OBSIDIAN ENTERPRISES INC
Form 10-K
February 13, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED OCTOBER 31, 2003 OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM ______________ TO _______________

0-17430
Commission File Number

OBSIDIAN ENTERPRISES, INC.
(Exact name of registrant as specified in its charter)

Delaware	35-2154335
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

111 Monument Circle, Suite 4800	
Indianapolis, IN	46204
(Address of principal executive offices)	(Zip Code)

(317) 237-4122
(Registrant's telephone number, including area code)

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

Common Stock ($0.0001 par value)
(Title of Class)

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 _X_ NO ____

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of the 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. [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ___ No _X_

As of April 30, 2003, the aggregate market value of the Company's common stock held by non-affiliates of the registrant, based on the average bid and ask price on such date, was approximately $3,209,900.

As of January 30, 2004, the registrant had 36,007,855 shares of common stock, 4,368,399 shares of Series C Preferred Stock and 134,758 shares of Series D Preferred Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

INFORMATION REQUIRED IN PART II AND PART III HAS NOT BEEN INCORPORATED BY REFERENCE.

ITEM 1. BUSINESS.

INTRODUCTION

Obsidian Enterprises, Inc, is a holding company headquartered in Indianapolis, Indiana. We have historically invested in and acquired small and mid size companies in basic industries such as manufacturing and transportation. We conduct business through our subsidiaries.

HISTORY AND DEVELOPMENT OF BUSINESS

We expanded our business and changed our management in 2001. Prior to that date, our only subsidiary, Danzer Industries, Inc., manufactured metal parts and truck bodies for the service and utilities markets. In 2001, Timothy S. Durham became our Chief Executive Officer and Chairman of the Board and we purchased four new businesses:

- Pyramid Coach, Inc., which provides luxury coach leases for corporations and the entertainment industry;

- U.S. Rubber Reclaiming, Inc., which owns and operates butyl-rubber reclaiming facilities;

- United Acquisition, Inc., which we operate as United Expressline and Southwest Trailers, manufactures steel-framed cargo, racing and specialty trailers; and

- Champion Trailer, Inc., manufacturer of customized racecar transporters, specialty exhibits trailers and mobile hospitality units (we sold this company in 2003).

We acquired these companies from Mr. Durham, Obsidian Capital Partners, L.P. and their other owners. Mr. Durham is one of the partners of Obsidian Capital Partners. We issued shares of our Series C Preferred Stock to pay for these companies.

In October 2001, we changed our state of incorporation from New York to Delaware and our name from Danzer Corporation to Obsidian Enterprises, Inc.

DESCRIPTION OF BUSINESS

OVERVIEW

Our headquarters are in Indianapolis, Indiana. Our goals are to maximize the profits of our current subsidiaries and to acquire additional manufacturing companies of similar size. We currently conduct business through five subsidiaries:

- U.S. Rubber;

- Pyramid Coach;

- Obsidian Leasing Co., Inc., the owner of some of the coaches operated by Pyramid Coach;
- United Expressline; and
- Danzer Industries.

We sold Champion in January 2003.

SEGMENTS

We operate in three industry segments:

- butyl-rubber reclaiming;
- trailer and related transportation equipment manufacturing; and
- coach leasing

All sales are in the Western Hemisphere, primarily in the United States. For quantitative segment information, see Note 13 to the Consolidated Financial Statements.

Butyl Rubber Reclaiming

Our butyl-rubber processing facilities are in two adjacent plants in Vicksburg, Mississippi. We collect various used and scrap butyl rubber products, primarily inner tubes from tires, and then reprocess these into reclaimed butyl rubber sheets. We distribute reclaimed butyl rubber products through an internal sales force.

Customers mix our reclaimed butyl rubber with virgin butyl rubber and use the product predominately as the inner liner of tubeless tires and also as inner tubes for tires and for tapes and mastics for pipelines. The combination of reclaimed butyl rubber with virgin butyl rubber facilitates some manufacturing processes, but the primary reason manufacturers use reclaimed butyl rubber is the cost savings offered compared to virgin butyl rubber.

We are the primary supplier of reclaimed butyl rubber to most of the tire industry in the United States and we also have tire manufacturer customers in Canada and Brazil. Three other enterprises engaged in reclaiming butyl rubber worldwide are:

- The Gujarat Company in India;
- Han Cook in Korea; and
- Vrederstein N.V. in the Netherlands.

These enterprises are not major competitors of ours for sales in the Western Hemisphere, because price is the primary competitive factor and cost of transportation increases the prices these other enterprises can offer. These enterprises do compete with us for scrap.

Two enterprises manufacture virgin butyl rubber for sale in the United States:

- Exxon Corporation; and
- Bayer AG.

These enterprises are much larger than we are, are well capitalized and have larger sales staffs. The prices these enterprises charge place an upper limit on the prices that we can charge for reclaimed butyl rubber.

We obtain our supply of scrap inner tubes from approximately 1000 scrap merchants worldwide but primarily Brazil, Venezuela, and India. Our ability to produce reclaimed butyl rubber is potentially restrained by the limited supply of scrap butyl rubber products. Since the introduction of tubeless tires for automobiles in the 1970s, the number of scrap inner tubes from sources in the United States has declined substantially. In the United States, inner tubes are now primarily limited to the agricultural and large truck tire market. In 2001, we began experimenting with reclaiming scrap butyl rubber pads from the manufacturers of other butyl rubber products. This pad scrap is created as a result of the manufacturing process for molded butyl rubber products and is available at approximately 60% of the cost of scrap inner tubes. Our work to date suggests that pad scrap may be a partial substitute for inner tubes as raw material for the Company's reclaimed butyl rubber product.

Although we have had long-term relationships with our primary customers, we do not have long-term contracts with them. Two of our reclaimed butyl rubber customers accounted for a substantial portion of our butyl rubber sales in 2003:

- Michelin: 41 %
- Kelley Springfield: 20%

The loss of either of these customers would materially and adversely affect our revenues. Our reclaimed butyl rubber products are generally ordered by customers monthly and shipped promptly after the order. Customers generally pay accounts on 30 to 60 day terms.

Trailer and Related Transportation Equipment Manufacturing

We manufacture service truck bodies at our facility in Hagerstown, Maryland. We manufacture truck bodies to order for original equipment truck manufacturers and under the Morrison trademark. We ship the finished bodies to the customer for installation on truck body chassis. We sell our private label products directly to our private label customers and market our proprietary "Morrison" products through a network of approximately 300 dealers who, in turn, sell to municipalities, utility companies, cable companies, phone companies and contractors. We market the truck bodies through an internal sales force.

Most truck body customers are in the East and Southeast United States. In 2002, our largest truck manufacturing customer filed for reorganization under Chapter 11 of the United States bankruptcy code and continues to operate. The loss of our relationship with the truck manufacturer had a material adverse effect on our business.

A significant number of companies manufacture service truck bodies in the United States. While many of these companies are relatively small and do not possess our technical capacity, a number of our competitors are much larger and possess equal or greater technical and financial resources. Four of these competitors are:

- Knapheide Manufacturing Co.;
- Omaha Standard, Inc.;
- Reading Body Works, Inc.; and
- Stahl, a Scott Fetzer Co., which is a wholly owned subsidiary of

Berkshire Hathaway, Inc.

We compete for truck body sales through price and service, with price being the most important factor. We also offer truck bodies made to the individually specified requirements of our customers.

We began manufacturing cargo trailers at our Hagerstown facility during 2002 to utilize the available manufacturing capacity and meet demand for cargo trailers.

We manufacture specialty racing, cargo and ATV trailers at facilities we own in Bristol, Indiana, and White Pigeon, Michigan. To increase our capacity to meet demands, we also began leasing a facility in Elkhart, Indiana, in 2003. Our trailer business is somewhat seasonal, with fewer orders during the months from November through January. We market our trailers under the names "United Expressline," "United Trailers," "Southwest Expressline," and "Southwest Trailers." During 2003, we began the process of consolidating the brand names under one brand, "United Trailers." Although the prices for our trailer brands can be as high as $75,000, the average price is approximately $3,900.

We sell our "United Trailers," "United Expressline," "Southwest Trailers," and "Southwest Expressline" product lines through two dealer networks that have approximately 300 dealers in the United States and Canada. Most of these dealers are located in the Midwest United States. Although we have formal agreements with a few of the dealers, most of the dealership arrangements are informal and nonexclusive. We conduct our sales through an internal sales force.

The trailers are built to order to dealer specifications. The terms of sale for the "United Trailers," "United Expressline," "Southwest Trailers," and "Southwest Expressline" products are FOB the plant with payment generally due upon the dealer taking delivery of the trailer. A few dealers have 30- or 60-day terms.

A significant number of companies manufacture specialty racing, cargo and ATV carriers in the United States. Although many of these companies are relatively small and do not possess our technical capability, a number of our competitors are much larger and possess equal or greater technical and financial resources. Four of these competitors are:

- Haulmark Industries;
- Pace American;
- U.S. Cargo; and
- Wells Cargo.

We compete for specialty racing, cargo and ATV trailer sales through price, quality and availability, but price generally is the important factor.

We purchase our raw materials for the trailer and related transportation equipment segment from numerous suppliers and have not had any difficulty in obtaining components or raw materials. During the last six months of fiscal 2003, the supply of plywood became limited. Although we had an adequate supply for our production needs, the prices nearly doubled during this period. At this time, we cannot estimate if or when the cost of plywood will return to historic levels, and we are pursuing alternate material sources.

We generally warrant our product to be free from defects in material and workmanship and performance under normal use and service for 12 months after shipment. Our obligation generally is limited to the repair or replacement of the defective product. Historically, our warranty costs have not been material to our consolidated financial statements.

At October 31, 2003, the backlog of our trailer and related transportation segment was approximately $4,650, composed of approximately $140 for truck bodies and $4,510 for specialty racing, cargo and ATV trailers. We expect to fill this backlog during the 2004 fiscal year.

Coach Leasing

We lease high-end luxury entertainment coaches from our facility in Joelton, Tennessee. We lease coaches for both short-term (weekly or monthly) and long-term periods.

At October 31, 2003, we managed 38 coaches. We also sometimes sublease coaches from other coach owners on a short-term basis.

DW Leasing, LLC, a company Mr. Durham controls, transferred 22 coaches to our subsidiary Obsidian Leasing in 2002. DW Leasing continues to own seven coaches that we manage. We also manage nine coaches owned by DC Investments Leasing, LLC, an entity controlled by Mr. Durham.

Our consolidated financial statements include the assets, liabilities and equity of DW Leasing and DC Investments Leasing and the results of their operations from January 1, 2001 and December 1, 2002 (inception of DC Investments Leasing), respectively. Both of these entities are in the business of coach leasing and their coaches are leased exclusively through Pyramid Coach. For additional information, see the discussion of FASB Interpretation No. 46 included in Note 2 to the Notes to Consolidated Financial Statements contained in Item 8.

We lease coaches through an internal sales force to the country, rock-n-roll, pop and traveling Broadway show entertainment industries. We also lease coaches to various corporations. During the year ended October 31, 2003, we leased coaches to a number of touring groups, including Ozzy Osbourne, Brad Paisley and the Broadway Show "Stomp." Our corporate customers include the Golf Channel.

Several other companies lease luxury coaches. Some of our larger competitors include:

- Entertainer Coaches of America;
- Florida Coach;
- Senators Coach; and
- Hemphill Brothers.

We believe that amenities are an important factor in leasing coaches to our target market and we equip our coaches with a full complement of amenities. We compete with other luxury coach providers based on a combination of quality, amenities, availability and price.

GOVERNMENT REGULATION

Federal, state, and local agencies regulate areas of our business, including for environmental and fire hazard control. They also regulate our work place to ensure safe working conditions for our employees. The trailers and truck bodies we manufacture must meet standards set by state and federal transportation authorities and the coaches we lease must comply with those standards and regulations. These regulatory bodies could take actions that would have a material adverse affect on our ability to do business.

EMPLOYEES

As of October 31, 2003, we had 405 employees. We have a labor contract through January 2005 with the United Brotherhood of Carpenters and Joiners of America for the approximately 40 production workers at our truck body manufacturing facility in Hagerstown, Maryland. None of the employees at our other facilities is represented by a labor union. We believe that our employee relations are satisfactory.

PATENTS AND PROPRIETARY TECHNOLOGY

We do not rely on any patents, registered trademarks, or special licenses to give us a competitive advantage. The "Morrison," "Danzer," "Pyramid," "United Trailer," "United Expressline," "Southwest Trailer," and "Southwest Expressline" brand names have brand recognition in the relevant market.

RESEARCH AND DEVELOPMENT

We have not incurred any material research and development expenses during any of our last three fiscal years and we do not contemplate incurring any material research and development expenses in the 2004 fiscal year.

FORWARD-LOOKING STATEMENTS

In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements. You can identify forward-looking statements by the use of words and phrases such as "expects," "plans," "will," "estimates," "forecasts," "projects," "believes," "anticipates," "looking forward" and other words and phrases of similar meaning. You also can identify forward-looking statements by the fact that they do not relate strictly to historical or current facts. Forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation." Readers should carefully review the risks described in this and other documents that we file from time to time with the Securities and Exchange Commission, including the quarterly reports on Form 10-Q to be filed by the Company in 2004. Readers are cautioned not to place undue reliance on the forward-looking statements, which speak only to the date of this Annual Report on Form 10-K. The Company undertakes no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

ITEM 2. PROPERTIES

The following describes the Company's properties:

Identification	Location	Ownership/Description	S
Headquarters	111 Monument Circle, Suite 4800, Indianapolis, IN 46204	3,700 square feet leased commercial office space	N
Butyl Rubber Processing	Vicksburg, Mississippi	Two adjacent plants aggregating	B

Plants		87,000 square feet, each owned by the Company and encumbered by a mortgage to PNC Bank	Pr
Truck Body Plant	Hagerstown, Maryland	75,000 square foot plant owned by the Company and encumbered by a mortgage to Fair Holdings, Inc.	T tr eq ma
United Expressline Plant	Bristol, Indiana	Several buildings aggregating 49,000 square feet owned by the Company and encumbered by a mortgage to First Indiana Bank NA	T tr eq ma
United Expressline Plant	Elkhart, Indiana	35,000 square foot plant leased by the Company	T tr eq ma
United Expressline Plant	White Pigeon, Michigan	47,000 square foot plant owned by the Company and encumbered by a mortgage to First Indiana Bank NA	T tr eq ma
Pyramid Coach Office	Joelton, Tennessee	12,000 square feet of office space and other facilities leased by the Company	C

The Company believes that its property, plant and equipment are well maintained and adequate for its requirements. The Company also believes that all of its assets are adequately covered by insurance.

ITEM 3. LEGAL PROCEEDINGS

All dollar amounts in Item 3 are in thousands (except for share and per share information).

On April 29, 2002, Markpoint Equity Fund J.V. ("Markpoint"), a Texas joint venture of which The Markpoint Company serves as Managing Partner, filed an action in the Texas District Court, Dallas County, seeking payment of $1,250 owed by Champion, a subsidiary subsequently divested, as further described in Note 4 to the Consolidated Financial Statements. On January 27, 2003, the Company reached an agreement to settle this liability for a cash payment of $675 and issuance to Markpoint of 32,143 shares of the Company's Series D preferred stock. In addition, the agreement provided Markpoint the option to require the Company to repurchase these shares at a price of $21 per share. The Company's repurchase obligation was guaranteed by Mr. Durham. Pursuant to an Assignment Agreement, dated May 12, 2003, the Company assigned all of its rights, title and interest in the repurchase option to Fair Holdings, Inc. in exchange for Fair Holding, Inc.'s assumption of the Company's repurchase obligations. The repurchase obligation as of October 31, 2003 has been recorded in the consolidated balance sheet as mandatory redeemable preferred stock. Fair Holdings exercised its options to acquire the Series D Preferred Stock from Markpoint on May 12 and November 10, 2003.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of our stockholders during the fourth quarter of the 2003 fiscal year.

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's common stock is currently traded on the Over-the-Counter Electronic Bulletin Board under the symbol "OBSD." The following table sets forth the high and low bid quotations for the common stock for the fiscal quarters indicated.

	FISCAL 2003		FISCAL 2002	
	High	Low	High	Low
1st Quarter	$0.26	$0.15	$0.25	$0.12
2nd Quarter	$0.25	$0.18	$0.36	$0.12
3rd Quarter	$0.26	$0.08	$0.27	$0.11
4th Quarter	$0.85	$0.14	$0.27	$0.10

The above quotations reflect inter-dealer prices, and may not include retail mark-up, mark down or commissions and may not necessarily represent actual transactions. At October 31, 2003, there were approximately 871 holders of record of the Company's common stock. Most of the shares of common stock are held in street name for an unknown number of beneficial owners. To date the Company has not paid a cash dividend on its common stock. The payment and amount of any future cash dividends would be restricted by the Company's lenders and will necessarily depend upon conditions such as the Company's earnings, financial condition, working capital requirements and other factors.

ITEM 6. SELECTED FINANCIAL DATA.

The following table sets forth certain selected consolidated financial information concerning the Company. This information is not covered by the independent auditor's report. For further information, see the accompanying Consolidated Financial Statements of Obsidian Enterprises, Inc. and subsidiaries for the years ended October 31, 2003 and 2002 and the ten-month period ended October 31, 2001 and the information set forth in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and in Item 8, "Financial Statements and Supplementary Data" below.

The information for the years ended December 31, 2000 and 1999 is for that of U.S. Rubber Reclaiming only, the accounting acquirer in the reverse merger further described in Items 7 and 8.

OPERATING DATA:

(Amounts in thousands, except per share data)

	Year Ended October 31, 2003	Year Ended October 31, 2002	Ten Months Ended October 31, 2001	--
Net sales	$ 59,295	$ 57,274	$ 24,689	$
Income (loss) from operations	(978)	449	981	
Discontinued operations, net of tax	(49)	(1,040)	(3,376)	
Cumulative effect of change in accounting principle	--	(2,015)	--	
Net income (loss)	(3,873)	(6,330)	(4,395)	
Basic and diluted earnings (loss) per share:				
From continuing operations	(.12)	(.09)	(.04)	

Discontinued operations	--	(.03)	(.13)
Cumulative effect of change in accounting principle	--	(.06)	--
Net income (loss) per share	(.12)	(.18)	(.17)

BALANCE SHEET DATA:

	October 31,		
	2003	2002	2001
Working capital (deficit)	$ 6,045	$ 1,591	$ (2,528)
Total assets	45,882	45,923	48,850
Long-term debt, including current portion and mandatory redeemable preferred stock	43,221	36,464	35,382
Stockholders' equity (deficit)	(3,253)	(689)	1,331

No dividends have been declared or paid in any period presented.

We adopted Statement of Financial Accounting Standards ("SFAS") No. 142, Goodwill and Other Intangible Assets, on November 1, 2001. SFAS No. 142 changed the accounting for goodwill from a model that required amortization supplemented by impairment tests to an accounting model based solely upon impairment tests. The consolidated operating data presented includes goodwill amortization only for the ten months ended October 31, 2001. Had the nonamortization provisions of SFAS No. 142 been effective prior to 2001, the net loss for the ten months ended October 31, 2001 would have been reduced by $76 to $4,319. There would be no change in earnings per share. All other periods presented would be unchanged.

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

All dollar amounts in this Item 7 are in thousands (except for share and per share information).

INTRODUCTION

Obsidian Enterprises, Inc. is a holding company headquartered in Indianapolis, Indiana. We conduct business through our subsidiaries:

- Pyramid Coach, Inc., a leading provider of corporate and celebrity entertainer coach leases;
- Obsidian Leasing, Inc., owner of coaches managed by Pyramid Coach;
- United Expressline, Inc., and its division, Southwest Trailers, manufacturers of steel-framed cargo, racing ATV and specialty trailers;
- U.S. Rubber Reclaiming, Inc., a butyl-rubber reclaiming operation; and
- Danzer Industries, Inc., a manufacturer of service and utility truck bodies and steel-framed cargo trailers.

While each of the subsidiaries markets its products or services independently, our emphasis is to provide high quality products and services by taking advantage of cross-selling opportunities, manufacturing and other operational efficiencies through each of the subsidiaries.

Organization of Financial Information

The Management's Discussion and Analysis provides material historical and prospective disclosures intended to enable investors and other users to assess our financial condition and results of operations. Statements that are not historical are forward-looking and involve risks and uncertainties discussed under the caption "Forward-Looking Statements" in Item 1 of this Annual Report on Form 10-K.

