between financial statement and tax bases of assets and liabilities. Valuation allowances are established when necessary to reduce the deferred tax asset to the amount expected to be realized. The components of

Congoleum Corporation  
Notes to Financial Statements (continued)  
(dollars in thousands, except per share amounts)

the deferred tax asset and liability relate to the following temporary differences:

	December 31, 1998	December 31, 1997
Deferred tax asset:		
Accounts receivable .....	\$ 949	\$ 933
Unfunded pension liability .....	3,895	4,362
Environmental remediation and product-related reserves .....	8,416	9,050
Postretirement benefit obligations .....	4,053	4,091
Other accruals .....	3,313	1,071

Total deferred tax asset .....	20,626	19,507
-----		
Deferred tax liability:		
Depreciation and amortization .....	(12,279)	(11,169)
Inventory .....	(3,058)	(1,752)
Other .....	(3,438)	(2,661)
-----		
Total deferred tax liability .....	(18,775)	(15,582)
-----		
Net deferred tax asset .....	\$ 1,851	\$ 3,925
=====		

#### 12. Supplemental Cash Flow Information:

Cash payments for interest were \$7,580, \$7,710 and \$8,168 for the years ended December 31, 1998, 1997 and 1996, respectively. Cash payments for income taxes were \$3,494, \$4,964 and \$4,335 for the years ended December 31, 1998, 1997 and 1996, respectively.

#### 13. Related Party Transactions:

The Company and its controlling shareholder, American Biltrite Inc. ("ABI"- see Note 17) provide certain goods and services to each other pursuant to agreements negotiated at arm's length. The Company had the following transactions with ABI:

	For the years ended December 31,		
	1998	1997	1996
Sales .....	\$ 868	\$ 964	\$1,213
Raw material transfers to ABI .....	3,493	2,942	3,115
Computer service income .....	134	145	226
Material purchases from ABI .....	7,079	5,269	5,814
Management fees .....	1,291	1,221	1,265
=====			

Amounts as of December 31, 1998 and 1997 due from an affiliate of ABI totaled \$243 and \$290, respectively. Amounts as of December 31, 1998 and 1997 due to ABI and its affiliates totaled \$1,425 and \$1,094, respectively.

#### 14. Major Customers:

Substantially all the Company's sales are to select flooring distributors and retailers located in the United States. Economic and market conditions, as well as the individual financial condition of each customer, are considered when establishing allowances for losses from doubtful accounts.

Two customers accounted for 25% and 22% of the Company's net sales for the year ended December 31, 1998, 23% and 19% for the year ended December 31, 1997, and 22% and 20% for the year ended December 31, 1996 and accounted for 42% and 40% of accounts receivable at December 31, 1998 and 1997, respectively.

#### 15. Environmental and Other Liabilities:

The Company records a liability for environmental remediation claims when a cleanup program or claim payments becomes probable and the costs can be reasonably estimated. As assessments and cleanup programs progress, these liabilities are adjusted based upon the progress in determining the timing and extent of remedial actions and the related costs and damages. The recorded liabilities are not reduced by the amount of insurance recoveries. Such estimated insurance recoveries are reflected in other noncurrent assets and are considered probable of recovery.

The Company is named, together with a large number (in most cases,

hundreds) of other companies, as a potentially responsible party ("PRP") in pending proceedings under the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), as amended, and similar state laws. In two instances, although not named as a PRP, the Company has received a request for information. These pending proceedings currently relate to seven disposal sites in New Jersey, Pennsylvania, Maryland, Connecticut and Delaware in which recovery from generators of hazardous substances is sought for the cost of cleaning up the contaminated waste sites. The Company's ultimate liability in connection with those sites may depend on many factors, including the volume of material contributed to the site, the number of other PRPs and their financial viability, the remediation methods and technology to be used and the extent to which costs may be recoverable from insurance. However, under CERCLA, and certain other laws, as a PRP, the Company can be held jointly and severally liable for all environmental costs associated with a site.

The most significant exposure to which the Company has been named a PRP relates to a recycling facility site in Elkton, Maryland. Two removal actions are substantially complete as of December 31, 1998, however, the groundwater remediation phase has not begun and the remedial investigation/feasibility study related to the groundwater remediation has not been approved.

The PRP group estimated that future costs of groundwater remediation would be approximately \$26 million of which, based on waste allocations amongst members of the PRP group, Congoleum's share was estimated to be approximately 5.5%. At December 31, 1998, the Company believes its probable liability, which has been recorded in other liabilities, based on present facts and circumstances, to be approximately \$2 million. A corresponding insurance receivable of \$1.5 million has been recorded in other noncurrent assets. No other PRP sites are material on an individual basis.

The Company also accrues remediation costs for certain of the Company's owned facilities on an undiscounted basis. Estimated total cleanup costs, including capital outlays and future maintenance costs for soil and groundwater remediation are primarily based on engineering studies.

Although there can be no assurance, the Company anticipates that these matters will be resolved over a period of years for amounts (including legal fees and other defense costs) which the Company believes based on current estimates of liability and, in part, on insurance coverage, and based on advice from counsel, will not have a material adverse effect on the financial position of the Company.

Asbestos-Related Liabilities: The Company is one of many defendants in approximately 657 pending claims (including workers' compensation cases) involving approximately 1,984 individuals as of December 31, 1998, alleging personal injury from exposure to asbestos or asbestos-containing products. There were 654 claims at December 31, 1997 which involved approximately 6,455 individuals. Activity related to asbestos claims during the years ended December 31, 1998 and 1997 was as follows:

	1998	1997
Claims at Jan. 1 .....	654	661
New Claims .....	203	126
Settlements .....	(63)	(44)
Dismissals .....	(137)	(89)
Claims at Dec. 31 .....	657	654

Congoleum Corporation  
Notes to Financial Statements (continued)  
(dollars in thousands, except per share amounts)

The total indemnity costs incurred, excluding the case noted below, to settle claims during 1998 and 1997 were \$2,160 and \$949, respectively, which were paid by the Company's insurance carriers, as were the related defense costs. The average indemnity cost per resolved claim was \$11 in 1998 and \$7 in 1997, all of which costs were covered by the Company's insurance carriers. Costs per claim vary depending on a number of factors, including the number of plaintiffs, the nature of their alleged exposure, and the location of the claim.

Nearly all claims allege that various diseases or health issues were contracted as a result of exposure to asbestos in the course of their activities either as independent contractors or as employees of shipyards or other industries utilizing asbestos-containing products (or, in the workers' compensation cases, as employees of the Company) and that included among such

products which allegedly caused their diseases were sheet products provided by the Company or resilient tile provided by the Amtico Tile Division of ABI (the "Tile Division"), or both. The Company discontinued the manufacture of asbestos-containing sheet products in 1983, and the Tile Division ceased manufacturing asbestos-containing tile products in 1984. In general, asbestos-containing products have not been found to pose a health risk unless significant amounts of free asbestos fibers become airborne. All of the asbestos in asbestos-containing sheet and tile products sold by the Company or the Tile Division was fully bonded or encapsulated during the manufacturing process. The Company has issued warnings not to remove asbestos-containing flooring by sanding or other methods that do not comply with governmental asbestos handling standards.

In one of the cases tried before a jury in Superior Court of California in Los Angeles held in May and June 1997, the Company and another defendant were found liable for \$3.3 million in damages, subject to proportional liability under California law. The Company had previously settled one count for an immaterial amount and had gone to trial for the remaining counts. The jury found that the Company was liable for only 25% of the plaintiff's non-economic damages but as a result of post-verdict motions the trial judge granted plaintiff's motion for judgment notwithstanding the verdict and held that California Proposition 51 (establishing proportionate liability for non-economic damages) did not apply in this case. The Company and the other defendant have appealed this decision. The Company's insurance carrier has paid for the defense costs incurred and has indicated that it would be responsible for paying the ultimate judgment in the case, subject to certain limitations.

At December 31, 1998, the Company has accrued approximately \$6.9 million for costs related to asbestos product liability. Estimated insurance coverage of \$3.3 million has been recorded in other noncurrent assets at December 31, 1998 and are considered probable of recovery.