The consolidated financial statements and notes are presented in Item 8 of this Annual Report on Form 10-K. Included in the consolidated financial statements are the consolidated statements of operations, consolidated balance sheets, consolidated statements of cash flows, and consolidated statements of stockholders' equity (deficit) and comprehensive loss. The notes, which are an integral part of the consolidated financial statements, provide additional information required to fully understand the nature of amounts included in the consolidated financial statements.

Significant Transactions and Financial Trends

Throughout these financial sections, you will read about significant transactions or events that materially contribute to, or reduce, earnings and materially affect financial trends. Significant transactions discussed in this Management's Discussion and Analysis include:

- a discounting program in the Trailer manufacturing segment in 2003,
- cost reduction initiatives for raw materials under "lean" manufacturing concepts,
- an asset impairment charge and discontinued operations recorded in fiscal 2002,
  - the cumulative effect of accounting principle as a result of adopting Statement of Financial Accounting Standard (SFAS) No. 142 in fiscal 2002, and

These significant transactions resulted from unique facts and circumstances that are not expected to recur with similar materiality or impact on continuing operations. While these items are important in understanding and evaluating financial results and trends, other transactions or events such as those discussed later in this Management's Discussion and Analysis may also have a material impact. An understanding of these transactions is necessary in order to estimate the likelihood that current trends will continue or these events will recur.

RESULTS OF OPERATIONS

OVERVIEW

During 2003, we were negatively impacted by general economic conditions and various company specific events discussed below. We were able to effect a significant restructuring and refinancing of our outstanding indebtedness and secured new funding (see "Liquidity and Capital Resources"). As discussed below, during 2004, we anticipate generating positive cash flow and increasing our working capital through improved operations and pursuing significant strategic acquisition initiatives.

- In the trailer and related transportation equipment manufacturing segment our major competitors were aggressive in their sales and marketing approach by offering price concessions and a variety of special programs designed to stimulate business. For the first time, we were forced to offer sales promotions and discount programs to maintain our market share. In lieu of future discounting to maintain market share, we have introduced a new line of trailers that is offered at competitive prices while maintaining historic profit margins. Our results in this segment were also affected by the significant increase in raw material prices primarily related to plywood during the last six months of the 2003 and the fact that the truck body market has been depressed for the past twenty-four months as the telecommunications industry has maintained low levels of capital spending. Given the current state of the telecommunications industry and economic conditions, we will continue to evaluate the operations and progress with the implementation of the trailer production in the Danzer operational facility. We are evaluating the trailer line implementation and its impact on operations on a continuous basis.

  Since we expect market conditions to remain very competitive, we introduced new cost reduction initiatives, including combining operations for United Expressline and Southwest and coordinating administrative and sales and marketing efforts under one brand name, United Trailers. In addition, we are implementing programs with a goal of reducing material cost as a percentage of sales by 3.0%, since we believe, compared to industry averages, that our cost of materials percentage appears to be above the industry average. Additional strategies in the trailer and related transportation segment include: building sales growth through our expansion of production facilities, market expansion through cross selling and additional geographical production at Danzer and other potential acquisitions.

- Our butyl rubber reclaiming segment increased sales by 8.7%. We were able to reduce some overall manufacturing costs by consolidating some of the operational facilities. However, additional costs were incurred to maintain the equipment in this very capital intensive operation. The availability of raw materials continues to be a concern as the use of Butyl inner tubes and reclaim disposal has decreased over the past several years. We continue to identify new market sources for raw material including a new recycling program with the chapters of The National FFA Organization. A new Fine Grind process was also initiated in 2003 which increases our ability to use other types of rubber in our Butyl reclaim process and as potential new natural rubber products.

- Fiscal 2003 was a record-setting year for our coach leasing segment for both net sales and earnings. Five additional coaches were added to our fleet at the end of the first quarter, and the entertainment industry and related tours began to pick up momentum due to improving economic conditions and additional marketing efforts. We were able to refinance a significant portion of the bank debt during the fourth quarter of 2002 and the first quarter of 2003, which reduced our overall effective rate of interest paid to approximately 8.5%. Utilization of our coaches has a significant impact on the earnings of this segment. The last six months of fiscal 2003 began to show improvements in our operations. We plan to leverage that momentum and continue to take steps to increase productivity and otherwise reduce costs to lay the groundwork for continuous improvement.

- As discussed below under "Liquidity and Capital Resources," during 2003 we began and substantially completed the process of refinancing and restructuring our outstanding indebtedness. At February 2, 2004, we had completed negotiation of a $12.0 million financing facility of which approximately $5.9 million is available for borrowing by the Company.

- We commenced a strategy in late 2003 of pursuing strategic acquisition opportunities that include targets both in our traditional, basic industries and manufacturing sectors as well as targets that possessed assets (including cash) that, while outside our traditional areas of focus, were available on terms that our management believed to be attractive. While no material negotiations are currently active with respect to any targets (other than Net Perceptions, Inc., which is discussed below and with respect to which we have commenced an exchange offer), we anticipate that over the course of 2004 we will pursue acquisition opportunities that we deem attractive in a variety of industry sectors. Ultimately, these acquisitions may (but can not be guaranteed) to result in our qualifying for listing on a national securities exchange, having increased financial resources and potentially a broader asset base and more diversified sources of revenue.

In addition, we plan to eliminate waste throughout the Company through the use of "lean" manufacturing concepts such as inventory control and managing purchases. We are strengthening our cultural values by focusing on teamwork, communication, and customer responsiveness.

Fiscal 2003 Compared with Fiscal 2002

The following table details our results of operations as a percentage of sales:

	Year Ended October 31,	
	2003	2002
Net sales	100.0%	100.0%
Cost of sales	87.3	83.5
Selling, general and administrative expenses	14.4	15.0
Loss on asset impairment	--	1.3
Loss from discontinued operations	--	1.8
Interest expense	6.0	6.2
Interest income	--	--

Net Sales

Net sales in fiscal 2003 were $59,295 million compared to $57,274 million in fiscal 2002, an increase of 3.5%. Sales growth was primarily driven by our coach leasing segment with the addition of five new buses. Our butyl rubber segment also had increases due to increased demand in the oil exploration and tire industries. The trailer and related equipment manufacturing segment had a slight increase due to the discounting that occurred in the industry during 2003 and overall reduction in the sale of truck bodies.

Looking ahead, we expect improvement of sales growth in fiscal 2004 compared to sales growth in 2003, driven primarily by:

- The introduction of new products in cargo trailers,
- Elimination of the discounting program for cargo trailers,
- Increased production capacity through our new leased facility in Elkhart, Indiana,
- Expected improvement in economic conditions, and
- Strategic marketing activities directed to expand our market share of cargo trailers on the East Coast through our Hagerstown Maryland facilities which is in its second year of production for cargo trailers.

Gross Profit

Gross profit as a percentage of sales decreased 3.8 percentage points from 16.5 percent in fiscal 2002 to 12.7 percent in fiscal 2003. The decrease was mainly the result of:

- The sales discount program for cargo trailers that took place in 2003 which lowered our gross margin by $1,511 million or 2.6%.
- Increased raw material costs in our trailer segment of 1%, primarily related to plywood which is a significant total of our raw materials used in production.
- Purchases of raw materials in our rubber reclaim segment from foreign sources thus increasing the cost.

Looking ahead, gross profit is expected to improve by discontinuing our discounting program for cargo trailers, implementation of our cost reduction initiatives, continued development of our fine grind production and the roll out of The National FFA Organization recycling project to find additional sources of butyl and other rubber sources.

Selling, General And Administrative (SG&A) Expenses

Our selling, general and administrative expenses decreased $53 or .6% for the year ended October 31, 2003 compared to 2002. The decrease is related primarily to the overall decrease in professional fees for services in assisting with creating better subsidiary reporting and post acquisition activities, the cost to obtain prior year audits to meet regulatory filing requirements and the cost of using outside consultants to provide accounting and related services to management.

Looking ahead, SG&A expense is expected to stay the same or increase slightly as we expect to grow our company through mergers and acquisitions which will include additional legal, accounting and regulatory filing expenses.

Interest Expense

Interest expense for the year ended October 31, 2003 as a percentage of average debt borrowings of $39,819 was 8.9%. Interest expense for the year ended October 31, 2002 as a percentage of average debt borrowings of $35,923 was 9.6%. The decrease is primarily due to the reduction of the prime rate as well as the refinancing debt and equity transactions discussed below in "Liquidity and Capital Resources," "Refinancing Activities," and "Partners Equity

Transactions."

Income Tax Provision

The income tax benefit for the year October 31, 2003 increased by $904 compared to the year ended October 31, 2002 The income tax benefit is created primarily through net operating loss carryforwards recognized to the extent they are available to offset the Company's net deferred tax liability.

Discontinued Operations

On October 30, 2002, our Board of Directors agreed to sell substantially all assets of Champion to an entity controlled by Messrs. Durham and Whitesell in exchange for assumption of all liabilities of Champion, other than its subordinated debt. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, Accounting for Impairment of Long-Lived Assets, the operating results of Champion have been classified as discontinued operations. The losses from discontinued operations for the year ended October 31, 2003 and 2002 represent the losses of Champion during these periods, net of tax benefit of $25 and $0, respectively. The loss from discontinued operations for the years ended October 31, 2003 and 2002 were $49 and $1,040, respectively.

Substantially all assets of Champion subject to its liabilities were sold on January 30, 2003. No gain or loss was recognized in the consolidated statement of operations due to the involvement of related parties. This transaction resulted in an increase in equity of $1,142.

Fiscal 2002 Compared with Fiscal 2001

The following table details our results of operations as a percentage of sales:

	Year Ended October 31, 2002	Ten Months Ended October 31, 2001
Net sales	100.0%	100.0%
Cost of sales	83.5	78.8
Selling, general and administrative expenses	15.0	17.2
Loss on asset impairment	1.3	--
Loss from discontinued operations	1.8	13.7
Interest expense	6.2	9.4

Our results of operations for 2001 are not comparable to 2002 because the results of operations in 2001 include only ten months of operations, which affects the comparability of the two periods.

In addition, the results of operations for the trailer manufacturing segment in 2001 do not include the operations of United and Danzer Industries for the entire ten-month period. Under accounting principles generally accepted in the United States of America, U.S. Rubber is treated as the acquirer in the June 21, 2001 Reorganization, and U.S. Rubber is treated as having acquired Champion and Pyramid at the beginning of 2001. Thus, the results of operations for the ten-month period ended October 31, 2001 include the operations of the following subsidiaries from the date shown below through October 31, 2001:

Subsidiary	Date
Danzer Industries	June 21, 2001
Pyramid	January 1, 2001

U.S. Rubber	January 1, 2000
United	July 31, 2001

Since Champion is accounted for as a discontinued operation, its results of operations and cash flow have been removed from our continuing operations for all periods presented.

Net Sales

As noted above, net sales for the period is not comparable due to the timing of the acquisitions and combining the operations. Net sales increased in 2002 primarily in cargo trailers due to additional demand driven by marketing effort and our Coach Leasing segment which increased sales due to the addition of two new coaches, increase in our utilization and marketing efforts to rock, pop, touring Broadway shows and corporate customers. These increases were partially offset by a continued reduction in the demand for truck bodies and reduced manufacturing capacity at the butyl rubber reclaiming facility due to a fire that closed a portion of the facility for approximately two months.

Gross Profit

Gross profit as a percentage of net sales was 16.5% in fiscal 2002 compared to 21.2% in 2001. The decrease was mainly a result of the reduced volume of truck bodies, and operational inefficiencies in the butyl rubber segment due to a fire. The coach leasing segment also had reduced gross margins as a result of leasing third-party buses for part of the year to meet current demand.

Selling, General And Administrative (SG&A) Expenses

As noted above, our selling, general and administrative expenses for the periods presented are not comparable. Our selling, general and administrative expenses decreased as a percentage of sales by 2.2% for the year ended October 31, 2002 versus the ten-month period ended October 31, 2001. although the change was affected by the integration of operations as noted above.

In addition, selling, general and administrative expenses were higher for the year ended October 31, 2002 than would be expected on an ongoing basis. This is due primarily to increased administrative costs that were necessary to continue the process of creating better subsidiary reporting, the use of outside professionals for services in assisting in post acquisition activities, the cost to obtain prior year audits to meet regulatory filing requirements, and the cost of providing accounting and related services to management, that will normally be performed by our personnel on a going forward basis.

The additional costs were partially offset by a business interruption claim related to the fire at the butyl rubber reclaiming facility in the amount of $325.

In addition, on February 1, 2002, we changed our estimates with regard to depreciation of coaches owned by DW Leasing and Obsidian Leasing by establishing a salvage value of approximately 38%. The depreciable lives of the coaches of 15 years was not changed. This change in estimate resulted in a reduction of selling, general and administrative expenses in the year ended October 31, 2002 of approximately $200.

Interest Expense

As discussed above, results between periods presented are not comparable. While the interest expense increased over the prior period primarily as a result of the transactions that occurred in June and July 2001, interest expense for the year ended October 31, 2002 as a percentage of average debt borrowings of $37,158 was 9.6%. Interest expense for the ten months ended October 31, 2001 as a percentage of average debt borrowings of $24,964 was 9.3% (11.2% on an annual basis). The decrease is primarily due to the reduction of the prime rate as well as the refinancing debt and equity transactions discussed below in "Liquidity and Capital Resources," "Refinancing Activities," and "Partners Equity Transactions."

Cumulative Effect of Change in Accounting Principle

We adopted the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of fiscal 2002. We completed our transitional impairment test in conjunction with the adoption of Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets during the quarter ended July 31, 2002. The impairment test indicated that a portion of the goodwill of Danzer Industries was impaired. Accordingly, we recorded $2,015 as a cumulative effect of change in accounting principle.

During the fourth quarter of 2002, we evaluated the recoverability of Danzer Industries' long-lived assets, including remaining goodwill, due to Danzer Industries' significant operating loss in 2002 and the Chapter 11 bankruptcy filing of a significant customer. We determined the estimated future undiscounted cash flows were below the carrying value of certain long-lived assets. As a result, we wrote off the remaining goodwill and recorded as an operating expense a charge of $720 as loss on asset impairment.

Discontinued Operations

On October 30, 2002, our Board of Directors agreed to sell substantially all assets of Champion to an entity controlled by Messrs. Durham and Whitesell in exchange for assumption of all liabilities of Champion, excluding its subordinated debt. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, Accounting for Impairment of Long-Lived Assets, we classified the operating results of Champion as discontinued operations. The losses from discontinued operations for the year ended October 31, 2002 and ten months ended October 31, 2001 of $1,040 and $3,376, respectively, represent the losses of Champion during these periods, net of tax benefit of $438 and $0, respectively. The loss in 2001 includes a charge for asset impairment of $2,305. Champion was not included in the financial statements for the year ended December 31, 2000. Sales of Champion in the year ended October 31, 2002 were $2,884 as compared to $3,365 for the ten months ended October 31, 2001. The decrease of $481 or 14.3% is attributable to lower order volume during 2002.

To facilitate the sale of substantially all assets of Champion, on January 27, 2003, we agreed to a settlement with Markpoint of its outstanding subordinated debt with Champion. In return for cancellation of the indebtedness and release of a pending legal action against us and Champion, we made a cash payment to Markpoint of $675 and issued to Markpoint 32,143 shares of our Series D preferred stock. In addition, we agreed to repurchase these shares at Markpoint's option at a price of $21 per share. Our repurchase obligation was guaranteed by Mr. Durham. Fair Holdings, Inc. assumed the repurchase obligation in 2003. See Note 11 to the consolidated financial statements. In calendar 2003 Markpoint exercised its option to require the repurchase of the shares and the shares were purchased by Fair Holdings, Inc. The shares issued to Markpoint have been recorded in the consolidated balance sheet as mandatory redeemable preferred stock. An amount of $338 was reclassified to equity in May 2003 when Fair Holdings acquired 16,072 shares of the Series D Preferred Stock for Markpoint and the repurchase requirement for those shares was eliminated.

Subsequent to year end, Fair Holdings acquired the remaining 16,071 shares of Series D Preferred Stock from Markpoint canceling the remaining repurchase obligation. The balance of mandatory redeemable Series D Preferred Stock at October 31, 2003 of $337 was reclassified to equity subsequent to year end.

Income Tax Provision

There was income tax benefit of $33 for the year ended October 31, 2002 due to the utilization of previously reserved net operating loss (NOL) carryforwards offset by taxable gains on debt forgiveness. The income tax benefit is created primarily through NOL carryforwards recognized to the extent they are available to offset our net deferred tax liability.

BUSINESS SEGMENTS

The following information provides perspective on our business segments' sales and operating results by segment for the year ended October 31, 2003, 2002 and the ten-month period ended October 31, 2001. The comments that follow should be read in conjunction with our consolidated financial statements and related notes contained in this Form 10-K.

The following table shows net sales by product segment:

	Year Ended October 31,		Ten Months Ended October 31,
	2003	2002	2001
Trailer manufacturing	$ 41,009	$ 40,775	$ 10,650
Butyl rubber reclaiming	11,005	10,125	9,874
Coach leasing	7,281	6,374	4,165
Total	$ 59,295	$ 57,274	$ 24,689

We allocate selling, general and administrative expenses to the respective subsidiaries primarily based on a percentage of sales. Amounts allocated by segment are as follows:

	Year Ended October 31,		Ten Months Ended October 31,
	2003	2002	2001
Trailer manufacturing	$ 1,174	$ 934	$ 245
Coach leasing	200	146	96
Butyl rubber reclaiming	317	232	275
Total	$ 1,691	$ 1,312	$ 616

TRAILER AND RELATED TRANSPORTATION EQUIPMENT MANUFACTURING

The following table shows sales, cost of sales and gross profit for this segment for the periods indicated:

	Year Ended October 31,		Ten Months Ended October 31,
	2003	2002	2001
Net sales	$ 41,009	$ 40,775	$ 10,650
Cost of sales	37,704	35,077	8,955
Gross profit	$ 3,305	$ 5,698	$ 1,695
Gross profit %	8.1%	14.0%	15.9%

Sales in this segment increased $234 or .6% over the comparable period of 2002. The increase was primarily related to the following factors. The sales of cargo trailers increased approximately $1,600 for the year ended October 31, 2003 as a result of additional production facilities. We added a new leased facility in Elkhart, Indiana, and production at our Danzer facility. We also made sales to existing customers in new markets. We also began a sales discount/rebate program to stimulate sales. While this program did increase the units sold, it resulted in a lower average price per unit.

The increase in cargo trailer sales was offset by the decrease in sales of truck bodies of approximately $1,375 for the year ended October 31, 2003. This reduction was related to the continued depressed condition of the telecommunications industry which has historically been a significant consumer of truck bodies, as well as the bankruptcy filing of a significant truck body customer in late 2002.

Looking ahead, sales for the trailer and related equipment manufacturing segment are expected to grow in fiscal 2004 compared to fiscal 2003 because we expect our new product line for cargo trailers, which has been well received, will eliminate the need for a discounting program. We also have additional production capacity in our new leased facility and at Danzer. We believe sales of truck bodies will continue at about the same level as 2003 unless a replacement market can be developed.

Gross profit decreased 5.9% primarily as a result of our discounting of cargo trailers that decreased our gross margin by 2.6 %. The sales discounts/rebates offered during 2003 have ended as of July 31, 2003 with the introduction of new product lines to compete in the market at higher gross margins than the discounted cargo trailers. Gross profits were also impacted by the rising costs of raw materials, primarily plywood which is a significant portion of materials in our cargo trailers. Plywood costs have nearly doubled in the last quarter of fiscal 2003 and reduced our overall gross margin by 1%. In addition the decreased volume at our truck body plant resulted in an inability to absorb fixed overhead costs. To offset these costs, management began production of cargo trailers in this facility during late 2002. Inefficiencies in the start up of this operation and additional production facilities in Elkhart, Indiana, have also had a negative impact in gross profit margins as compared to the year ended October 31, 2002.

Gross profit for the year ended October 31, 2002 was impacted by the reduced volume of truck bodies sold and only partially offset by reductions in personnel at these facilities and increased volume in the cargo trailer product line.

BUTYL RUBBER RECLAIMING

The following table shows sales, cost of sales and gross profit for this segment for the periods indicated:

	Year Ended October 31, 2003	Year Ended October 31, 2002	Ten Months Ended October 31, 2001
Net Sales	$ 11,005	$ 10,125	$ 9,874
Cost of Sales	9,972	9,407	8,884
Gross Profit	$ 1,033	$ 718	$ 990
Gross Profit %	9.4%	7.1%	10.0%

Net sales in this segment for the year ended October 31, 2003 as compared to 2002 increased 8.7% in the amount of $880. Sales in this segment were higher in 2003 because of increased demand from our tire manufacturing customers and an increase in pricing. Net sales also increased due to increased demand for pipeline mastic wraps produced with reclaimed butyl rubber. Demand for this product fell dramatically beginning in October 2001 as a result of a decline in the price of crude oil in late 2001, which caused a decline in new oil exploration. As the price of crude oil has increased, the demand for those uses has also increased.

Net sales in this segment for the year ended October 31, 2002 as compared to the ten-month period ended October 31, 2001 increased 2.5%. However, sales in this segment were lower than anticipated for the year ended October 31, 2002 compared to the ten months ended October 31, 2001 due to damage at a production facility in May 2002 as a result of a fire at an adjacent property. The damage caused the facility to be closed for approximately two months and resulted in our being unable to fill all outstanding customer orders. This facility resumed production during July 2002. During 2002, we recorded an insurance recovery for business interruption of $325 as a reduction of general and administrative costs. In addition to the effects of the fire, sales for 2002 were below historical levels due to the factors enumerated below.

Significant portions of sales in this segment are to tire manufacturing companies. The tire manufacturers continued to see lower volumes of tire production during 2002. Accordingly, sales to these customers are below historical levels.

The lack of consistent sources of raw materials has also been a constraint on generating additional sales volume. The primary material used in reclaiming is scrap inner tubes. Since the introduction of the tubeless tire for automobiles in the 1970s, sources of material have declined substantially. Management has been testing other materials including butyl pad scrap as a replacement material for the past several years with some success. In addition, alternative sources of material, including overseas sources, are being pursued to provide a consistent supply of material in the future.

Looking ahead, sales are expected to grow in fiscal 2004 compared to fiscal

2003. Sales growth will depend greatly on successful implementation of our recycling program with the chapters of The National FFA Organization and finding other sources of material. In addition, the continued implementation of our Fine Grind process will increase the our ability to utilize some additional rubber products in our Butyl reclaim process and add potential new products.

Gross profit as a percentage sales increased 2.3% for the year ended October 31, 2003 compared to 2002. The primary reason for this increase is due to efficiency gains with the consolidation of our plant operations in 2003. Although we gained some efficiency in consolidating plant operations, our reclaim process is most efficient when raw material consists of primarily road worn inner tubes with a mix of other butyl rubber. During 2003 we were also able to utilize raw material previously subject to valuation allowances in the amount of approximately $145. However, the benefit of this usage is partially offset by the additional processing and labor costs involved in its usage. Since the introduction of the tubeless tire for automobiles in the 1970s, sources of material have declined substantially and the cost of available raw materials has increased. As a result of having to use less than optimum raw material mix in the reclaiming process, additional processing time is incurred to ensure delivery of quality product. Management has been testing other materials including butyl pad scrap as a replacement material for the past several years with some success. In addition, alternative sources of material, including overseas sources, are being pursued to provide a consistent supply of material in the future.

Operating results between fiscal year 2002 and fiscal year 2001 are not comparable, because the results of operations in 2001 include only ten months of operations. Gross profit percentage decreased from 10% for the ten months ended October 31, 2001 to 7.1% for the year ended October 31, 2002 as a result of constraints on achieving operating efficiency including lack of consistent raw material supply, the fire discussed above, and reduced use of raw materials previously subject to valuation allowances. During 2002 we were able to utilize raw material previously subject to valuation allowances in the amount of approximately $404 as compared to $578 in 2001.

Looking ahead, our segment earnings are expected to improve, but will depend greatly on the success of finding consistent sources of raw material and improved efficiencies in our operations.

COACH LEASING

The following table shows sales, cost of sales and gross profit for this segment for the periods indicated:

	Year Ended October 31,		Ten Months Ended October 31,
	2003	2002	2001
Net Sales	$ 7,281	$ 6,374	$ 4,165
Cost of Sales	4,060	3,357	1,618
Gross Profit	$ 3,221	$ 3,017	$ 2,547
Gross Profit %	44.2%	47.3%	61.1%

Sales for year ended October 31, 2003 increased 14.2% in the amount of $907 over 2002. The increase in sales is attributable to marketing efforts and the addition of five coaches during the first quarter of 2003. Our marketing efforts on specialized tour groups such as golf course trips, Broadway musicals, corporate customers, and rock and pop bands have expanded our customer base as these customers are in addition to the country and western performers who have traditionally been this segment's primary customer base. The additional five coaches plus an additional coach purchased in the fourth quarter of 2003 increase the average number of coaches in the fleet to 38 for the year ended October 31, 2003, compared to 32 for the year ended October 31, 2002.

Operating results are not comparable for the year ended October 31, 2002 and the ten months ended October 31, 2001, because the results of operations in 2001 include only ten months of operations. Sales for the year ended October 31, 2002 increased 53% in the amount of $2,209 over the ten-month period ended October 31, 2001. The increase in sales is attributable to an additional two months in the period and additional revenue from the increased use of employee coach drivers versus independent contractors paid directly by the customer. These factors were partially offset by a decrease in utilization from 75% in 2001 to 69% in 2002. The average fleet size in 2002 of 32 was comparable to 2001. We believe the increased revenue is a result of its marketing efforts to rock and roll, pop, touring Broadway shows and corporate customers. These customers are in addition to the traditional country and western performers who have historically been this segment's primary customer base. This business is seasonal in nature and historically is stronger in the spring, summer and fall months.

Looking ahead, we expect segment sales in fiscal 2004 to increase with the full-year impact increase in the total number of coaches added to our fleet. We are also working to continually improve our utilization percentage. Our total utilization rate was approximately 69% for 2003 and 2002, which indicates the period of time the coach is being leased.

Gross profit percentage for this segment was 44.2% for the year ended October 31, 2003 compared to 47.3% for the year ended October 31, 2002. The reduction is attributable primarily to the need to sublease additional buses from third parties to meet current demand during peak periods and increased operating costs for insurance.

Gross profit for this segment was 47.3% for the year ended October 31, 2002 compared to 61.1% for the comparable ten-month period ended October 31, 2001. The reduction is primarily attributable to two factors. First, during the summer, additional coaches were leased from unrelated third parties to meet current demand. The additional lease cost has been recorded as a component of cost of sales and represents an increase of approximately 5% as a percentage of sales. This segment had no lease cost for outside coaches in the comparable period of 2001. Second, additional drivers have been added as employees during 2002 adding approximately 7% as a percentage of sales to the costs of direct wages and benefits for the quarter. In the comparable period ended October 31, 2001, a larger percentage of coach drivers were independent contractors paid directly by the customer. In addition, the two additional months of activity for the year ended October 31, 2002 include the months of November and December which are historically slower months, resulting in lower gross profits for this segment.

Looking ahead, we expect fiscal 2004 gross profit to be higher than 2003 with the additional sales related to the six new coaches added which reduces the need to sublease from third parties.

LIQUIDITY AND CAPITAL RESOURCES

OVERVIEW

In June 2001, we purchased four new businesses and began operations as a consolidated holding company with multiple operating subsidiaries. In the period since June 2001, we have incurred losses and reductions in our equity. During this period we have financed our losses and have been able to refinance certain third party obligations with DC Investments, LLC and its subsidiary Fair Holdings and other third parties. Our borrowings from Fair Holdings have been on terms that may not have been available from other sources. As of October 31, 2003, our total debt outstanding to Fair Holdings was $14,158.

We are continuing to address our liquidity and working capital through various means including operational changes and financing matters which are discussed below. During the period these plans are put in place, we have continued to receive financing, and have in place arrangements to receive additional financial support from Fair Holdings if necessary.

WORKING CAPITAL

Our businesses are working capital intensive and require funding for purchases of production inventory, capital expenditures and expansion and upgrading of facilities. Each of our subsidiaries have separate revolving credit agreements and term loan borrowings through which the subsidiary finances its operations together with cash generated from operations. Our working capital position (current assets over current liabilities) was positive at October 31, 2003 by $6,045. At the end of fiscal year 2002, our working capital position was $1,591. The increase in working capital is primarily attributable to our ability to finance working capital and financial losses through long-term borrowings from a related party under a line of credit agreement. The following table highlights several key measures of our working capital performance:

	2003	2002
Average cash and cash equivalents	$ 1,034	$ 725
Average short-term debt	4,023	6,769
Average inventories, net	7,385	6,439
Average receivables, net	3,486	3,439
Average days receivables outstanding	21.9	21.1
Inventory turnover	7.0	7.4

Average short-term debt decreased in fiscal 2003 compared to fiscal 2002 primarily due to the timing of maturities on certain line of credit facilities and refinancing certain debt with a related party on a long term basis. The increased average inventories, net was primarily due to additional purchases for expected sales volumes and additional production capacity to build more cargo trailers. These factors also affected our inventory turnover which decreased from 7.4 in 2002 to 7.0 in 2003. Our average days receivables outstanding increased slightly to 21.9 in 2003 compared to 21.1 in 2002 but are low due to the prepayment of our tours for coach leasing and good collection efforts with customers.

We expect that average receivables and inventory levels in fiscal 2004 will increase slightly compared to fiscal 2003 due to higher planned sales volumes. We also anticipate both average days outstanding for receivables and inventory turnover to be about the same in fiscal 2004 compared to fiscal 2003 as we continue efforts to improve asset utilization.

We continue to address liquidity and working capital issues in a number of ways. In fiscal 2003, net cash used in continuing operations was $2,604. The use of cash and working capital was primarily related to the discounting program and overall economic conditions as described above. In 2004 we expect our operations to generate positive cash and increase our overall working capital through improved operations by;

- Discontinuing the cargo trailer discounting program that ended in July 2003 with the introduction of a new product line to replace the need to provide discounts to maintain market share. The new product line has a competitive price, while providing gross profits at historic levels.

- Cost reduction initiatives for raw materials in the trailer and related transportation manufacturing segment with the implementation of alternative materials and additional discounts through purchasing.

- Implementation of the new fine grind production process in the butyl rubber reclaiming segment. The new process will maximize the use of the existing raw materials in the existing butyl reclaim production and also provide potential additional production of natural rubber.

- Capitalize on the trailer production line put in place in the fourth quarter of 2002 that provides a new product line to the existing customers of Danzer. This production line and related sales effort have allowed us to enter a new market along the East coast of the U.S. Our ability to capitalize on this opportunity will be a determining factor on our ability to reduce this operation's use of working capital resources. Management will continue to evaluate the operations on a continuous basis.

- We continue to look for ways to strengthen our liquidity, equity and working capital through ongoing evaluations of merger and acquisition candidates. As fully described in the Registration Statement on Form S-4 and the other filings we have made with the SEC, on December 15, 2003 we commenced an exchange offer for all of the outstanding shares of Net Perceptions, Inc., a developer of software products for the retail industry which has been winding down its operations and whose assets are predominately cash or cash equivalents. We cannot predict whether we will be successful in acquiring some or all of the outstanding shares of Net Perceptions in exchange for our common shares due to the fact that several important conditions are in the control of the Board of Directors of Net Perceptions. If we are successful in acquiring all of the outstanding shares based upon our latest proposal, the effect of the transaction would be to substantially increase our working capital and equity and to substantially increase the number of our outstanding common shares. If we are unsuccessful in acquiring Net Perceptions, we will have incurred substantial expenses which will impact our operating results and available working capital.

- Overall improvements in economic conditions

In addition, management believes that the following steps started in early 2003 and currently underway will continue to improve our working capital, strengthen our equity and place us in a position to successfully enhance our liquidity. These steps include:

- The divestiture of Champion in the first quarter of 2003 as described below under "Champion Transactions" which improved the Company's overall equity and working capital position.

- Our refinancing activities in the fourth quarter of 2002 and first quarter of 2003 reduced our interest costs and decreased the proportion of debt which has been classified as a current liability.

We refinanced certain coaches transferred from DW Leasing to Obsidian Leasing with various existing lenders and with Fair Holdings. Two senior lenders representing approximately 80% of Obsidian Leasing Company's debt have refinanced their respective loans which included a substantial reduction in the interest rates and a longer amortization of the debt. The debt was refinanced by the existing lenders for 80% of the current amount outstanding. The remaining 20% was financed through a note payable to Fair Holdings. In addition to the above refinancing, on December 17, 2002, Obsidian Leasing sold four coaches to DC Investments Leasing, LLC ("DC Investments Leasing"), a newly created entity owned 50% by the Company's Chairman, in exchange for DC Investments Leasing's satisfaction of the debt outstanding on such coaches. DC Investments Leasing paid this debt through a financing at terms that included a reduction in interest rates. In addition, DC Investments Leasing also acquired five additional coaches that were previously to be purchased by us thereby eliminating our existing purchase commitment for the coaches. DC Investments Leasing also entered into a management agreement with Pyramid under which all nine coaches described above will be leased by Pyramid.

- On January 3, 2003, Obsidian Leasing repaid debt due to former shareholders in the amount of $928 with a loan from Fair Holdings at terms further described in Note 8 to the consolidated financial statements. The loan with Fair Holdings provided funds to repay maturing notes with proceeds from a long-term obligation without using operating capital.

- During January 2003, United and U.S. Rubber obtained modifications to provide less stringent requirements on certain financial covenants with their respective lenders.

- On March 28, 2003, Fair Holdings acquired the line of credit and term debt due to the senior lender of Danzer in the amount of $1,488 under an assignment and assumption agreement. The maturity date of the line of credit included in the assignment and assumption agreement was extended to April 2006, increased maximum borrowings under the line of credit from $1,000 to $1,500 and the debt covenants required by the senior lender were waived through the end of the term. All other terms of the assumed notes remain the same.

- During March 2003, United completed a compensation review and update and provided a revised pay scale which realigns the Company with its industry and reduces compensation costs. United also continues to develop its new production facility to increase productivity and plant efficiency.

- During 2003, U.S. Rubber has continued to consolidate its butyl reclaiming operations from two plants to one to maximize production and efficiently utilize equipment. The consolidation has provided some pieces of equipment to be at times temporarily idle until the Company completes its implementation of a new production process for "fine grind rubber." Existing and new equipment will be required to complete the "fine grind" production line.

- In October 2003, we received $250 in proceeds from the issuance of 14,285 shares of Series D Preferred Stock to Partners under an existing capital contribution agreement further described under "Guarantee of Partners." The proceeds were used to maintain compliance with certain debt covenants with the senior lender of U.S. Rubber.

- We secured an additional financial commitment from Fair Holdings to provide, as needed, additional borrowings under a $12,000 line of credit agreement, which expires on January 1, 2007. Currently, approximately $5,955 is available to us under the agreement.

Management believes the steps taken to improve our operations will positively impact our liquidity and working capital for fiscal 2004. However, success is dependent on our ability to restore gross profits and capitalize on potential new markets in the trailer and related transportation manufacturing segment, obtain consistent material supply in the butyl rubber reclaiming segment and continue to grow the coach leasing segment. If our operating results are less than expected, the increased commitment from Fair Holdings will provide additional liquidity in 2004.

FINANCIAL COVENANTS

Significant financial covenants in our credit agreements are the maintenance of minimum ratios, levels of earnings to funded debt and fixed charge coverage rate. We did not meet requirements and covenants in certain debt agreements. At October 31, 2003, United had violated financial covenants with First Indiana Bank and Huntington Capital Investment Company. United has received waivers of these violations through November 1, 2004 from First Indiana along with modifications to its covenants. Huntington Capital Investment Company also waived their covenant violations and we are currently in discussions regarding modifications to the covenants.

Various subsidiary companies were in violation of requirements to provide year-end financial statements to various lenders within 90 days of the close of the 2003 year end. Management has received extensions of time from the lenders.

Our high level of debt creates liquidity issues for us and the stringent financial covenants that are common for this type of debt increase the probability that our subsidiaries may from time to time be in technical default under these loans. These risks are mitigated, in part, for our United and U.S. Rubber subsidiaries by the right described below under "Guarantees of Partners." They are also mitigated by the divestiture of Champion, and the completed refinancing efforts with respect to U.S. Rubber and the coach leasing segment.

Long-Term Assets

Long-term assets as of October 31, 2003 were $32,300 compared to $32,900 as of October 31, 2002. The net decrease was $600 and primarily due to amortization of intangible assets and the disposal of assets held for sale related to Champion. Net property and equipment increased due to higher spending on production equipment and new coaches.

Capital Structure

The following table details our total capitalization components:

	2003	2002
Short-term debt	$ 2,379	$ 5,667
Long-term debt, including Redeemable Preferred Stock	40,842	30,797
Stockholders' deficit	$ (3,253)	$ (689)

Total debt increased in fiscal 2003 by $6,757 compared to fiscal 2002. The increase relates primarily to the increase in working capital needs by funding operational losses, financing of operational equipment and coaches and an increase in the valuation of Mandatory Redeemable Preferred Stock. Shareholders equity decreased as a result of the current year loss.

CASH AVAILABILITY

On a consolidated basis, at October 31, 2003, we had approximately $1,100 of cash and cash equivalents. Danzer Industries, U.S. Rubber, United, and Obsidian Enterprises each have revolving credit lines available for working capital at each individual entity. Borrowings under the credit facilities are available to the lesser of the maximum amount or the borrowing base as defined in the credit agreement. At October 31, 2003, additional current availability under these credit lines and maximum availability if supported by their individual borrowing base are:

Company	Current Availability	Maximum Availability
Danzer Industries (1)	$ 200	$ 200
U.S. Rubber	344	1,941
United	--	150
Obsidian Enterprises (1)	5,955	5,955

(1) Additional borrowings only through Fair Holdings, Inc., a Related Party

PARTNERS EQUITY TRANSACTIONS

Partners, our major shareholder, was required under the Plan of Reorganization to fund through the purchase of additional preferred stock certain ongoing administrative expenses of the Company to complete the Plan of Reorganization, complete all required current and prior year audits to meet the regulatory filing requirements, and ensure all annual and quarterly SEC filings are completed to enable the registration of the preferred stock issued to Partners. The amounts expended through October 31, 2002 approximated $1,275. Pursuant to the agreement with Partners, we converted these amounts to equity in exchange for issuance to Partners of convertible preferred stock in October 2002. Additional expenses of $270 in excess of amounts Partners was obligated to pay were funded by Fair Holdings, Inc. and subsequently converted to Series D Preferred Stock. The total liability of $1,545 converted to equity was incurred as follows: $364 capitalized in the reverse merger transaction; $376 as expenses incurred in 2001; and $805 as expenses incurred in 2002.

In 2002, Partners converted $1,290 of notes payable and accrued interest from us to Partners to 402,906 shares of our Series C Preferred Stock.

In October 2003, Partners acquired 14,285 shares of the Company's Series D Preferred Stock for $250 under the capital contribution agreement described under "Guarantee of Partners" below.

GUARANTEES OF PARTNERS

We have an agreement with Partners that gives us the right to mandate a capital contribution from the Partners if the lenders to U.S. Rubber or United were to declare a default. In either of those events, the Company has the right to enforce a capital contribution agreement with Partners up to $1,370 on U.S. Rubber and $1,000 on United to fund the respective subsidiary's shortfall. These payments, if any, would be applied directly to reduce the respective subsidiary's debt obligations to the lender. During 2003 Partners acquired 14,285 shares of Series D Preferred stock for $250 under the above agreement. The proceeds were loaned to U.S. Rubber to keep the Company in compliance with its fixed charge coverage ratio for its revolving line of credit agreement.

CHAMPION TRANSACTIONS

In 2002, the Board of Directors authorized the Chairman of the Board of the Company to explore various options to divest Champion Trailer or, at a minimum, restructure this operation of the business. As a result, DC Investments negotiated the purchase of the loans of Bank One to Champion.

In 2002, Champion was also indebted to Markpoint under a subordinated credit facility in the amount of $1,250 and was in violation of certain covenants related to the loan. Subsequent to DC Investments purchasing the Bank One debt in a nonrecourse assignment, Markpoint filed a lawsuit in Texas state court seeking payment in full for their subordinated debt from Champion or the Company under a guarantee agreement.