Although there can be no assurance, the Company believes, based upon the nature of its asbestos-containing products and its experience with cases to date, that any potential liability from pending personal injury claims relating to the Company's asbestos-containing products will not have a material adverse effect on the financial position of the Company.

The total balances of environmental and asbestos-related liabilities and the related insurance receivables deemed probable of recovery at December 31 are as follows:

(in millions)	1998		1997	
	Liability	Receivable	Liability	Receivable
Environmental liabilities .....	\$9.2	\$2.9	\$7.9	\$1.4
Asbestos product liability .....	6.9	3.3	6.6	3.3
Other .....	1.1	--	.5	--
Total .....	\$17.2	\$6.2	\$15.0	\$4.7

Other: In the ordinary course of its business, the Company becomes involved in lawsuits, administrative proceedings, product liability, and other matters. In some of these proceedings, plaintiffs may seek to recover large and sometimes

Congoleum Corporation  
Notes to Financial Statements (continued)  
(dollars in thousands, except per share amounts)

unspecified amounts and the matters may remain unresolved for several years. On the basis of information furnished by counsel and others, the Company does not believe that these matters, individually or in the aggregate, will have a material adverse effect on its business or financial condition.

16. Stock Option Plan:

Under the Company's stock option plan, options to purchase up to 800,000 shares of the Company's Class A Common Stock may be issued to officers and key employees. Such options may be either incentive stock options or nonqualified stock options, and the options' exercise price must be at least equal to the fair value of the Company's Class A Common Stock on the date of grant. All options granted have ten-year terms and vest over five years at the rate of 20% per year beginning on the first anniversary of the date of grant.

Effective January 1, 1996, the Company adopted the disclosure-only option under SFAS No.123, "Accounting for Stock-Based Compensation." The Company continues to use the accounting method under APB Opinion No. 25 (APB 25) and related interpretations for its employee stock options. Under APB 25, when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Pro forma disclosure, as required by SFAS No. 123, regarding net income and earnings per share has been determined as if the Company had accounted for its employee stock options under the fair value method of SFAS No. 123. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for 1998, 1997, and 1996, respectively: option forfeiture of 15%; risk-free interest rates of 4.80%, 5.76%, and 5.99%; no dividends; volatility factors of the expected market price of the Company's common stock of .365 for 1998, .356 for 1997, and .388 for 1996; and a weighted-average expected life of the options of 7 years.

For purposes of the pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. Certain options repriced in 1998 were not fully vested and, accordingly, were subject to a new vesting schedule. The additional compensation (along with any existing unamortized compensation) will be amortized over the new vesting period beginning in 1998. The Company's estimated pro forma compensation expense from stock options for the years ended December 31, 1998, 1997, and 1996, respectively, was \$648, \$631, and \$585. The Company's pro forma net income for the years ended December 31, 1998, 1997, and 1996, respectively, is as follows: 1998, \$6,792 or \$0.75 per share; 1997, \$6,110, or \$0.62 per share; and 1996, \$11,512, or \$1.15 per share. The initial impact on pro forma net income may not be representative of compensation expense in future years, when the effect of the amortization of multiple awards would be reflected in the pro forma disclosures.

A summary of the Company's stock option activity, and related information is as follows:

December 31, 1998:

	Shares	Weighted average exercise price
Options outstanding beginning of year	511,900	\$13.01
Options granted*	345,000	9.00
Options exercised	--	--
Options forfeited*	(230,900)	12.72
Options outstanding end of year	626,000	\$10.91
Exercisable at end of year	180,000	\$13.00
Weighted average remaining contractual life	8 years	--
Stock options available for future issuance	172,000	--

\*Includes 208,500 options repriced in 1998

Congoleum Corporation  
Notes to Financial Statements (continued)  
(dollars in thousands, except per share amounts)

December 31, 1997:

	Shares	Weighted average exercise price
Options outstanding beginning of year	484,500	\$12.89
Options granted	56,000	14.25
Options exercised	(2,000)	13.00
Options forfeited	(26,600)	13.53
Options outstanding end of year	511,900	\$13.01
Exercisable at end of year	185,200	\$12.95

contractual life .....	7 years	--
Stock options available for future issuance .....	286,100	--