To facilitate the sale of substantially all assets of Champion, on January 27, 2003, the Company agreed to a settlement with Markpoint of its outstanding subordinated debt with Champion. In return for cancellation of the indebtedness and release of a pending legal action against the us and Champion, we made a cash payment to Markpoint of $675 and issued to Markpoint 32,143 shares of the Company's Series D preferred stock. In addition, we agreed to repurchase these shares at a price of $21 per share. Our repurchase obligation was guaranteed by Mr. Durham. Fair Holdings, Inc. assumed the repurchase obligation. See Item 13 "Certain Relationships and Related Transactions." In calendar 2003 Markpoint exercised its option to require the repurchase of the shares and the shares were purchased by Fair Holdings, Inc. Subsequent to the settlement, the Company's Board of Directors authorized the sale of Champion, which was completed January 30, 2003.

Off-Balance Sheet Arrangements and Contractual Obligations

It is not our usual business practice to enter into off-balance sheet arrangements, except for off-balance sheet arrangements related to operating lease commitments described below in the table of contractual obligations.

CASH FLOWS

A summary of our contractual cash obligations for the fiscal years ending 2004 through 2007 and 2008 and thereafter at October 31, 2003 is as follows:

Contractual Obligations	Total	2004	2005	2006	2
Long-term debt, and all debt service interest payments	$ 51,616	$ 5,182	$ 17,563	$ 11,377	$
Operating leases	1,177	452	314	220	
Mandatory redeemable preferred stock	2,140	337	--	1,803	
Total contractual cash obligations	$ 54,933	$ 5,971	$ 17,877	$ 13,400	$

Cash flow and liquidity are discussed further below, and in the footnotes to our consolidated financial statements.

We also have commercial commitments as described below:

Other Commercial Commitment	Total Amount Committed	Outstanding at October 31, 2003	Dat
Line of credit, related party	$ 1,500	$ 1,300	April 1
Line of credit, bank	4,400	4,250	Februar
Line of credit, bank	4,000	2,059	October
Line of credit, related party	12,000	6,045	January

Our net cash used in continuing operations for the year ended October 31, 2003 was $2,604. This is comprised of a loss from continuing operations of $3,824, offset by noncash depreciation and amortization of $2,850, increases in accounts receivable of $357, inventories of $140, other assets of $54, and customer deposits of $51 and decreases in deferred taxes of $1,003, accounts payable of $709 and accrued expenses of $96. In addition, we had noncash losses on sale of equipment of $10, loss on marketable securities of $72, minority interest of $172, accretion of interest of $394 and stock-based compensation of $30.

Net cash flow provided from financing activities for the year ended October 31, 2003 was $6,496. This is comprised of borrowings of long-term debt and net borrowings of short-term debt of $11,091 and proceeds from capital contributions of $250, offset by principal repayments of long-term debt of $3,865 and payments to related parties of $885. We also paid debt issuance costs of $95.

Cash flow was used in investing activities for the year ended October 31, 2002 of $3,623. This is comprised of purchases of property and equipment of $3,654 and proceeds from the sale of property and equipment of $31.

The total increase in cash is summarized as follows:

	Year Ended October 31,	
	2003	2002
Net cash provided by (used in) continuing operations	$ (2,604)	$ 322
Net cash provided by (used in) investing activities	(3,623)	(588)
Net cash provided by financing activities	6,496	618
Net cash flow provided by (used in) discontinued operations	(41)	39
Increase in cash and cash equivalents	$ 228	$ 391

Inflation

We are subject to the effects of inflation and changing prices. In our opinion, changes in net sales and net earnings that have resulted from inflation have not been material to the fiscal years presented but there is no assurance that inflation and changing prices will not materially affect us in the future. We attempt to deal with these inflationary and pricing pressures by actively pursuing internal cost reduction efforts and introducing corresponding price increases.

Market Risk

Due to the nature of our operations and the highly leveraged acquisitions incurred with variable debt we are subject to exposures that arise from fluctuations in interest rates. To manage the volatility relating to this exposure, we evaluate our exposures and attempt to minimize any negative effects by refinancing.

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are summarized in the footnotes to our financial statements. Some of the most critical policies are also discussed below.

As a matter of policy, we review our major assets for impairment. Our major operating assets are accounts receivable, inventory, intangible assets and property and equipment. We have not historically experienced significant bad debts expense, although the filing of Chapter 11 bankruptcy during 2002 of a customer resulted in a bad debt charge of $379. However, we believe our reserve for doubtful accounts of $496 should be adequate for any exposure to loss in our October 31, 2003 accounts receivable. We have also established reserves for slow-moving and obsolete inventories and believe the reserve of $321 is adequate. We depreciate our property and equipment and amortize intangible assets (except for goodwill) over their estimated useful lives. Property and equipment are reviewed for impairment when events and circumstances indicate impairment factors may be present. Currently, operating results at our truck body manufacturing facility, including the bankruptcy of a significant truck body customer, indicate the assets of this facility may become subject to impairment. Accordingly, we are analyzing these assets for impairment in conjunction with our analysis of the continuing operations of this facility. In addition, consolidation of facilities at our butyl rubber reclaiming operation has resulted in some equipment at the facility being temporarily idle as we implement a new production line for "fine grind" rubber. Should this new process not utilize all of the idle equipment, we will analyze such equipment for impairment. As of October 31, 2003, we determined there is no impairment of our property and equipment.

Goodwill and intangibles are reviewed annually for impairment or more frequently when events and circumstances indicate potential impairment factors are present. We have established the first day of the fourth quarter as the date for our annual goodwill impairment test. In assessing the recoverability of our goodwill, we must make various assumptions regarding estimated future cash flows and other factors in determining the fair values of the respective assets. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for these assets in future periods. Based on the annual goodwill and intangibles test for impairment as of October 31, 2003, we determined there is no impairment of our goodwill and intangibles.

The initial cost of coaches acquired is depreciated over a straight-line basis to a salvage value of 38% of original cost. Subsequent enhancements and refurbishments of coaches are depreciated over five years using the straight-line method. The age of coaches in our fleet range from less than one year to ten years, with an average age of approximately four years. Actual value of coaches after 15 years is dependent on several factors including the level of maintenance and the market conditions at the time of disposal. We have not disposed of a material number of coaches, and our estimate of depreciation is based on information other than actual disposal experience. Accordingly, we continue to evaluate our estimates with respect to the actual depreciation of such vehicles based on market conditions and our experience in disposals when they occur. Depreciation expense related to the coaches for the year ended October 31, 2003 was approximately $575. If future factors indicate that our salvage value on the coaches should be reduced to 20%, depreciation expense would have to be increased approximately $166 to $741. If it is determined that the coaches have no salvage value, estimated depreciation expense for the coaches for the year ended October 31, 2003 would have approximated $927.

In conjunction with financing of the acquisition of United, we issued 386,206 shares of Series C preferred stock to Huntington Capital Investment Company ("Huntington"). The note purchase agreement includes a provision that gives Huntington the option to require us to repurchase these shares at 90% of market value upon the earlier of: a) fifth anniversary of issuance of such shares, b) default under the subordinated debt agreement, c) other factors related to a sale of substantially all of our assets as defined in the agreement. Increases in the value of our stock will result in a corresponding increase to this repurchase requirement. Accordingly, a substantial increase in stock price at the repurchase date may have an adverse impact on our liquidity. At October 31, 2003, we had violated certain financial covenants defined in the subordinated debt agreement with Huntington. We received a waiver of these violations and are negotiating an amendment to the agreement as of October 31, 2003.

CONTINGENCIES

The Company is party to ordinary litigation incidental to its business. No current pending litigation is expected to have a material adverse effect on results of operations, financial condition or cash flows.

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Obsidian Enterprises, Inc.
Indianapolis, Indiana

We have audited the accompanying consolidated balance sheets of Obsidian Enterprises, Inc. and Subsidiaries as of October 31, 2003 and 2002, and the related consolidated statements of operations, stockholders' equity (deficit) and comprehensive loss, and cash flows for the years ended October 31, 2003 and 2002 and the ten months ended October 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Obsidian Enterprises, Inc. and Subsidiaries as of October 31, 2003 and 2002, and the results of their operations and their cash flows for the years ended October 31, 2003 and 2002 and the ten months ended October 31, 2001, in conformity with accounting principles generally accepted in the United States of America

As discussed in Note 8 and Note 15 to the financial statements, the Company has borrowings totaling $14,158,000 from DC Investments, LLC and its subsidiary, Fair Holdings, LLC, entities controlled by the Company's chairman.

Our audit of the consolidated financial statements of Obsidian Enterprises, Inc. and Subsidiaries included Schedule II, contained herein, for the years ended October 31,2003 and 2002 and the ten months ended October 31, 2001. In our opinion, such schedule presents fairly the information required to be set forth therein, in conformity with accounting principles generally accepted in the United States of America.

/s/ McGladry & Pullen, LLP

Elkhart, Indiana
February 2, 2004

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(in thousands)

	October 31, 2003
Assets	
Current assets:	
Cash and cash equivalents	$ 1,148
Marketable securities	114
Accounts receivable, net of allowance for doubtful accounts of $496 for 2003 and $495 for 2002 (Note 8)	3,665
Accounts receivable, related parties (Note 15)	52
Inventories, net (Notes 6 and 8)	7,455
Prepaid expenses and other assets	531
Deferred income tax assets (Note 14)	550
Total current assets	13,515
Property, plant and equipment, net (Notes 7 and 8)	24,480
Other assets:	

Intangible assets (Notes 3 and 5):	
Goodwill not subject to amortization	6,434
Noncompete agreements, less accumulated amortization of $399 for 2003 and $222 for 2002	487
Trade name and customer relations, less accumulated amortization of $290 for 2003 and $208 for 2002	637
Deferred debt costs, less accumulated amortization of $218 for 2003 and $97 in 2002	320
Other	9
Assets of subsidiary held for sale (Note 4)	--
	$ 45,882

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

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(in thousands)

	October 31, 2003
Liabilities and Stockholders' Deficit	
Current liabilities:	
Current portion of long-term debt (Note 8)	$ 2,379
Accounts payable, trade	2,742
Accounts payable, related parties (Note 15)	837
Accrued compensation	666
Accrued expenses	560
Customer deposits	286
Total current liabilities	7,470
Long-term debt, net of current portion (Note 8)	24,765
Long-term debt, related parties (Note 8 and 15)	13,937
Deferred income tax liabilities (Note 14)	651
Liabilities of subsidiary held for sale (Note 4)	--
Commitments and contingencies (Note 16)	
Minority interest	172
Mandatory redeemable preferred stock (Note 11):	
Class of Series C Preferred Stock: 386,206 shares outstanding for 2003 and 2002 (Note 11)	1,803
Class of Series D Preferred Stock: 16,071 shares outstanding for	

2003 (Note 11)	337
Stockholders' deficit (Note 12):	
Common stock, par value $.0001 per share; 40,000,000 shares authorized; 36,007,855 shares outstanding	3
Preferred stock, 5,000,000 shares authorized; Class of Series C Preferred Stock, par value $.001, 4,600,000 authorized, 3,982,193 shares issued and outstanding in 2003 and 2002; 200,000 shares of undesignated Preferred Stock authorized	5
Preferred stock, 200,000 shares authorized; Class of Series D convertible preferred stock, par value $.001, 118,687 and 88,330 shares issued and outstanding in 2003 and 2002	--
Additional paid-in capital	11,743
Accumulated other comprehensive loss	--
Accumulated deficit	(15,004)
Total stockholders' deficit	(3,253)
	$ 45,882

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

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands except per share and share data)

	Year Ended October 31,	
	2003	2002
Net sales	$ 59,295	$ 57,274
Cost of sales	51,736	47,841
GROSS PROFIT	7,559	9,433
Selling, general and administrative expenses	(8,537)	(8,589)
Loss on asset impairment (Note 3)	--	(720)
Insurance settlement	--	325
Income (loss) from operations	(978)	449
Other income (expense):		
Interest expense (Note 8)	(3,547)	(3,552)
Other income	17	12
Other expense	(81)	(217)

Loss before income taxes, discontinued operations, and cumulative effect of change in accounting principle		(4,589)		(3,308)
Income tax benefit (Note 14)		937		33
Loss from continuing operations before discontinued operations and cumulative effect of change in accounting principle		(3,652)		(3,275)
Loss from discontinued operations, net of tax (Note 4)		(49)		(1,040)
Loss before cumulative effect of change in accounting principle		(3,701)		(4,315)
Cumulative effect of change in accounting principle, net of tax (Note 3)		--		(2,015)
Loss before minority interest		(3,701)		(6,330)
Minority interest		(172)		--
Net loss	$	(3,873)	$	(6,330)
Basic and diluted loss per share attributable to common shareholders (Note 2):				
From continuing operations	$	(.12)	$	(.09)
Discontinued operations, net of tax		--		(.03)
Cumulative effect of accounting change, net of tax		--		(.06)
Net loss per share	$	(.12)	$	(.18)
Weighted average common and common equivalent shares outstanding, basic and diluted:		36,007,855		36,007,855

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

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT) AND COMPREHE

(dollars in thousands)

Comprehensive Income (Loss)	Common Stock Shares	Common Stock Amount	Series C Prefer Shares

Balance at December 31, 2000	--	17,760,015	1	
Conversion of debt to common stock	--	1,750,000	--	
To record the effect of the reverse merger June 21, 2001 (Note 6)	--	--	1	1,970,
Conversion of Series C Preferred Stock to common stock	--	16,497,840	1	(824,
Issuance of 2,593,099 shares of Series C Preferred Stock associated with the acquisition of United and capital contribution (Note 6)	--	--	--	2,206,
Unrealized gain on available-for-sale marketable securities	140	--	--	
Fair value adjustment on redeemable preferred stock	--	--	--	
2001 net loss	(4,395)	--	--	
Total comprehensive loss	$ (4,255)			
Balance at October 31, 2001		36,007,855	3	3,352,
Issuance of 30,000 shares of Series C Preferred Stock associated with U.S. Rubber, net of tax	$ --	--	--	30,
Issuance of 589,230 shares of Series C Preferred Stock associated with Fair Holdings and Obsidian Capital Partners, LP	--	--	--	589,
Issuance of 88,330 shares of Series D Preferred Stock associated with Fair Holdings and Obsidian Capital Partners, LP	--	--	--	
Exercise of stock warrants in exchange for 10,000 shares of Series C Preferred Stock	--	--	--	10,
Distributions to members of DW Leasing	--	--	--	
Unrealized loss on available-for-sale marketable securities	(86)	--	--	
Fair value adjustment on redeemable preferred stock	--	--	--	
2002 net loss	(6,330)	--	--	
Total comprehensive loss	$ (6,416)			
Balance at October 31, 2002		36,007,855	3	3,982,
Contribution to capital from sale of Champion to related party		--	--	
Tax effect of sale of coaches to DC Investments Leasing, LLC		--	--	
Extension of stock options		--	--	
Assignment of 16,072 shares of Series D mandatory redeemable Preferred Stock		--	--	
Issuance of 14,285 shares of Series D Preferred Stock associated with Obsidian Capital Partners, LP		--	--	
Loss on available-for-sale marketable securities	--	--	--	
Fair value adjustment on redeemable Preferred Stock		--	--	
2003 net loss	(3,873)	--	--	
Total comprehensive loss	$ (3,873)			
Balance at October 31, 2003		36,007,855	3	3,982,

[Remainder of table on following page]

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	Additional Paid-in Capital	Other Comprehensive Income (Loss)	Earnings (Accumulated Deficit)	Total
Balance at December 31, 2000	--	--	4,938	4,9
Conversion of debt to common stock	355	--	--	3
To record the effect of the reverse merger June 21, 2001 (Note 6)	3,760	(103)	(4,938)	(1,2
Conversion of Series C Preferred Stock to common stock	--	--	--	
Issuance of 2,593,099 shares of Series C Preferred Stock associated with the acquisition of United and capital contribution (Note 6)	1,497	--	--	1,5
Unrealized gain on available-for-sale marketable securities	--	140	--	1
Fair value adjustment on redeemable preferred stock	70	--	--	
2001 net loss	--	--	(4,395)	(4,3
Total comprehensive loss				
Balance at October 31, 2001	5,682	37	(4,395)	1,3
Issuance of 30,000 shares of Series C Preferred Stock associated with U.S. Rubber, net of tax	1,017	--	--	1,0
Issuance of 589,230 shares of Series C Preferred Stock associated with Fair Holdings and Obsidian Capital Partners, LP	1,885	--	--	1,8
Issuance of 88,330 shares of Series D Preferred Stock associated with Fair Holdings and Obsidian Capital Partners, LP	1,545	--	--	1,5
Exercise of stock warrants in exchange for 10,000 shares of Series C Preferred Stock	20	--	--	
Distributions to members of DW Leasing	--	--	(107)	(1
Unrealized loss on available-for-sale marketable securities	--	(86)	--	(
Fair value adjustment on redeemable preferred stock	35	--	--	
2002 net loss	--	--	(6,330)	(6,3
Total comprehensive loss				
Balance at October 31, 2002	10,184	(49)	(10,832)	(6
Contribution to capital from sale of Champion to related party	1,142	--	--	1,1
Tax effect of sale of coaches to DC Investments Leasing, LLC	(96)	--	--	(
Extension of stock options	30	--	--	
Assignment of 16,072 shares of Series D mandatory				

redeemable Preferred Stock	337	--	--	3
Issuance of 14,285 shares of Series D Preferred Stock associated with Obsidian Capital Partners, LP	250	--	--	2
Loss on available-for-sale marketable securities	--	49		
Fair value adjustment on redeemable Preferred Stock	(104)	--	(299)	(4
2003 net loss	--	--	(3,873)	(3,8
Total comprehensive loss				
Balance at October 31, 2003	$ 11,743	$ --	$(15,004)	$ (3,2

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

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended October 31,	
	2003	2002
Cash flow from operating activities from continuing operations:		
Loss from continuing operations	$ (3,824)	$ (5,290
Adjustments to reconcile loss from continuing operations to net cash provided by (used in) operating activities:		
Cumulative effect of change in accounting principle	--	2,015
Loss on asset impairment	--	720
Depreciation and amortization	2,850	2,568
Loss on debt refinancing	--	181
Loss (gain) on sale of equipment	10	41
Loss on marketable securities	72	--
Stock-based compensation	30	--
Minority interest	172	--
Accretion of interest	394	162
Deferred income taxes	(1,003)	(40
Changes in operating assets and liabilities net of effect of acquisitions:		
Accounts receivable, net	(357)	264
Inventories, net	(140)	(1,752
Other assets	(54)	336
Accounts payable, trade	(709)	545
Accrued expenses	(96)	(339
Customer deposits	51	473
Net cash provided by (used in) operating activities from continuing operations	(2,604)	(116
Cash flows from investing activities from continuing operations:		
Capital expenditures	(3,654)	(910

Proceeds from sale of equipment	31	322
Acquisition-related closing costs	--	--
Purchase of marketable equity securities	--	--
Cash received in reverse merger and other acquisitions	--	--
Cash payments in connection with the purchase of U.S. Rubber, net of cash acquired	--	--
Cash payments in connection with the purchase of assets of United, net of cash acquired	--	--
Proceeds from sale of marketable equity securities	--	--
Net cash used in investing activities from continuing operations	(3,623)	(588

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

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended October 31,	
	2003	2002
Cash flows from financing activities from continuing operations:		
Advances from (repayments to) related parties	(885)	1,066
Net borrowings on lines of credit	1,352	1,265
Borrowings on long-term debt, including related parties	9,739	2,318
Principal repayments on long-term debt, including related parties	(3,865)	(3,258
Debt issuance costs	(95)	(248
Distributions to members of DW Leasing	--	(107
Exercise of warrant	--	20
Proceeds from capital contributions and sale of common stock	250	--
Net cash provided by financing activities from continuing operations	6,496	1,056
Net cash flow provided by (used in) discontinued operations	(41)	39
Increase in cash and cash equivalents	228	391
Cash and cash equivalents, beginning of year	920	529
Cash and cash equivalents, end of year	$ 1,148	$ 920
Interest paid	$ 2,956	$ 3,415
Taxes paid	$ 96	$ 22

Noncash:				
Contribution to capital from sale of Champion to related party	$	1,142	$	--
Issuance of mandatory redeemable preferred stock in conjunction with the sale of Champion	$	675	$	--
Assignment and assumption of mandatory redeemable preferred stock to Fair Holdings	$	337	$	--
Tax effect of sale of coaches to a related party recorded as a reduction of equity	$	96	$	--
Reclassification of debt due to assumption of credit agreement by Fair Holdings	$	1,488	$	--
Refinancing of debt, including related-party amounts	$	--	$	12,122
Conversion of contributed amounts to equity	$	--	$	5,104
Coaches and equipment purchased with debt	$	221	$	1,220
Fair value changes of mandatory redeemable preferred stock	$	403	$	35
Purchase price adjustment and conversion of accounts payable to debt	$	--	$	225
Seller note on acquisition of United	$	--	$	--
Seller note on acquisition of U.S. Rubber	$	--	$	--

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

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(all amounts in thousands, except per share and share data)

1. DESCRIPTION OF BUSINESS AND CHANGE OF NAME

Obsidian Enterprises, Inc. ("Obsidian Enterprises"), formerly Danzer Corporation, was reorganized (the "Reorganization") through an Acquisition and Plan of Reorganization with U.S. Rubber Reclaiming, Inc. and Related Entities ("U.S. Rubber Companies"), which was consummated on June 21, 2001 (the "Effective Date"). The Acquisition and Plan of Reorganization of Obsidian Enterprises with U.S. Rubber Companies was accounted for as a reverse acquisition as the shareholders of the U.S. Rubber Companies owned a majority of the outstanding stock of Obsidian Enterprises subsequent to the Acquisition and Plan of Reorganization. For accounting purposes, U.S. Rubber Reclaiming, Inc. is deemed to have acquired Obsidian Enterprises.

Pursuant to the Plan of Acquisition and Reorganization described further in Note 5, United Expressline, Inc. was acquired July 31, 2001.

The resulting entities, considered accounting subsidiaries of U.S. Rubber Reclaiming, Inc. (the accounting acquirer) and legal subsidiaries of Obsidian Enterprises, Inc. (formerly Danzer) after the Acquisition and Plan of Reorganization, are as follows:

U.S. Rubber Reclaiming, Inc. ("U.S. Rubber", the accounting acquirer), which is engaged in reclaiming scrap butyl rubber into butyl reclaim for resale to manufacturers of rubber products.

Obsidian Enterprises, Inc. (formerly Danzer, the legal acquirer), a holding company.

Danzer Industries, Inc. ("Danzer Industries"), which is principally engaged in the design, manufacture and sale of truck bodies and cargo trailers.

Pyramid Coach, Inc. ("Pyramid"), which is engaged in the leasing of coaches, designed and fitted out for use for travel by country, rock bands and other business enterprises, primarily on weekly to monthly leases. The coach leasing segment also includes the assets, liabilities, equity and results of operations of DW Leasing, LLC ("DW Leasing"), Obsidian Leasing Company, Inc. ("Obsidian Leasing"), formed November 1, 2001 and DC Investments Leasing, LLC ("DC Investments Leasing), formed December 13, 2002. DW Leasing and DC Investments Leasing are controlled by individuals who are also controlling shareholders of Obsidian Enterprises, Inc. and, accordingly, Pyramid. In addition, these entities meet the requirements for consolidation under FASB Interpretation No. 46 (FIN No. 46), Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51, as further discussed in Note 2. DW Leasing, Obsidian Leasing and DC Investments Leasing also own the majority of the coaches operated by Pyramid. All intercompany transactions are eliminated in consolidation.

United Expressline, Inc. ("United") manufactures and sells general use cargo trailers and specialty trailers used in the racing industry and for other special purposes.

Champion Trailer, Inc. ("Champion"), which manufactures and sells transport trailers to be used primarily in the auto racing industry. Effective October 2002, the Company's Board of Directors agreed to a plan to dispose of Champion as further described in Note 4. The sale of Champion was completed January 30, 2003. Accordingly, the operations of Champion are classified as discontinued operations in the accompanying financial statements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION:

The accompanying consolidated financial statements present the accounts of Obsidian Enterprises, Inc. and its wholly owned subsidiaries described in Note 1 for the periods ended October 31, 2003, 2002 and 2001. The entities are collectively referred to herein as the "Company." All significant intercompany transactions and balances have been eliminated in consolidation. The 2003 results of operations include the operations of DC Investments Leasing from December 2002 (its inception). The accompanying 2001 statement of operations includes the operations of U.S. Rubber, Pyramid and its related entity (DW Leasing) for the ten-month period ended October 31, 2001. January 1, 2001 was the beginning of the calendar year of the accounting acquirer U.S. Rubber. U.S. Rubber changed its fiscal year end to adopt Danzer's (legal acquirer and previous registrant) year end. The 2001 financial statements also include the operating results of Obsidian Enterprises, Inc. (formerly Danzer Corporation) and Danzer Industries, its wholly owned subsidiary, from June 21, 2001 (date of acquisition) through October 31, 2001. In addition, they include the results of United from July 31, 2001 (date of acquisition) through October 31, 2001. See Note 5 for further discussion.

BASIS OF PRESENTATION:

In the period since June 2001, the Company has incurred losses and reductions in equity. During this period losses and certain third party debt repayments have been financed with Fair Holdings, Inc. ("Fair Holdings"), an entity controlled by the Company's Chairman. Borrowings from Fair Holdings have been on terms that may not have been available from other sources. As of October 31, 2003, total debt outstanding to DC Investments, LLC and its subsidiary Fair Holdings was $14,158.

The Company has continued to address liquidity and working capital through various means including operational changes and financing matters which are discussed below. During the period these plans were put in place, the Company received financial support from Fair Holdings.

During 2003 and 2002, the Company has undertaken various actions to improve its operations and liquidity. Such actions as described below include the sale of Champion, conversion of debt to equity and refinancing of certain of its debt agreements as described in Note 8. Management believes that the Company has financing agreements in place to provide adequate liquidity and working capital throughout fiscal 2004. However, there can be no assurance that such working capital and liquidity will in fact be adequate. Therefore, the Company may be required to draw upon other liquidity sources. The Company has therefore secured an increased financial commitment from Fair Holdings to provide, as needed, additional borrowings under a $12 million line of credit agreement, which expires January 1, 2007. Currently, availability under the agreement is approximately $5,995.

In view of these matters realization of assets and satisfaction of liabilities in the ordinary course of business is dependent on the Company's ability to generate sufficient cash flow to satisfy its obligations on a timely basis, maintain compliance with its financing agreements and continue to receive financing support from Fair Holdings to provide liquidity if needed.

Management, as a part of its plan towards resolving these issues and generating positive cash flow and earnings, has taken the actions as described below. Although management believes these actions will improve operations and liquidity, there can be no assurance that such actions will sufficiently improve operations or liquidity.

- During fiscal 2003:

    - Refinancing activities have reduced interest costs and decreased the proportion of debt that had been classified as a current liability. Certain coaches transferred from DW Leasing to Obsidian Leasing were financed with Fair Holdings and various existing lenders. Two senior lenders representing approximately 80% of Obsidian Leasing Company's debt have refinanced their respective loans which included a substantial reduction in the interest rates and a longer amortization of the debt. The debt was refinanced by the existing lenders for 80% of the current amount outstanding. The remaining 20% was financed through a note payable to Fair Holdings. In addition to the above refinancing, on December 17, 2002, Obsidian Leasing sold four coaches to DC Investments Leasing in exchange for DC Investments Leasing's satisfaction of the debt outstanding on such coaches. DC Investments Leasing paid this debt through a refinancing at terms that included a reduction in interest rates. In addition, DC Investments Leasing also acquired five additional coaches that were previously to be purchased by us thereby eliminating our existing purchase commitment for the coaches. DC Investments Leasing also entered into a management agreement with Pyramid under which all nine coaches described above will be leased by Pyramid.

    - On January 3, 2003, Obsidian Leasing repaid debt due to former shareholders in the amount of $928 with proceeds from a loan from Fair Holdings at terms further described in Note 8. The loan with Fair Holdings provided funds to repay maturing notes with proceeds from a long term obligation without using operating capital.

    - During January 2003, United and U.S. Rubber obtained modifications to provide less stringent requirements on certain financial covenants with their respective lenders.

- o On March 28, 2003, Fair Holdings acquired the line of credit and term debt due to the senior lender of Danzer in the amount of $1,488 under an assignment and assumption agreement. The maturity date of the line of credit included in the assignment and assumption agreement was extended to April 2006, and the debt covenants required by the senior lender were waived through the end of the term. All other terms of the assumed notes remain the same.

- o During March 2003, United completed a compensation review and update and provided a revised pay scale which realigns the Company with its industry and reduces compensation costs. United also continues to develop its new production facility to increase productivity and plant efficiency.

- o During 2003, U.S. Rubber continued to consolidate its butyl reclaiming operations from two plants to one to maximize production and efficiently utilize equipment. The consolidation has provided some pieces of equipment to be at times temporarily idle until the Company completes its implementation of a new production process for "fine ground rubber". Existing and new equipment will be required to complete the "fine grind" production line. The new process will maximize the use of the existing raw materials in the Company's existing butyl reclaim production and also provide additional products of natural rubber.

- o The Company's truck body division at Danzer continues to negatively impact the Company's cash flows. The trailer production line was put in place in the fourth quarter of 2002 to support the production needs at United and also provide a new product line to the existing customers of Danzer, allowing us to enter a potential new market along the East coast of the U.S. The Company needs to capitalize on this new market opportunity to reduce the use of working capital at Danzer. Management will continue to evaluate the operations throughout 2004.

- o In October 2003, we received $250 in proceeds from the issuance of 14,285 shares of Series D Preferred Stock to Obsidian Capital Partners, LP ("Partners") under an existing capital contribution agreement further described under "Guarantee of Partners." The proceeds were used to maintain compliance with certain debt covenants with the senior lender of U.S. Rubber.

- o We secured an additional financial commitment from Fair Holdings to provide, as needed, additional borrowings under an $12,000 line of credit agreement, which expires on January 1, 2007. Currently, approximately $5,955 is available to us under the agreement.

o During fiscal 2002:

- o On March 7, 2002, the Company completed a series of transactions with the subordinated lender at U.S. Rubber resulting in an increase in equity and a decrease in liabilities of $1,017. The subordinated lender received 30,000 shares of Series C Preferred Stock in this transaction.

- o On March 20, 2002, DC Investments, LLC ("DC Investments"), an entity controlled by the Company's Chairman, acquired all outstanding debt due to the senior lender of Champion in the amount of $602 in a nonrecourse assignment. Under the terms of the Company's agreement with DC Investments, this amount has been reclassified as a long-term liability.

- o On April 30, 2002, the Company converted $1,290 of debt and accrued interest due to Partners, majority owner of the Company, to equity in exchange for 402,906 shares of Series C Preferred Stock.

- On April 30, 2002, the Company converted $596 of debt and accrued interest due to Fair Holdings to equity in exchange for 186,324 shares of Series C Preferred Stock.

- On August 28, 2002, the Company completed refinancing of the line of credit facility and a term loan at United. The amount of maximum borrowings on the line of credit facility was increased and the maturity date extended to February 1, 2004. In addition, the maturity date of the term note was extended to July 1, 2004 and monthly principal payments were reduced by approximately 50%.

- On October 24, 2002, the Company refinanced the outstanding bank debt at U.S. Rubber with a new lender at terms more favorable than the previous lender.

- During 2002, the Board of Directors authorized the Chairman of the Board to explore various options regarding the operations at Champion. Options included divestiture, restructuring of operations or closing the facility. It was determined in the best interests of the Company to sell Champion. On January 30, 2003, the Company completed the sale of substantially all assets of Champion to an entity owned by Messrs. Durham and Whitesell, Chairman and President of the Company, respectively, as described in Note 4.

- On October 24, 2002, the Company converted $1,275 of debt to Partners in exchange for 72,899 shares of Series D Convertible Preferred Stock.

- On October 24, 2002, the Company converted $270 of debt to Fair Holdings in exchange for 15,431 shares of Series D Convertible Preferred Stock.

The above factors combined with additional actions by management at the operating subsidiaries have contributed to the Company's working capital of $6,045 at October 31, 2003 and $1,591 at October 31, 2002.

REVENUE RECOGNITION:

Sales are recorded when title passes to the customer (FOB shipping point) or when services are performed in accordance with agreements with customers. The Company accumulates costs of trailers in work-in-process inventory until completion. The Company recognizes repair revenue when services are provided to the customer. Shipping and handling charges billed to the customers are included in net sales. Shipping and handling costs incurred by the Company are included in cost of sales.

For operating leases, income is recognized on a straight-line basis over the lease term. Recognition of income is suspended when management determines that collection of future income is not probable (generally after 90 days past due). Recognition is resumed if the receivable becomes contractually current and the collection of amounts is again considered probable. Operating lease equipment is carried at cost less accumulated depreciation and is depreciated to estimated residual value using the straight-line method over the lease term or projected economic life of the asset.

FAIR VALUE OF FINANCIAL INSTRUMENTS:

The carrying amounts of cash and cash equivalents, receivables, accounts payable, and accrued liabilities approximate fair value because of the short maturity of these instruments. The carrying amounts of long-term receivables approximates fair value as the effective rates for these instruments are comparable to market rates at year end. The carrying amount of investments approximates fair market value. The carrying amount of variable rate debt and fixed rate debt to unrelated parties approximates fair value, as a result of the current interest rates paid on the Company's borrowings being at market. The fair value of fixed rate debt to related parties is impractical to determine based on the nature of the obligations and the relationship to the lender. The carrying value of mandatory redeemable preferred stock approximates market value determined based on the thirty-day average closing price of the Company's common stock.

MARKETABLE SECURITIES:

The Company classifies its marketable securities as available for sale. The securities consist of equity securities, which are stated at fair value, with net unrealized gains or losses on the securities recorded as accumulated other comprehensive income (loss) in stockholders' equity (deficit). Realized gains and losses are included in earnings and are derived using the specific identification method for determining the cost of the securities. Decreases in the market value of the securities considered to be other than temporary are recorded in earnings. For the year ended October 31, 2003, the Company recorded $72 in the statement of operations related to the permanent decline in the fair value of the marketable securities. This amount includes a reclassification of $49 from accumulated other comprehensive income for unrealized losses previously recorded.

PROPERTY, PLANT AND EQUIPMENT:

Building, equipment, furniture and fixtures are recorded at historical cost with depreciation taken using primarily the straight-line method over their estimated useful lives. Life ranges for property and equipment are as follows:

Buildings and improvements	30 - 39 years
Plant machinery and equipment	5 - 7 years
Furniture and fixtures	5 - 7 years
Coach fleet	15 years
Coach refurbishments	5 years
Vehicles	5 - 10 years

The Company's coach leasing business consists of a fleet of luxury coaches (generally a 45 foot bus shell converted to a luxury coach) that are leased to entertainment personalities, corporate groups and other traveling programs. The coach fleet is comprised of a mixture of vehicles ranging from new (the most recent acquired in September 2003) to approximately 10 years old. The average age of the coaches is four years. They can be segregated as follows:

Age	
1-3 years	20 coaches
4-6 years	10 coaches
7-10 years	8 coaches

The initial cost of coaches acquired is depreciated over a straight-line basis to a salvage value of 38% of original cost. Subsequent enhancements and refurbishments of coaches are depreciated over five years using the straight-line method. Actual value of coaches after 15 years is dependent on several factors including the level of maintenance and the market conditions at the time of disposal. We have not disposed of a material number of coaches, and our estimate of depreciation is based on information other than actual disposal experience. Accordingly, we continue to evaluate our estimates with respect to the actual depreciation of such vehicles based on market conditions and our experience in disposals when they occur. Should future factors indicate the current depreciation policy is not adequate, we will adjust the depreciation rates, and such adjustments may have an adverse impact on our results of operations.

CONCENTRATION OF CREDIT RISK:

The Company maintains cash balances at a bank, which at various times throughout the year exceeded the Federal Deposit Insurance Corporation (FDIC) limit.

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of trade receivables. The Company's customers are not concentrated in any one specific geographic region. The credit risk associated with trade receivables within the various industries may be affected by changes in economic or other conditions and may, accordingly, impact the Company's overall credit risk. The Company reviews a customer's credit history before extending credit. Allowances for doubtful accounts are established based on specific customer risk, historical trends and other information. Also see major customers described below.

ORGANIZED LABOR:

Certain of Danzer Industries' employees, which represent 10% of total employees, are currently represented by the United Brotherhood of Carpenters and Joiners of America, Local Union No. 340, whose contract is in effect to January 2005. The contract contains provisions that affect compensation to be paid to employees included in the union.

ALLOWANCE FOR DOUBTFUL ACCOUNTS.

The Company records an allowance for doubtful accounts based on specifically identified amounts that are believed to be uncollectible. An additional allowance is recorded based on certain percentages of aged receivables, which are determined based on historical experience and assessment of the general financial conditions affecting the Company's customer base. If actual collections experience changes, revisions to the allowance may be required. The Company has a limited number of customers with individually large amounts due at any given balance sheet date. Any unanticipated change in one of those customer's credit worthiness or other matters affecting the collectibility of amounts due from such customers could have a material affect on results of operations in the period in which such changes or events occur. After all attempts to collect a receivable have failed, the receivable is written off against the allowance.

GOODWILL, INTANGIBLE ASSETS AND DEFERRED COSTS:

Goodwill, net was $6,434 at October 31, 2003 and 2002. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, Goodwill and Other Intangible Assets, goodwill associated with acquisitions consummated after June 30, 2001 in the amount of $5,829 was not being amortized in the 2001 financial statements. All other goodwill was being amortized on a straight-line basis over 15 years through October 31, 2001. Effective November 1, 2001, the Company adopted SFAS No. 142 and completed transitional impairment testing during the third quarter. This transitional test resulted in an impairment charge of $2,015 in 2002 that has been recorded as a change in accounting principle as discussed in Note 3. There were no impairment charges recorded in 2003.

Other intangible assets, net were $1,124 and $1,383 at October 31, 2003 and 2002, respectively. These amounts include trade names, customer relations and backlogs and other items, which are being amortized on a straight-line basis over lives ranging from three months to 10 years. At October 31, 2003 and 2002, accumulated amortization amounted to $689 and $430, respectively.

Amortization of goodwill and other intangible assets described above for the years ended October 31, 2003 and 2002 and the ten months ended October 31, 2001 was $259, $440 and $303, respectively. Estimated amortization expense for each of the ensuing years through October 31, 2008, is, respectively, $259, $259, $215, $82 and $82. Accumulated amortization on goodwill in the amount of $76 was written off in 2002 with the impairment discussed in Note 3.

Deferred debt issuance costs are amortized over the term of the related debt, primarily four to five years.

STOCK-BASED COMPENSATION:

The Company accounts for stock-based compensation under the provisions of APB No. 25. The Company has adopted the disclosure-only provisions of SFAS No. 123, Accounting for Stock-Based Compensation. Accordingly, no compensation expense is recognized if the exercise price of stock options equals the fair market value of the underlying stock at the date of grant. Had compensation expense for the Company's stock option plans been determined based on the fair value at the grant date for awards consistent with the provisions of SFAS No. 123, the Company's basic and diluted net income (loss) per share would have been as follows:

	Year Ended October 31, 2003	Year Ended October 31, 2002	Ten Months Ende October 31, 200
Net income (loss) as reported	$ (3,873)	$ (6,330)	$ (4,39
Deduct total stock-based employee compensation expense determined under fair value methods	--	--	-
Pro forma net income (loss)	$ (3,873)	$ (6,330)	$ (4,39
Income (loss) per share:			
As reported:			
Basic and diluted	$ (.12)	$ (.18)	$ (.
Pro forma:			
Basic and diluted	$ (.12)	$ (.18)	$ (.

There were no stock options issued for the years ended October 31, 2003 and 2002 and the ten month period ended October 31, 2001. During the year ended October 31, 2003, certain options were extended. Their effect on pro forma net income was immaterial.

INCOME TAXES:

The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes, as required. Under SFAS No. 109, deferred tax assets and liabilities are recorded for any temporary differences between the financial statement and tax bases of assets and liabilities, using the enacted tax rates and laws expected to be in effect when the taxes are actually paid or received. (See Note 14.)

USE OF ESTIMATES:

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of assets, liabilities, revenues and expenses and the related disclosures of contingent assets and liabilities. Significant items subject to such estimates and assumptions include valuation allowances for accounts receivable, inventories and deferred tax assets, the fair values of assets and liabilities when allocating the purchase price of acquisitions, and the carrying value of property and equipment and goodwill. Actual results may differ from those estimates.

CASH EQUIVALENTS:

For purposes of the statement of cash flows presentation, cash equivalents are unrestricted, highly liquid short-term cash investments with an original maturity of three months or less.

IMPAIRMENT OF LONG-LIVED ASSETS, INCLUDING INTANGIBLES:

The Company evaluates the carrying value of long-lived assets whenever significant events or changes in circumstances indicate the carrying value of these assets may be impaired. The Company evaluates potential impairment of long-lived assets by comparing the carrying value of the assets to the expected future cash flows resulting from the use of the assets. In addition, the Company adopted SFAS No. 142 effective November 1, 2001 and completed transitional impairment testing that resulted in an impairment charge of $2,015, which is recorded as a cumulative effect of change in accounting principle in 2002. In addition, the Company completed additional impairment testing in the fourth quarter of 2002, as further discussed in Note 3, resulting in an impairment charge of $720. There were no impairment charges recorded during 2003.