December 31, 1996:

	Shares	Weighted average exercise price
Options outstanding		
beginning of year .....	481,000	\$13.00
Options granted .....	22,000	10.63
Options exercised .....	--	--
Options forfeited .....	(18,500)	13.00
Options outstanding end of year .....	484,500	\$12.89
Exercisable at end of year .....	94,100	\$13.00
Weighted average remaining contractual life .....	8 years	--
Stock options available for future issuance .....	65,500	--

#### 17. Stockholders' Equity:

Holders of the Class B shares are entitled to two votes per share on all matters submitted to a vote of stockholders other than certain extraordinary matters. The holders of the Class A shares are entitled to one vote per share on all matters submitted to a vote of stockholders.

In November 1998, the Board of Directors authorized the Company to repurchase an additional \$5,000 of the Company's common stock (Class A and Class B shares) through the open market or through privately negotiated transactions, bringing the total authorized common share repurchases to \$15,000. Under the total plan, Congoleum has repurchased \$9,763 of common stock through December 31, 1998. Shares of Class B stock repurchased (totaling 595,000) have been retired. As of December 31, 1998, ABI owned 4,395,605 Class B shares that represented 63.8% of the voting control of the Company.

#### 18. Quarterly Financial Data (Unaudited):

The following table sets forth certain unaudited quarterly financial information.

	Year ended December 31, 1998			
	First Quarter	Second Quarter	Third Quarter (a)	Fourth Quarter
Net sales .....	\$63,875	\$69,750	\$68,644	\$56,857
Gross profit .....	17,357	21,001	21,930	16,841
Net income .....	427	2,645	1,493	2,875
Net income per common share .....	\$.05	\$.29	\$.17	\$.32

	Year ended December 31, 1997			
	First Quarter	Second Quarter	Third Quarter (a)	Fourth Quarter
Net sales .....	\$61,083	\$64,909	\$69,526	\$57,008
Gross profit .....	18,241	19,805	19,676	14,711
Net income .....	1,013	2,104	2,198	1,426
Net income per common share .....	\$.10	\$.21	\$.22	\$.15

(a) Third quarter 1998 includes a \$2.4 million (after tax) charge (\$0.26 per share for the quarter) for an extraordinary item (see Note 5).

(b) Fourth quarter 1997 includes a \$0.3 million (after tax) charge (\$0.03 per share) for an extraordinary item (see Note 5).

=====  
To the Board of Directors  
and Stockholders of  
Congoleum Corporation:

We have audited the accompanying balance sheets of Congoleum Corporation as of December 31, 1998 and 1997, and the related statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of Congoleum Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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 financial statements referred to above present fairly, in all material respects, the financial position of Congoleum Corporation at December 31, 1998 and 1997, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania  
February 12, 1999

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Directors and Officers  
=====

Board of Directors

Roger S. Marcus  
Chairman of the Board, President and Chief Executive Officer of Congoleum Corporation and Chairman of the Board and Chief Executive Officer of American Biltrite Inc.

Cyril C. Baldwin, Jr.  
Chairman of the Board of Cambrex Corporation

David N. Hurwitz  
Former President and Chief Executive Officer of Goodson Newspaper Group

John N. Irwin III  
Managing Director of Hillside Capital Incorporated

Mark N. Kaplan  
Partner, Skadden, Arps, Slate, Meagher & Flom LLP (Attorneys)

Richard G. Marcus  
Vice Chairman of Congoleum Corporation and President and Chief Operating Officer of American Biltrite Inc.

William M. Marcus  
Executive Vice President and Treasurer of American Biltrite Inc.