MAJOR CUSTOMERS:

The following is a list of the Company's customers that represent 10% or more of consolidated net sales:

	Year Ended October 31,		Ten Months Ended October 31,
	2003	2002	2001
Butyl rubber sales:			
Customer (1)	--	--	13%
Customer (2)	--	--	8%

EARNINGS PER SHARE:

Basic per-share amounts are computed, generally, by dividing net income or loss attributable to common shareholders by the weighted-average number of common shares outstanding. Diluted per-share amounts are computed similar to basic per-share amounts except that the weighted-average shares outstanding are increased to include additional shares for the assumed exercise of stock options and warrants, if dilutive.

As described in Note 8, the Company has a note payable agreement which is convertible by the holder to common stock totaling 5,000,000 shares at a conversion rate of $0.10 per share. In addition, and as described in Note 12, the Company has options outstanding to purchase a total of 800,000 shares of common stock, at a weighted average exercise price of $0.09. The Company also has outstanding Series C and Series D Preferred Stock that are convertible by the holders into common shares at a conversion rate of twenty-to-one and one-hundred-seventy-five-to-one, respectively, as further described below. However, because the Company incurred a loss for all periods presented, the inclusion of those potential common shares in the calculation of diluted loss per share would have an antidilutive effect.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Basic and diluted loss per share have been computed as follows:

	Year Ended October 31,	
	2003	2002
Loss before discontinued operations and cumulative effect of accounting change	$ (3,824)	$ (
Change in fair value of mandatory redeemable preferred stock	(403)	
Loss attributable to common shareholders before discontinued operations and cumulative effect of accounting change	(4,227)	(
Loss from discontinued operations, net of tax	(49)	(
Cumulative effect of change in accounting principle	--	(
Net loss attributable to common shareholders	$ (4,276)	$ (
Weighted average common and common equivalent shares outstanding, basic and diluted	36,007,855	36,00
Loss per share, basic and diluted, attributable to common shareholders:		
From continuing operations	$ (.12)	$ (
Discontinued operations	--	(
Cumulative effect of accounting change	--	(
Net loss per share	$ (.12)	$ (

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

The Company's Series C Preferred Stock and Series D Preferred Stock, which have all the rights and privileges of the Company's common stock, are convertible at rates of 20 to 1 and 175 to 1, respectively. The inclusion of these potential common shares in the calculation of loss per share would have an antidilutive effect. The Company's stockholders have approved amendments to our Certificate of Incorporation and the Certificates of Designation for the Series C Preferred Stock and Series D Preferred Stock that will allow the holders of the preferred stock to convert their shares into common stock. We expect that the conversion of the shares will occur in February 2004. Accordingly, we are presenting the following pro forma information to indicate the effect on earnings per share had such shares been converted to common shares for the periods presented.

On December 3, 2003, the stockholders and Board of Directors approved a 50-to-1 reverse stock split. The reverse stock split will be effective February 16, 2004. As a result of the reverse stock split and the amendment to the Certificate of Incorporation described above, approximately 720,151 shares of our common stock will be outstanding and the number of authorized shares of common stock will be reduced to 10,000,000. Pro forma basic and diluted loss per share have been computed below as if the Series C and Series D Preferred Stock were converted to common stock. For the years ended October 31, 2003 and 2002 and the ten months ended October 31, 2001, the Series C Preferred Stock has been reflected on a weighted average basis outstanding as common shares of 87,367,980, 81,194,826 and 75,212,925 respectively. The Series D Preferred Stock has been reflected on a weighted average basis outstanding as common shares of 19,930,630 and 297,264 for the years ended October 31, 2003 and 2002, respectively. There were no Series D Preferred Stock shares issued or outstanding during the ten months ended October 31, 2001.

	Year Ended October 31,		Ten Mon Octob
	2003	2002	2
Pro forma weighted average common shares outstanding, basic and diluted	143,306,465	117,499,946	73
Pro forma net loss per share, basic and diluted, attributable to common shareholders	$ (.03)	$ (.05)	$

The pro forma net loss per share is presented for informational purposes only and is not indicative of the weighted average common shares outstanding or net loss per share presented in accordance with accounting principles generally accepted in the United States of America.

INSURANCE RECOVERY:

On May 16, 2002, U.S. Rubber was damaged by a fire at an adjacent property. The Company completed processing its claims with its insurance carrier for damaged equipment and facilities and business interruption losses on August 16, 2002. There was no material gain or loss on involuntary conversion as a result of this fire. An insurance recovery related to the business interruption claim, net of incurred costs, in the amount of $325 has been recognized as reduction of operating costs in 2002.

COMPREHENSIVE INCOME:

SFAS No. 130, Reporting Comprehensive Income, establishes standards for reporting and display of comprehensive income and its components in financial statements. It requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. Comprehensive income consists of net earnings, the net unrealized gains or losses on available-for-sale marketable securities and is presented in the consolidated statement of stockholders' equity.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS:

In January 2003, the Financial Accounting Standards Board (FASB) issued FIN No. 46. This Interpretation addresses the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. DW Leasing and DC Investments Leasing, which are included in the Company's consolidated financial statements, are subject to the provisions of FIN No. 46. Historically, these entities have generated negative operating results and the operating model did not anticipate income in excess of losses previously recognized in the consolidated financial statements. However, during 2003, DW Leasing and DC Investments Leasing reported positive operating results. As a result, minority interest related to the income of DC Investments Leasing in the amount of $172 has been recorded as a charge in the 2003 consolidated statement of operations and has been recognized on the consolidated balance sheet. Future operating results of DC Investments Leasing, if positive, will continue to be charged to minority interest. In addition, should DW Leasing generate future income in excess of previously recognized losses, such amounts would be charged to minority interest in the consolidated statement of operations and recognized as minority interest on the consolidated balance sheet. During 2003, DW Leasing recorded income of $210. As of October 31, 2003, accumulated losses of DW Leasing recognized in consolidated statements of operations exceeded income by approximately $331.

In December 2003, the FASB issued FIN 46R, Consolidation of Variable Interest Entities, which supercedes FIN 46. Application of the revised interpretation is required in the financial statements of companies that have interests in special purpose entities for periods ending after December 15, 2003 The adoption of FIN 46R will not have a material impact on our financial statements due to the previous combination of these entities under EITF 90-15.

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities, which amends SFAS No. 133. This statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. This statement is effective for contracts entered into or modified after June 30, 2003. We do not anticipate that the adoption of this statement will have a significant impact on our financial statements.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. The standard further defines the accounting for certain financial instruments that, under previous guidance, issuers could account for as equity or report between the liability and equity section of the balance sheet. The standard requires that those instruments be classified as liabilities in statements of financial position. This standard is effective for interim periods beginning after June 15, 2003 except for certain provisions which are deferred indefinitely. The adoption of this standard did not have a material impact on the Company's financial position, results of operations, cash flows, or its debt covenants, as the Company's mandatory redeemable preferred stock does not include redemption provisions under an event certain to occur.

3. CHANGE IN ACCOUNTING PRINCIPLES, GOODWILL AND INTANGIBLE ASSETS, AND IMPAIRMENT OF LONG-LIVED ASSETS

The Company adopted the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of fiscal 2002. Accordingly, effective with the November 1, 2001 adoption of SFAS No. 142, goodwill is no longer amortized but is instead subject to an annual impairment test. The Company completed its transitional impairment test in conjunction with the adoption of SFAS No. 142 during the quarter ended July 31, 2002. The impairment test indicated that a portion of the goodwill related to the trailer manufacturing segment was impaired. Accordingly, $2,015 has been recorded as a cumulative effect of change in accounting principle in 2002. This charge was reflected in the first quarter pursuant to the implementation guidelines.

The Company reviews the recoverability of the carrying value of long-lived assets, primarily property, plant and equipment and related goodwill and other intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. Impairment losses are recognized when the fair value is less than the asset's carrying value. When indicators of impairment are present, the carrying values of the assets are evaluated in relation to the operating performance and future undiscounted cash flows of the underlying business. The net book value of the underlying assets is adjusted to fair value if the sum of expected future undiscounted cash flows is less than book value. Fair values are based on quoted market prices and assumptions concerning the amount and timing of estimated future cash flows and assumed discount rates, reflecting varying degrees of perceived risk.

During October 2002, the Company also evaluated the recoverability of the long-lived assets, including the remaining goodwill associated with Danzer. Deteriorating performance, including reduced sales and the bankruptcy of a major customer, brought the recoverability of those assets into question. The evaluation resulted in an additional goodwill impairment charge of $720. There were no goodwill impairment charges recorded in 2003.

The Company's truck body division at Danzer continues to negatively impact the Company's cash flows. The trailer production line was put in place in the fourth quarter of 2002 to support the production needs at United and also provide a new product line to the existing customers of Danzer and open a potential new market along the East coast of the U.S. Given the current state of the telecommunications industry and economic conditions, management will continue to evaluate the operations and progress with the implementation of the trailer production. In conjunction with the analysis of the Danzer operations, the Company has continued to analyze the potential for asset impairment at the Danzer operation. Total assets of Danzer as of October 31, 2003 were $3,198, which consists of $1,260 of current assets and $1,938 of net property and equipment, and represents approximately 7% of total consolidated assets. The analysis has not resulted in an impairment charge.

The changes in the carrying amounts of goodwill related to continuing operations are as follows:

	Trailer Manufacturing	Holding Company	Total
Balance, October 31, 2001	$ 8,560	$ 650	$ 9,210
Purchase price adjustment	(41)	--	(41)
Impairment charges	(720)	--	(720)
Cumulative effect of change in accounting principle	(2,015)	--	(2,015)
Balance, October 31, 2002 and 2003	$ 5,784	$ 650	$ 6,434

Had SFAS No. 142 been effective at the beginning of 2001, the nonamortization provisions would have reduced the net loss for the ten months ended October 31, 2001 by $76, resulting in an adjusted net loss of $4,319 and no change in earnings per share.

4. DISCONTINUED OPERATIONS

On October 30, 2002, the Company's Board of Directors agreed to sell the assets of Champion to an entity controlled by Messrs. Durham and Whitesell (Officers of the Company) for the assumption of all liabilities of Champion excluding its subordinated debt. The decision to divest Champion was based on the entity's inability to achieve profitable operations in the foreseeable future without substantial cash infusion. The Company also agreed in principal to settle the outstanding subordinated debt due to Markpoint Equity Fund J.V. ("Markpoint") from Champion in exchange for a cash payment of $675 and issuance to the debt holder of 32,143 shares of the Company's Series D Preferred Stock. In addition, the agreement provided Markpoint the option to require the Company to repurchase these shares at a price of $21 per share. The sale of Champion was completed on January 30, 2003. Champion is accounted for as a discontinued operation and therefore the results of operations and cash flows have been removed from the Company's continuing operations for all periods presented. In addition, assets and liabilities of Champion included in the sale have been removed from the consolidated balance sheet as of October 31, 2003 and are included in the consolidated balance sheet as of October 31, 2002 as "Assets of subsidiary held for sale" and "Liabilities of subsidiary held for sale," respectively.

The sale of Champion resulted in an increase in equity of the Company of $1,142, net of tax of $97. No gain or loss was recognized on the sale because of the involvement of related parties.

A summary of the Company's discontinued operations for the years ended October 31, 2003 and 2002, and ten months ended October 31, 2001 follows.

	Year Ended October 31,	Ten Months Ended October 31,

	2003	2002	2001
Net sales	$ 170	$ 2,882	$ 3,365
Operating expenses	(286)	(4,066)	(4,148)
Impairment loss	--	--	(2,305)
Other income (expense)	127	(4)	--
Interest expense	(85)	(290)	(288)
Net loss	(49)	(1,040)	(3,376)

A summary of assets and liabilities of subsidiary held for sale at October 31, 2002 are as follows:

Assets of subsidiary held for sale:	
Inventories	$ 551
Other current assets	177
Property and equipment, net	715
Other	95
	$ 1,538

Liabilities of subsidiary held for sale:	
Accounts payable and accrued expenses	$ 709
Customer deposits	313
Long-term debt	--
Long-term debt, related parties	1,826
	$ 2,848

5. ACQUISITIONS AND PLAN OF REORGANIZATION

As previously discussed in Notes 1 and 2, on June 21, 2001, a change of control of the Registrant occurred through an Acquisition Agreement and Plan of Reorganization by and among Danzer, Danzer Industries, Inc., a wholly owned subsidiary of Danzer, and Partners, Timothy S. Durham (the newly elected Chairman of the Board of Danzer), and other individual owners of Pyramid and Champion. On the Acquisition Date, Danzer acquired: all of the outstanding capital stock of Pyramid in exchange for 810,099 shares of Danzer Series C Preferred Stock ("Danzer Preferred"); all of the outstanding capital stock of Champion for 135,712 shares of Danzer Preferred and all of the outstanding capital stock of U.S. Rubber for 1,025,151 shares of Danzer Preferred. On July 31, 2001, Danzer acquired all of the outstanding capital stock of United Acquisition, Inc. ("UAI"), the holding company formed to acquire assets of United, from Partners for 2,593,099 shares of Danzer Preferred.

After the series of transactions were completed on July 31, 2001, Partners owned 75.42% of the total voting, convertible capital stock (Preferred) of Danzer. The preacquisiton Danzer shareholders and their successors owned the remaining capital stock representing 24.58% of the total voting capital stock (Common). Since the U.S. Rubber Companies are so much larger than Danzer, and the existing U.S. Rubber shareholders obtained a majority interest in the stock of Danzer, they have been treated, for accounting purposes, as the acquirer in the Reorganization (reverse merger). In addition, on July 31, 2001, Partners, through UAI, acquired substantially all of the assets of United, an Indiana-based manufacturer of enclosed cargo and specialty trailers, for approximately $15,358. The purchase price and purchase accounting has been allocated to the assets and liabilities of United based on their fair values. Partners exchanged 100% of its shares of UAI for shares of Series C Preferred Stock of Danzer. As a result, UAI became a wholly owned subsidiary of Danzer and operates under the name of "United Expressline, Inc."

ACQUISITION OF DANZER AND SUBSIDIARY:

The purchase price and purchase accounting was allocated to the assets and liabilities of Danzer based on their fair values. The purchase price was based on the value of Danzer's equity determined to be $3,257 plus acquisition costs of $964.

The allocation to tangible assets included $2,300 and $1,536 of net liabilities assumed. The excess of the purchase price over the fair value of the identifiable tangible and intangible net assets of $3,457 was allocated to goodwill. Of this amount, $650 was allocated to Danzer and $2,807 allocated to Danzer Industries, its subsidiary.

ACQUISITION OF UNITED EXPRESSLINE, INC.:

The allocation of purchase price to intangibles include existing brand name, noncompete, and the customer base. Intangibles included $822 for brand name, $886 for noncompete, and $105 for the customer base. The excess of the purchase price of $15,358 over the fair value of the identifiable tangible and intangible net assets of $5,821 has been allocated to goodwill. The value assigned to tangible assets totaled $7,563.

The following schedule is a description of acquisition costs of Danzer and United Expressline, Inc. and the respective purchase price allocations:

	Danzer	United
Purchase price:		
Preferred stock	$ 3,257	$ --
Cash to seller	--	11,050
Seller note	--	1,500
Liabilities assumed	--	1,670
Acquisition costs, including amounts to related parties (see Note 15)	964	1,138
Total purchase price	$ 4,221	$ 15,358
Purchase price allocation:		
Current assets, including accounts receivable and inventory, net of current liabilities assumed	$ 329	$ 5,559
Land, property and equipment	2,300	2,004
Goodwill	3,457	5,829
Intangible assets	--	1,813
Other assets	65	153

Less debt assumed	(1,930)	--
Total purchase price allocation	$ 4,221	$ 15,358

PRO FORMA INFORMATION:

The unaudited condensed consolidated results of operations on a pro forma basis as if the reorganization had occurred as of the beginning of the periods projected are as follows:

The unaudited condensed consolidated results of operations shown below are presented on a pro forma basis and represent the results of Danzer, Danzer Industries, U.S. Rubber, Pyramid, DW Leasing and Obsidian Leasing on a combined basis. Champion has been excluded from the amounts below, as it is currently shown as discontinued operations. In addition, United is treated as if the business combinations of these entities occurred at the beginning of the periods presented. The schedule below includes all depreciation, amortization and nonrecurring charges for all entities for the period shown.

	Ten Months Ended October 31, 2001
Net sales	$ 49,830
Loss from continuing operations	$ (491)
Loss from continuing operations per share - basic and diluted	$ (.02)

The pro forma financial information is presented for informational purposes only and is not indicative of the operating results that would have occurred had the Reorganization been consummated as of the above dates, nor are they necessarily indicative of future operating results.

6. INVENTORIES

Inventories are stated at the lower-of-cost (first-in, first-out method) or market and are comprised of the following components:

	October 31, 2003	October 31, 2002
Raw materials	$ 4,647	$ 3,655
Work-in-process	499	709
Finished goods	2,630	3,417
Valuation reserve	(321)	(466)
Total	$ 7,455	$ 7,315

6. INVENTORIES, CONTINUED

The Company provides valuation reserves for inventory considered obsolete or not currently available for use in production. Inventory reserves at U.S. Rubber are related to excess scrap butyl rubber not currently available for use without further processing; therefore, it has minimal value. Changes in the valuation reserve are as follows:

Balance at October 31, 2001	$ (833)
Provision for losses	(50)
Use of reserved inventory	417
Balance at October 31, 2002	(466)
Use of reserved inventory	145
Balance at October 31, 2003	$ (321)

7. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is summarized by major classification as follows:

	October 31, 2003	October 31, 2002
Land and improvements	$ 497	$ 488
Buildings and improvements	3,436	3,520
Plant machinery and equipment	10,497	9,767
Furniture and fixtures	326	334
Coach fleet and vehicles	15,982	12,971
Coach refurbishments	474	341
Total	31,212	27,421
Less accumulated depreciation	(6,732)	(4,373)
Net property, plant and equipment	$ 24,480	$ 23,048

Depreciation expense of property, plant and equipment for the years ended October 31, 2003 and 2002, and the ten months ended October 31, 2001 included in continuing operations was $2,401, $2,128, and $1,752, respectively.