C. Barnwell Straut  
Managing Director of Hillside Capital Incorporated

Corporate Officers

Roger S. Marcus  
Chairman of the Board, President and Chief Executive Officer

Richard G. Marcus  
Vice Chairman

Robert N. Agate  
Executive Vice President

David W. Bushar  
Senior Vice President - Manufacturing

Howard N. Feist III  
Senior Vice President - Finance and Secretary

Dennis P. Jarosz  
Senior Vice President - Marketing

James K. Morando  
Senior Vice President - Sales

Peter J. Rohrbacher  
Senior Vice President - Engineering

Thomas A. Sciortino  
Senior Vice President - Administration

Merrill M. Smith  
Senior Vice President - Technology

Corporate Information

Corporate Headquarters

Congoleum Corporation  
3705 Quakerbridge Road  
P.O. Box 3127  
Mercerville, NJ 08619-0127  
(609) 584-3000  
Internet: www.Congoleum.com

General Counsel

Patterson, Belknap, Webb & Tyler LLP  
1133 Avenue of the Americas  
New York, NY 10036-6710

Independent Auditors

Ernst & Young LLP  
Two Commerce Square  
Suite 4000  
2001 Market Street  
Philadelphia, PA 19103

Registrar and Transfer Agent

Registrar and Transfer Company  
10 Commerce Drive  
Cranford, NJ 07016  
(908) 497-2300

Market Information

The Company's Class A Common Stock is listed on the New York Stock Exchange. The following table reflects the high and low prices (rounded to the nearest one-sixteenth) based on New York Stock Exchange trading over the past two years.

1998	High	Low
First Quarter .....	11 1/4	9 1/16
Second Quarter .....	10 1/2	9 1/16
Third Quarter .....	9 3/4	6
Fourth Quarter .....	9 7/16	6
1997	High	Low
First Quarter .....	14 7/8	11 3/4
Second Quarter .....	13 1/8	10 1/2
Third Quarter .....	13 3/4	10 11/16
Fourth Quarter .....	11 9/16	8 3/4

The Company does not anticipate paying any cash dividends in the foreseeable future. Any future change in the Company's dividend policy is within the discretion of the Board of Directors and will depend, among other things, on the Company's earnings, debt service and capital requirements, restrictions in financing agreements, business conditions and other factors that the Board of Directors deem relevant. The payment of cash dividends is limited under the terms of the Indenture relating to the Company's Senior Notes and the terms of the Company's existing revolving credit facility, subject to the Company's cumulative earnings and other factors.

The number of registered and beneficial holders of the Class A Common Stock on February 10, 1999 was approximately 1,100.

#### Annual Meeting

The 1999 Annual Meeting of the Stockholders of Congoleum Corporation will be held on Wednesday, May 5, 1999 in the Long Lane Room, 2nd Floor, The First National Bank of Boston, 100 Federal Street Boston, Massachusetts at 10:00 a.m. local time.

#### Stockholder Information

The Company will supply any owner of common stock, upon written request to Mr. Howard N. Feist III of the Company at the address set forth herein, and without charge, a copy of the Annual Report on Form 10-K for the year ended December 31, 1998, which has been filed with the Securities and Exchange Commission.

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Exhibit 21.1 - Subsidiaries of the Company

Congoleum Intellectual Properties, Inc.  
Congoleum International Incorporated  
Congoleum Financial Corporation

## Exhibit 23.1 - Consent of Independent Auditors

We consent to the incorporation by reference in this Annual Report (Form 10-K) of Congoleum Corporation of our report dated February 12, 1999 included in the 1998 Annual Report to Shareholders of Congoleum Corporation.

Our audits also included the financial statement schedule of Congoleum Corporation for the years ended December 31, 1998, 1997 and 1996 listed in Item 14(a). This schedule is the responsibility of Congoleum Corporation's management. Our responsibility is to express an opinion based on our audits. In our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also consent to the incorporation by reference in the Registration Statements (Form S-8 Nos. 33-97220 and 333-34653) pertaining to the Congoleum Corporation 1995 Stock Option Plan of this report on the financial statement schedule and our report dated February 12, 1999, with respect to the 1998 financial statements of Congoleum Corporation incorporated by reference in the Annual Report (Form 10-K) for the year ended December 31, 1998.

Ernst & Young LLP  
Philadelphia, Pennsylvania  
March 24, 1999

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Exhibit 27.1 - Financial Data Schedule

This schedule contains summary financial information extracted from the financial statements included in the Company's Form 10-K for the fiscal year ended December 31, 1998 and is qualified in its entirety by reference to such financial statements.

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