8. FINANCING ARRANGEMENTS

The Company has the following outstanding debt as of October 31, 2003 and 2002:

	Debt
	October 31, 2003

U.S. Rubber	
Line of credit to a bank, bearing interest at prime (4.00% at October 31, 2003), borrowings not to exceed the greater of $4,000 or the borrowing base (85% of eligible accounts receivable and 42% of eligible inventories), interest payable monthly, balance due October 2005, collateralized by substantially all assets of U.S. Rubber	$ 2,059
Note payable to a bank, interest payable monthly at prime plus .50% (4.50% at October 31, 2003), monthly principal payments of $48, due October 2005, collateralized by substantially all assets of U.S. Rubber.	3,476
Note payable to DC Investments, LLC, interest payable monthly at 15%, balloon payment due March 2007, subordinate to bank debt.	700
Other	50
Subtotal U.S. Rubber	6,285

8. FINANCING ARRANGEMENTS, CONTINUED

	Debt
	October 31, 2003
Pyramid, DW Leasing, Obsidian Leasing and DC Investments Leasing	
Various installment loans, repayable in monthly installments totaling $135 including interest ranging from the three-month LIBOR rate plus .12% (1.24% at October 31, 2003) to 13.1% through November 2007 and applicable balloon payments thereafter through December 2007, less unamortized discount ($212 at October 31, 2003) first lien on assets financed (finance acquisition and asset purchases). A portion of the borrowings guaranteed by the members of DW Leasing.	$ 11,186
Former shareholders of Pyramid and related companies installment loans, repayable in monthly installments of interest at 9% through December 2002 with a balloon payment in January 2003, collateralized by Security Agreements for Pyramid, DW Leasing and the members of DW Leasing (finance acquisition).	--
Notes payable to Fair Holdings, Inc., repayable in monthly installments of interest ranging from 10% to 14% through October 2012 and applicable balloon payments through November 2012.	4,056
Other	31
Subtotal Pyramid, DW Leasing, Obsidian Leasing and DC Investments Leasing	15,273

8. FINANCING ARRANGEMENTS, CONTINUED

	Debt
	October 31, 2003
Danzer Industries	
Line of credit to Fair Holdings, maximum borrowing equal to $1,500, interest payable monthly at the LIBOR Daily Floating Rate plus 3.2% (4.32% at October 31, 2003), due April 2006. Collateralized by substantially all assets of Danzer and guaranteed by Obsidian Enterprises.	$ 1,331
Note payable to Fair Holdings, requires monthly principal installments of $6, interest accrues at the LIBOR Daily Floating Rate plus 3.2% (4.32% at October 31, 2003), due April, 2006. Collateralized by substantially all assets of Danzer and guaranteed by Obsidian Enterprises.	961
Line of credit to a bank	--
Note payable to a bank	--
Term loans payable to US Amada, Ltd. Monthly payments currently aggregating $13 including interest at 10%, loans due January 2003, collateralized by equipment financed	14
Equipment loans payable--monthly payments currently aggregating $2 including interest of 9.50% to 11.30% through November 2006. Collateralized by equipment financed.	85
Other	19
Subtotal Danzer Industries	2,410

8. FINANCING ARRANGEMENTS, CONTINUED

	Debt
	October 31, 2003
United	

Line of credit to a bank, maximum borrowing equal to $4,000, with a base of 80% of eligible accounts receivable plus 50% of raw material, work-in-process and finished goods inventory. Interest payable monthly at prime plus .75% (4.75% at October 31, 2003), due November 1, 2004. Collateralized by substantially all assets of United and guaranteed by Obsidian Enterprises, Inc.*	$	4,000
Temporary overline of credit with bank, interest payable monthly at prime plus .75% (4.75% at October 31, 2003), due on demand, collateralized by substantially all assets of United and guaranteed by Obsidian Enterprises, Inc. *		250
Notes payable to a bank, requires monthly principal installments of $48 plus interest ranging from prime plus 1% (5.00% at October 31, 2003) to prime plus 2% (6.00% at October 31, 2003), due through July 2006, collateralized by substantially all assets of United and guaranteed by Obsidian Enterprises, Inc.*		1,484
Subordinated note payable to Huntington Capital Investment Company, interest payable quarterly at 14% per annum, balloon payment of outstanding principal balance due July 26, 2006, less unamortized discount ($1,091 and $1,309 at October 31, 2003 and 2002, respectively). Unsecured and subordinate to line of credit and notes payable above.*		2,409
Note payable to former shareholder, interest payable monthly at 9% per annum, balloon payment of outstanding principal balance due July 27, 2006. Unsecured and subordinate to line of credit, notes payable and Huntington debt above.*		1,500
Note payable to Renaissance (formerly parent of Danzer Corporation), interest payable monthly at 8% per annum, with monthly principal payments beginning July 2004 at a rate of $10 for each $1,000 of outstanding principal, due July 2008. Convertible at the option of the holder to common stock of Obsidian Enterprises at a conversion price of $.10 per share. The loan agreement also restricts dividend payments without the prior consent of the lender.*		500
Note payable to a former shareholder, requires monthly principal installments of $16 including interest at 9%, due March 2003		--

8. FINANCING ARRANGEMENTS, CONTINUED

	Debt
	October 31, 2003
United, continued	
Other including 41 to Fair Holdings	122
Subtotal United	10,265

*United was in technical default of certain loan covenants with its senior and subordinated lender at October 2003. United has obtained waivers of the violations from the lenders and modifications of various covenants with these lenders.

Obsidian Enterprises, Inc.	
Line of credit to Fair Holdings, maximum borrowing equal to $12,000, interest payable monthly at 10%, due January 2007, collateralized by all assets of Obsidian Enterprises and guaranteed by certain officers	6,045
Note payable to Fair Holdings, interest payable monthly at 15%, balloon payment due March 2007, guaranteed by certain officers	803
Note payable to Fair Holdings, interest payable monthly at 5.25%, paid during 2003	--
Note payable to The Markpoint Company, interest payable monthly at 13.50%, commencing June 1, 2000, balloon payment of outstanding principal balance due May 2005, collateralized by substantially all assets of Champion and subordinate to Champion notes payable to DC Investments LLC	--
Subtotal Obsidian Enterprises, Inc.	6,848
Champion	
Notes payable to DC Investments, LLC, interest payable monthly at rates ranging from 5.25% to 5.50%, balloon payments due January 2004 and June 2005	--
Other	--
Subtotal Champion	--
Total all companies	41,081
Less liabilities of subsidiary held for sale	--
Less related-party amounts presented separately	(13,937)
Less current portion	(2,379)
	$ 24,765

Following are the maturities of long-term debt for each of the next five years and thereafter:

2004	$ 2,379
2005	20,494
2006	8,446
2007	3,455
2008	547
Thereafter	5,760
	$ 41,081

Various subsidiary companies were in violation of requirements to provide year end financial statements to various lenders within 90 days of the close of the 2003 year end. Management has received an extension of time from the lenders. Renaissance US Growth & Income Trust PLC and FBSUS Special Opportunities Trust PLC, the holders of debentures that completed the financing of United, provided the Company an extension in exchange for warrants to the debenture holders to purchase up to 16,000 shares of the Company's common stock at an exercise price of $.20 per share.

The Company has an agreement with Partners that gives the Company the right to mandate a capital contribution from Partners if the lenders to U.S. Rubber and/or United were to declare a default. In that event, the Company has the right to enforce a capital contribution agreement with Partners up to $1,370 on U.S. Rubber and $1,000 on United to fund the respective subsidiary's shortfall. Those payments, if any, would be applied directly to reduce the respective subsidiary's debt obligations to the lender. During 2003 a capital call was made for $250 for U.S. Rubber to bring the Company in compliance with certain bank covenants. Partners received 14,285 shares of Series D Preferred Stock in exchange for the capital call.

The following details significant changes in debt during the year ended October 31, 2003:

PYRAMID, DW LEASING AND OBSIDIAN LEASING AND DC INVESTMENTS LEASING:

On January 3, 2003, Obsidian Leasing paid off debt in the amount of $928 to former shareholders of Pyramid and related companies with proceeds from a note with Fair Holdings which includes monthly interest payments of 13% of the outstanding principal amount and a balloon principal payment in January 2006.

On December 17, 2002, Obsidian Leasing sold four coaches to DC Investments Leasing in exchange for DC Investments Leasing's satisfaction of the debt outstanding on such coaches. In addition, DC Investments Leasing also acquired five additional coaches that were previously to be purchased by the Company thereby eliminating the Company's existing purchase commitment for such coaches. The Company refinanced the debt on the four coaches in addition to financing the five additional coaches. DC Investments Leasing entered into an agreement with First Indiana for $2,741 of the debt with interest payable at prime plus 1/2% and a maturity of December 2007. DC Investments Leasing also incurred debt with Fair Holdings for the remaining 20% of the net book value of the transferred and new coaches. Terms of the debt with Fair Holdings include monthly interest payments on the principal amount of $677 at 14% and a maturity of January 2008. DC Investments Leasing also entered into a management agreement with Pyramid under which all nine coaches described above will be leased by Pyramid.

DANZER:

As of January 31, 2003, Danzer was in violation of certain covenants included in its credit agreement and First Forbearance Agreement dated October 14, 2002 with its senior lender. On February 28, 2003, the Company and the lender entered into a Second Forbearance Agreement waiving these violations. On March 28, 2003, the credit agreement was assumed by Fair Holdings under an assumption and continuation agreement. An amendment was made as of the effective date of the agreement to extend the maturity date of the line of credit agreement to April 1, 2006 and the debt covenants required by the senior lender were waived through the end of the term. In September 2003 the line of credit was amended to increase the total availability from $1,000 to $1,500. All other terms of the agreement will continue as stated in the original agreement dated August 15, 2001.

UNITED:

On December 26, 2002, United amended its credit agreement to provide additional working capital. The amendment included a "temporary overline" line of credit with maximum borrowings not to exceed the lesser of $650 or the remainder of the borrowing base less the outstanding principal amount of the revolving line of credit. Interest is payable monthly at a rate of prime plus 3/4%.

On January 28, 2004, United amended its line of credit agreement to extend the maturity date of the original $4,000 line to November 2004, waive United's current debt violations, and modify the covenants for future reporting periods. In addition, United is required to pay the additional $250 outstanding on their line of credit at October 31, 2003 during 2004. Therefore, $4,000 of United's line of credit amount has been reclassified as long-term debt at October 31, 2003.

OBSIDIAN ENTERPRISES:

On February 2, 2004, Obsidian Enterprises, Inc.'s line of credit with Fair Holdings was amended. Maximum borrowings were increased from $8,000 to $12,000, and the maturity date was extended from January 2005 to January 2007.

9. LEASING ARRANGEMENTS

In October 2001, the Company entered into a sales-leaseback arrangement. Under the arrangement, the Company sold equipment and leased it back for a period of five years. The leaseback has been accounted for as an operating lease. The loss of $218 realized in the transaction was deferred and was being amortized to income in proportion to rental expense over the term of the lease. Proceeds from the sale of $1,050 were used to reduce borrowings under the line of credit.

During October 2002, in conjunction with the refinancing described in Note 8, the Company repurchased the equipment. The unamortized loss of $175 as of October 24, 2002 was included as part of the equipment purchase price capitalized.

9. LEASING ARRANGEMENTS, CONTINUED

The Company has various operating lease commitments, principally related to machinery and equipment, office equipment, and facilities. The approximate future minimum annual rentals under the terms of these leases, which expire on various dates through the year ending October 31, 2008, are as follows:

Year Ending October 31,	
2004	$ 452
2005	314
2006	220
2007	173
2008	18
	$ 1,177

Rental expense under operating leases for the years ended October 31, 2003 and

2002 and the ten months ended October 31, 2001 was $594, $562, and $514, respectively.

10. EMPLOYEE BENEFIT PLANS

The Company, through certain of its subsidiaries, has defined contribution 401(k) plans which permit voluntary contributions up to 20% of compensation and which provide Company-matching contributions of up to 10% of employee contributions not to exceed 6% of employee compensation. 401(k) plan expense for the years ended October 31, 2003 and 2002 and the ten-month period ended October 31, 2001 was approximately $128, $148, $35, respectively.

11. MANDATORY REDEEMABLE PREFERRED STOCK

In conjunction with the United acquisition described in Note 5, the Company issued 386,206 shares of Series C Preferred Stock to Huntington Capital Investment Corporation ("Huntington"), the senior subordinated lender of United. The note purchase agreement included a provision giving Huntington the option to require the Company to repurchase the Series C Preferred Stock. Under the terms of the agreement, Huntington has the option of requiring the Company to repurchase these shares at 90% of market value at the date of redemption upon the earlier of: a) fifth anniversary of issuance of such shares, b) default under the subordinated debt agreement, c) other factors related to a sale of substantially all assets of the Company as defined in the agreement.

A portion of the note purchase agreement proceeds of $3,500 was allocated to the stock issued based on the thirty day average closing value of the Company's common stock prior to the transaction. As the redemption value is variable, the Company recognizes changes in the estimated fair value each quarter. Changes in fair value are adjusted through additional paid in capital or retained earnings when additional paid in capital related to the fair value change has been reduced to zero. At October 31, 2003, the estimated redemption requirement is $1,803 to be paid July 2006.

11. MANDATORY REDEEMABLE PREFERRED STOCK, CONTINUED

In conjunction with the sale of Champion discussed in Note 4, the Company agreed to settle the outstanding subordinated debt due to Markpoint from Champion in exchange for a cash payment of $675 and issuance to the debt holder of 32,143 shares of the Company's Series D Preferred Stock. The agreement provided Markpoint the option to require the Company to repurchase these shares at a price of $21 per share. The repurchase option was available to Markpoint as follows: 16,072 shares during the period May 1, 2003 to June 1, 2003 and 16,071 shares during the period November 1, 2003 to December 1, 2003. On May 12, 2003, under an Assignment Agreement, the Company transferred all rights, title and interest in the repurchase option to Fair Holdings. Markpoint exercised the repurchase option with respect to 16,072 shares on May 12, 2003 and was paid $338 by Fair Holdings. The exercise of the option resulted in the reduction of the liability and an increase in additional paid in capital of $337 as of October 31, 2003. Subsequent to October 31, 2003, Markpoint exercised the option for the remaining 16,071 shares and those shares also were acquired by Fair Holdings.

12. STOCKHOLDERS' EQUITY

PREFERRED STOCK:

The original capital structure of Danzer prior to the merger was comprised of the following: 5,000,000 authorized shares of $.001 par value preferred stock; 10,500 shares authorized of the Class of 10% Cumulative Senior Preferred Stock (Series A) with no shares issued or outstanding as 7,650 shares were retired; (Series B) Cumulative Convertible Senior Preferred Stock with 16,000 shares authorized and no shares issued or outstanding as 16,000 shares were retired. In addition, the Company had 20,000,000 authorized shares of common stock with 17,760,015 shares outstanding at December 31, 2000.

In June 2001, Danzer issued an aggregate of 1,750,000 shares of Danzer unregistered common stock in connection with the exchange of $355 of debt. On June 21, 2001, Danzer amended its articles of incorporation to authorize up to 4,500,000 shares of Series C Preferred Stock. In conjunction with the merger and acquisitions (described in Note 5) of June 21, the Company issued 1,970,962 of Series C Preferred Stock. The shareholders of Pyramid and Champion then converted 824,892 shares of preferred stock to 16,497,840 of common stock. In addition, on July 5, 2001, the Company increased the authorized shares of common stock by 20,000,000 to 40,000,000. On July 31, 2001, the Company issued 2,593,099 shares of additional Series C Preferred Stock related to the United acquisition.

As a result of the reverse merger, U.S. Rubber became the accounting acquirer and accordingly, under purchase accounting, became the Registrant. Therefore, the 2000 financial statements became those of U.S. Rubber. However, under purchase accounting for a reverse merger, the stockholders' equity section of the Registrant (formerly Danzer Corporation) became the equity of the merged entity. Accordingly, the statement of changes in stockholders' equity reflects that purchase accounting.

12. STOCKHOLDERS' EQUITY, CONTINUED

On October 4, 2001, the Company changed its name from Danzer Corporation to Obsidian Enterprises, Inc. In addition, 5,000,000 shares of Preferred Stock were authorized with the domestication of Obsidian Enterprises, Inc. in Delaware. On October 9, 2001, the Company filed designation of preferences, rights and limitations of 4,600,000 shares of Series C Preferred Stock. This transaction results in 400,000 shares of authorized but undesignated preferred stock and cancellation of the Series A and B shares.

The Series C Preferred Stock is convertible at the option of the holder at any time, unless previously redeemed, into shares of common stock of the Company at an initial conversion rate of 20 shares of common stock for each share of convertible stock. However, the convertible preferred stock may not be converted prior to the corporation filing a registration statement for such shares. Holders of the convertible preferred stock have voting rights which entitle them to cast on each matter submitted to a vote of the stockholders of the Company the number of votes equal to the number of shares of common stock into which such shares of Series C Preferred could be converted.

On March 7, 2002, the Company completed a series of transactions with the subordinated lender at U.S. Rubber resulting in an increase in equity and a decrease in liabilities of $1,016. The subordinated lender received 30,000 shares of Series C Preferred Stock in this transaction.

On April 30, 2002, the Company converted $1,290 of debt and accrued interest owed to Partners and $596 of debt and accrued interest owed to Fair to equity through the issuance to Partners and Fair of 402,906 shares and 186,324 shares, respectively, of Series C Preferred Stock which are convertible into an aggregate of 11,784,600 shares of common stock of the Company.

In August 2002, warrants for 10,000 shares of Series C Convertible Stock were exercised. The shares were issued in exchange for a cash payment of $20.

On October 24, 2002, the Company amended its Articles of Incorporation to authorize 200,000 shares of Series D Preferred Stock. The Series D Preferred Stock is convertible at the option of the holder at any time, unless previously redeemed, into shares of common stock of the Company at an initial conversion rate of 175 shares of common stock for each share of Series D Preferred Stock. However, the stock may not be converted prior to the Company filing a registration statement for such shares. Holders of the Series D Preferred Stock have voting rights which entitle them to cast on each matter submitted to a vote of the stockholders of the Company the number of votes equal to the number of shares of common stock into which such shares of Series D Preferred could be converted.

On October 24, 2002, 88,300 of the Series D Preferred Stock shares were sold in the transactions described below which were exempt from Securities Act registration under Section 4(2) of the Securities Act, relating to sales by an issuer not involving a public offering.

On October 24, 2002, the Company converted $1,276 of debt to Partners in exchange for 72,899 shares of Series D Preferred Stock. The conversion was the result of Partners' requirement under the Plan of Reorganization to fund through the purchase of additional preferred stock certain ongoing administrative expenses of the Company to complete the Plan of Reorganization, complete all required current and prior year audits to meet the regulatory filing requirements, and ensure all annual and quarterly SEC filings are completed to enable the registration of the preferred stock issued to Partners.

12. STOCKHOLDERS' EQUITY, CONTINUED

On October 24, 2002, the Company converted $270 of debt to Fair in exchange for 15,431 shares of Series D Preferred Stock. The conversion was the result of Fair's agreement to cover similar expenses as Partners as described above in excess of the amount Partners was obligated to pay.

On May 12, 2003, 16,072 shares of Series D Preferred Stock, previously classified as mandatory redeemable preferred stock (see Note 11) were acquired by Fair Holdings from Markpoint.

On October 13, 2003, the Company issued 14,285 shares of Series D Preferred Stock for $250. The issuance was as a result of a capital call from Partners who were obligated to fund additional capital required to maintain compliance with the debt covenants of U.S. Rubber.

STOCK OPTIONS:

On May 7, 1990, Danzer's stockholders approved a stock option plan to issue both "qualified" and "nonqualified" stock options. Under the plan, 800,000 options to purchase shares of the Company's common stock may be issued at the discretion of the Company's Board of Directors. The option price per share is determined by the Company's Board of Directors, but in no case will the price be less than 85% of the fair value of the common stock on the date of grant. Options under the plan will have a term of not more than ten years with accelerated termination upon the occurrence of certain events.

In April 1998, Danzer granted 600,000 stock options, exercisable at $.10 per share, to its president. The options vest over two years and expire in April 2004. None of these options have been exercised as of October 31, 2003.

In September 1998, Danzer adopted a qualified incentive stock option plan under Section 422 of the Internal Revenue Code. Options granted under the plan will be granted at prices not less than fair value of the Company's stock at the date of grant, have a term not more than ten years and have other restrictions as determined by statute.

In September 1998, Danzer granted a total of 604,500 stock options, exercisable at $.10 per share, to certain employees. The options expired November 2001. As a result of voluntary termination, 75,000 options expired in 1999 and 192,000 options expired in 2000. The balance of 247,500 options outstanding expired November 1, 2002.

On July 24, 2001, the Board adopted, and on October 5, 2001, the Company's stockholders approved, the 2001 Long Term Incentive Plan (the "2001 Plan"). The 2001 Plan authorizes the granting to the Company's directors, key employees, advisors and consultants of options intended to qualify as Incentive Options within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), options that do not so qualify ("Non-Statutory Options"), restricted stock and Other Stock-Based Awards that are not Incentive Options or Non-Statutory Options. The awards are payable in Common Stock and are based on the formula which measures performance of the Company. There was no performance award expense in 2003, 2002 or 2001. No options under this plan were granted to any employees. Options are exercisable for up to 10 years from the date of grant.

12. STOCKHOLDERS' EQUITY, CONTINUED

On December 13, 2003, the Company's Board of Directors approved the extension of the expiration date of 200,000 fixed stock options, exercisable at $.05. The original expiration date of December 31, 2002 was originally extended to December 31, 2003 and subsequently to June 30, 2004. The Company recognized $30 of compensation expense related to the extension of the options during the year ended October 31, 2003.

The Company accounts for stock-based compensation under the provisions of APB No. 25. The Company has adopted the disclosure-only provisions of SFAS No. 123, Accounting for Stock-Based Compensation. Accordingly, no compensation expense is recognized if the exercise price of stock options equals the fair market value of the underlying stock at the date of grant. Had compensation expense for the Company's stock option plans been determined based on the fair value at the grant date for awards consistent with the provisions of SFAS No. 123, the Company's basic and diluted net income (loss) per share would not have changed. See Note 2 for comparison of net income and net income per share as reported and as adjusted for the pro forma effects of determining compensation expense in accordance with SFAS 123.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants in 2000 and 1999, respectively: risk-free interest rates of 6.4 and 5.5 percent; dividend yield of 0 percent in both years; expected lives of 5 years; and volatility of 978 and 170 percent. The estimated weighted average fair value of options granted during 2000 and 1999 were $0.10 and $0.05 per share, respectively. Following is a summary of transactions of granted shares under option for the years ended October 31, 2003 and 2002 and the ten months ended October 31, 2001:

	2003	2002

	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	S
Outstanding, beginning of year	800,000	.09	1,047,500	.09	1,
Issued during the year	--	--	--	--	
Canceled or expired during the year	--	--	(247,500)	.10	
Exercised during the year	--	--	--	--	
Outstanding, end of year	800,000	.09	800,000	.09	1,
Eligible, end of year for exercise	800,000	.09	800,000*	.09	1,

12. STOCKHOLDERS' EQUITY, CONTINUED

A further summary about fixed options outstanding at October 31, 2003 is as follows:

	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Numbe Exercis
Exercise price of $.10	600,000*	.5 yr.	.10	600,0
Exercise price of $.05	200,000	.67 yr.	.05	200,0

*In accordance with the Plan of Reorganization and Merger and the related "Letter agreements," the above options cannot be exercised until the Company amends its articles of incorporation to authorize shares of approximately 120,000,000 and has registered such shares.

STOCK WARRANTS:

The Company has issued warrants to purchase common stock to several parties. In January 2003, the Company agreed to a modification of terms with the debenture holders to provide for less stringent covenants. In exchange for this modification, the Company issued warrants to the debenture holders to purchase up to 16,000 shares of the Company's common stock at an exercise price of $.20 per share. These warrants expire January 24, 2006. The issuance of the warrants had no material impact on earnings.

The following table summarizes the outstanding warrants for the years ended October 31, 2003 and 2002:

	Outstanding Warrants October 31, 2002	Issued During the Year	Exercise Price	Wa Ex in
Common Stock:				
Renaissance US Growth & Income Trust PLC	8,000	8,000	.20	
BFSUS Special Opportunities Trust PLC	8,000	8,000	.20	

	Outstanding Warrants October 31, 2001	Issued During the Year	Exercise Price	Wa Ex in
Common Stock:				
Renaissance US Growth & Income Trust PLC	--	8,000	$.20	
BFSUS Special Opportunities Trust PLC	--	8,000	$.20	
Series C Preferred Stock:				
Duncan-Smith Co., 10,000 shares, expire August 31, 2002	10,000	--	$2.00	(1
Markpoint financing agreement expiring May 2008 associated with Champion**	Zero**	--	$.01	

**The number of warrants available under the agreement with Markpoint is based on twenty-five percent of the fair market value of Champion to be determined based on a formula including a multiple of EBITDA. No warrants are currently available under this agreement based on the operating results and stockholder's deficit of Champion. As discussed in Notes 4 and 16, the Company agreed to a settlement with Markpoint in January 2003. Accordingly, these warrants have been terminated.

In February 2004, the Company received an extension of the requirement to provide audited financial statements to debenture holders. In exchange for this extension, the Company issued warrants to each of the debenture holders to purchase up to 8,000 shares of the Company's common stock at an exercise price of $.20 per share. These warrants expire February 9, 2007.

CONVERTIBLE DEBT:

As described in Note 8, the Company has a note payable agreement which is convertible by the holder to common stock totaling 5,000,000 shares at a conversion rate of $0.10 per share.

13. BUSINESS SEGMENT DATA AND GEOGRAPHIC DATA

The Company operates in three industry segments comprised of trailer and related transportation equipment manufacturing; coach leasing; and butyl rubber reclaiming. All sales are in North and South America primarily in the United States, Canada and Brazil. All segment information is presented from continuing operations and before cumulative effect of change in accounting method. Selected information by segment follows:

	Year Ended October 31, 2003		
	Trailer Manufacturing	Coach Leasing	Butyl Rubber Reclaiming
Sales:			
Domestic	$ 37,590	$ 7,281	$ 9,893
Foreign	3,419	--	1,112
Total	$ 41,009	$ 7,281	$ 11,005
Cost of goods sold	$ iv>		

)

Cash and cash equivalents at beginning of year

51,167

44,628

Cash and cash equivalents at end of period

$

65,234

$

26,835

Supplemental cash flow information

Cash paid during the period for:

Interest

$

398

$

533

Income taxes—net	$ 2,303	$ 4,198

See notes to unaudited condensed consolidated financial statements.

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CTS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS/ (LOSS) - UNAUDITED
(In thousands of dollars)

	Three Months Ended		Six Months Ended	
	July 4, 2010	June 28, 2009	July 4, 2010	June 28, 2009
Net earnings/(loss)	$ 5,892	$ (7,025)	$ 10,323	$ (42,674)
Other comprehensive earnings/(loss):				
Cumulative translation adjustment	(203)	2,249	(1,636)	2,277
Amortization of retirement benefit adjustments (net of tax)	687	660	1,416	1,474
Comprehensive earnings/(loss)	$ 6,376	$ (4,116)	$ 10,103	$ (38,923)

See notes to unaudited condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED
July 4, 2010

NOTE A – Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared by CTS Corporation ("CTS" or "the Company"), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. The unaudited condensed consolidated financial statements should be read in conjunction with the financial statements, notes thereto, and other information included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

The accompanying unaudited condensed consolidated financial statements reflect, in the opinion of management, all adjustments (consisting of normal recurring items) necessary for a fair statement, in all material respects, of the financial position and results of operations for the periods presented. 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, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ materially from those estimates. The results of operations for the interim periods are not necessarily indicative of the results for the entire year.

NOTE B – Equity-Based Compensation

At July 4, 2010, CTS had five equity-based compensation plans: the 1996 Stock Option Plan ("1996 Plan"), the 2001 Stock Option Plan ("2001 Plan"), the Nonemployee Directors' Stock Retirement Plan ("Directors' Plan"), the 2004 Omnibus Long-Term Incentive Plan ("2004 Plan"), and the 2009 Omnibus Equity and Performance Incentive Plan ("2009 Plan"). All of these plans, except the Directors' Plan, were approved by shareholders. As of December 31, 2009, additional grants can only be made under the 2004 and 2009 Plans. CTS believes that equity based awards align the interest of employees with those of its shareholders.

The 2009 Plan, and previously the 1996 Plan, 2001 Plan and 2004 Plan, provides for grants of incentive stock options or nonqualified stock options to officers, key employees, and nonemployee members of CTS' board of directors. In addition, the 2009 Plan and the 2004 Plan allowed for grants of stock appreciation rights, restricted stock, restricted stock units, performance shares, performance units, and other stock awards.

The following table summarizes the compensation expense included in the Unaudited Condensed Consolidated Statements of Earnings/(Loss) for the three and six months ended July 4, 2010 and June 28, 2009 relating to these plans:

	Three Months Ended		Six Months Ended	
($ in thousands)	July 4, 2010	June 28, 2009	July 4, 2010	June 28, 2009
Stock options	$1	$13	$3	$32
Restricted stock units	905	846	2,164	1,770
Total	$906	$859	$2,167	$1,802

The following table summarizes the status of these plans as of July 4, 2010:

	2009 Plan	2004 Plan	2001 Plan	1996 Plan
Awards originally available	3,400,000	6,500,000	2,000,000	1,200,000
Stock options outstanding	—	276,850	713,513	128,350
Restricted stock units outstanding	550,427	281,403	—	—
Options exercisable	—	276,850	713,513	128,350
Awards available for grant	2,716,516	281,000	—	—

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Stock Options

Stock options are exercisable in cumulative annual installments over a maximum 10-year period, commencing at least one year from the date of grant. Stock options are generally granted with an exercise price equal to the market price of the Company's stock on the date of grant. The stock options generally vest over four years and have a 10-year contractual life. The awards generally contain provisions to either accelerate vesting or allow vesting to continue on schedule upon retirement if certain service and age requirements are met. The awards also provide for accelerated vesting if there is a change in control event.

The Company estimates the fair value of the stock option on the grant date using the Black-Scholes option-pricing model and assumptions for expected price volatility, option term, risk-free interest rate, and dividend yield. Expected price volatilities are based on historical volatilities of the Company's stock. The expected option term is derived from historical data on exercise behavior. The dividend yield is based on historical dividend payments. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

A summary of the status of stock options as of July 4, 2010 and June 28, 2009, and changes during the six-month periods then ended, is presented below:

	July 4, 2010		June 28, 2009	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at beginning of year	1,179,088	$ 13.72	1,294,263	$ 14.53
Exercised	(17,000)	$ 7.70	—	$ —
Expired	(43,375)	$ 44.79	(96,925)	$ 21.37
Forfeited	—	$ —	—	$ —
Outstanding at end of period	1,118,713	$ 12.61	1,197,338	$ 13.98
Exercisable at end of period	1,118,713	$ 12.61	1,176,588	$ 13.98

The total intrinsic value of share options exercised during the six-month period ended July 4, 2010 was $30,000. There were no share options exercised during the six-month period ended June 28, 2009.

The weighted-average remaining contractual life of options outstanding and options exercisable at July 4, 2010 is 2.8 years. The aggregate intrinsic value of options outstanding and options exercisable at July 4, 2010 is approximately $341,000.

A summary of the nonvested stock options as of July 4, 2010 and June 28, 2009, and changes during the six-month periods then ended, is presented below:

	July 4, 2010		June 28, 2009	
	Options	Weighted-average Grant-Date Fair Value	Options	Weighted-average Grant-Date Fair Value
Nonvested at beginning of year	20,750	$ 6.24	74,525	$ 6.36
Vested	(20,750)	$ 6.24	(53,775)	$ 6.41
Forfeited	—	$ —	—	$ —
Nonvested at end of period	—	$ —	20,750	$ 6.24

The total fair value of shares vested during the six-month periods ended July 4, 2010 and June 28, 2009 was approximately $130,000 and $345,000, respectively. As of July 4, 2010, there was no unrecognized compensation cost related to nonvested stock options. CTS recognized expense on a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in substance, multiple awards.

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The following table summarizes information about stock options outstanding at July 4, 2010:

Range of Exercise Prices	Options Outstanding Number Outstanding at 7/4/10	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Options Exercisable Number Exercisable At 7/4/10	Weighted Average Exercise Price
$ 7.70 – 11.11	710,163	3.14	$ 9.41	710,163	$ 9.41
13.68 – 16.24	227,800	3.23	$ 14.12	227,800	$ 14.12
23.00 – 25.10	180,250	0.79	$ 23.23	180,250	$ 23.23
42.69	500	0.36	$ 42.69	500	$ 42.69

Service-Based Restricted Stock Units

Service-based restricted stock units ("RSUs") entitle the holder to receive one share of common stock for each unit when the unit vests. RSUs are issued to officers and key employees as compensation. Generally, the RSUs vest over a three-year period. A summary of the status of RSUs as of July 4, 2010 and June 28, 2009, and changes during the six-month periods then ended is presented below:

	July 4, 2010 RSUs	July 4, 2010 Weighted-average Grant-Date Fair Value	June 28, 2009 RSUs	June 28, 2009 Weighted-average Grant-Date Fair Value
Outstanding at beginning of year	854,745	$ 8.47	700,358	$ 10.76
Granted	271,500	$ 7.52	390,850	$ 6.09
Converted	(280,495)	$ 8.97	(205,591)	$ 10.56
Forfeited	(13,920)	$ 6.62	(12,780)	$ 11.87
Outstanding at end of period	831,830	$ 8.34	872,837	$ 8.70
Weighted-average remaining contractual life	5.32 years		4.9 years	

CTS recorded compensation expense of approximately $657,000 and $1,544,000 related to service-based restricted stock units during the three and six month periods ended July 4, 2010, respectively. CTS recorded compensation expense of approximately $638,000 and $1,308,000 related to service-based restricted stock units during the three and six month periods ended June 28, 2009, respectively.

As of July 4, 2010, there was $2.6 million of unrecognized compensation cost related to nonvested RSUs. That cost is expected to be recognized over a weighted-average period of 1.3 years. CTS recognizes expense on a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in substance, multiple awards.

Performance-Based Restricted Stock Units

On February 6, 2007, CTS granted performance-based restricted stock unit awards for certain executives. Executives received a total of 17,100 units based on achievement of year-over-year sales growth and free cash flow performance goals for fiscal year 2007. These units will cliff vest and convert one-for-one to CTS common stock on December 31, 2010.

On February 8, 2008, CTS granted performance-based restricted stock unit awards to certain executives. Vesting may occur, if at all, at a rate from zero percent to 200% of the target amount of 42,200 units in 2010 subject to certification of the 2009 fiscal year results by CTS' independent auditors. Vesting is dependent upon CTS' achievement of sales growth targets. No awards were granted as the sales growth targets were not met.

On February 2, 2010, CTS granted performance-based restricted stock unit awards for certain executives. Vesting may occur in the range from zero percent to 200% of the target amount of 78,000 units in 2012 subject to certification of the 2011 fiscal year results by CTS' independent auditors. Vesting is dependent upon CTS' achievement of sales growth targets.

CTS recorded compensation expense of approximately $74,000 and $177,000 related to performance-based restricted stock units during the three and six month periods ended July 4, 2010, respectively. CTS recorded compensation expense of approximately $16,000 and $51,000 related to performance-based restricted stock units during the three and six month periods ended June 28, 2009, respectively. As of July 4, 2010 there was approximately $530,000 of unrecognized compensation cost related to performance-based RSUs. That cost is expected to be recognized over a weighted-average period 1.1 years.

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Market-Based Restricted Stock Units

On July 2, 2007, CTS granted a market-based restricted stock unit award for an executive officer. An aggregate of 25,000 units may be earned in performance years ending in the following three consecutive years on the anniversary of the award date. Vesting may occur in the range from zero percent to 150% of the target award on the end date of each performance period and is tied exclusively to CTS total stockholder return relative to 32 enumerated peer group companies' total stockholder return rates. The vesting rate will be determined using a matrix based on a percentile ranking of CTS total stockholder return with peer group total shareholder return over a three-year period.

On February 5, 2008, CTS granted market-based restricted stock unit awards for certain executives. In the first half of 2010, 57,300 restricted stock units were vested. Such vesting was dependent upon CTS' total stockholder return relative to 29 enumerated peer group companies' stockholder return rates.

On February 4, 2009, CTS granted market-based restricted stock unit awards for certain executives and key employees. Vesting may occur in the range from zero percent to 200% of the target amount of 128,000 units in 2011. Vesting is dependent upon CTS total stockholder return relative to 28 enumerated peer group companies' stockholder return rates.

On February 2, 2010, CTS granted market-based restricted stock unit awards for certain executives and key employees. Vesting may occur in the range from zero percent to 200% of the target amount of 117,000 units in 2012. Vesting is dependent upon CTS total stockholder return relative to 28 enumerated peer group companies' stockholder return rates.

CTS recorded compensation expense of approximately $173,000 and $441,000 related to market-based restricted stock units during the three and six month periods ended July 4, 2010, respectively. CTS recorded compensation expense of approximately $192,000 and $411,000 related to market-based restricted stock units during the three and six month periods ended June 28, 2009, respectively. As of July 4, 2010, there was approximately $1.1 million of unrecognized compensation cost related to market-based RSUs. That cost is expected to be recognized over a weighted-average period of 1.1 years.

Stock Retirement Plan

The Directors' Plan provides for a portion of the total compensation payable to nonemployee directors to be deferred and paid in CTS stock. The Directors' Plan was frozen effective December 1, 2004. All future grants will be from the 2004 Plan.

NOTE C—Fair Value Measurement

The table below summarizes the financial liability that was measured at fair value on a recurring basis as of July 4, 2010:

($ in thousands)	Carrying Value at July 4, 2010	Quoted Prices in Active Markets for Identical (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

Long-term debt	$ 65,900	$ —	$ 65,900	$ —

The table below summarizes the financial liability that was measured at fair value on a recurring basis as of December 31, 2009:

($ in thousands)	Carrying Value at December 31, 2009	Quoted Prices in Active Markets for Identical (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Long-term debt	$ 50,400	$ —	$ 50,400	$ —

CTS' long-term debt consists of a revolving debt agreement. There is a readily determinable market for CTS' revolving credit debt and is classified within Level 2 of the fair value hierarchy as the market is not deemed to be active. The fair value of long-term debt was measured using a market approach which uses current industry information.

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NOTE D – Inventories, net

Inventories consist of the following:

($ in thousands)	July 4, 2010	December 31, 2009
Finished goods	$ 5,807	$ 7,220
Work-in-process	16,791	12,941
Raw materials	46,188	34,187
Total inventories, net	$ 68,786	$ 54,348

NOTE E – Debt

Long-term debt was comprised of the following:

($ in thousands)	July 4, 2010	December 31, 2009
Revolving credit agreement, weighted-average interest rate of 1.0% (2010), and 1.1% (2009) due in 2011	$65,900	$50,400

On June 27, 2006, CTS entered into a $100 million, unsecured revolving credit agreement. Under the terms of the revolving credit agreement, CTS can expand the credit facility to $150 million, subject to participating banks' approval. There was $65.9 million and $50.4 million outstanding under the revolving credit agreement at July 4, 2010 and December 31, 2009, respectively. At July 4, 2010 and December 31, 2009, CTS had $31.3 million and $46.8 million available under this agreement, net of standby letters of credit of $2.8 million, respectively. Interest rates on the revolving credit agreement fluctuate based upon LIBOR and the Company's quarterly total leverage ratio. CTS pays a commitment fee on the undrawn portion of the revolving credit agreement. The commitment fee varies based on the quarterly leverage ratio and was .15 percent per annum at July 4, 2010. The revolving credit agreement requires, among other things, that CTS comply with a maximum total leverage ratio and a minimum fixed charge coverage ratio. Failure of CTS to comply with these covenants could reduce the borrowing availability under the revolving credit agreement. CTS was in compliance with all debt covenants at July 4, 2010. The revolving credit agreement requires CTS to deliver quarterly financial statements, annual financial statements, auditors certifications and compliance certificates within a specified number of days after the end of a quarter and year-end. Additionally, the revolving agreement contains restrictions limiting CTS' ability to: dispose of assets; incur certain additional debt; repay other debt or amend subordinated debt instruments; create liens on assets; make investments, loans or advances; make acquisitions or engage in mergers or consolidations; engage in certain transactions with CTS' subsidiaries and affiliates; and the amounts allowed for stock repurchases and dividend payments. The revolving credit agreement expires in June 2011. CTS has the intent and ability to renew its obligation incurred under the revolving credit agreement for a period extending beyond one year from the balance-sheet date on or before the expiration date.

NOTE F – Retirement Plans

Net pension (income)/postretirement expense for the three and six-months ended July 4, 2010 and June 28, 2009 include the following components:

	Three Months Ended	Six Months Ended

($ in thousands)	July 4, 2010	June 28, 2009	July 4, 2010	June 28, 2009
PENSION PLANS				
Service cost	$744	$779	$1,491	$1,558
Interest cost	3,310	3,440	6,642	6,872
Expected return on plan assets (1)	(6,079)	(6,101)	(12,162)	(12,197)
Settlement cost	—	—	234	—
Amortization of prior service cost	153	126	510	252
Amortization of loss	991	1,221	1,990	2,442
Net pension income	$(881)	$(535)	$(1,295)	$(1,073)

1) Expected return on plan assets is net of expected investment expenses and certain administrative expenses.

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($ in thousands)	Three Months Ended July 4, 2010	Three Months Ended June 28, 2009	Six Months Ended July 4, 2010	Six Months Ended June 28, 2009
OTHER POSTRETIREMENT BENEFIT PLAN				
Service cost	$3	$2	$6	$5
Interest cost	75	79	150	157
Amortization of gain	—	(25)	—	(50)
Net postretirement expense	$78	$56	$156	$112

NOTE G – Segments

CTS' reportable segments are grouped by entities that exhibit similar economic characteristics and the segments' reporting results are regularly reviewed by CTS' chief operating decision maker to make decisions about resources to be allocated to these segments and to evaluate the segments' performance.

CTS has two reportable segments: 1) EMS and 2) Components and Sensors. EMS includes the higher level assembly of electronic and mechanical components into a finished subassembly or assembly performed under a contract manufacturing agreement with an original equipment manufacturer ("OEM") or other contract manufacturer. Additionally, for some customers, CTS provides full turnkey manufacturing and completion including design, bill-of-material management, logistics, and repair.

Components and sensors are products which perform specific electronic functions for a given product family and are intended for use in customer assemblies. Components and sensors consist principally of automotive sensors and actuators used in commercial or consumer vehicles; electronic components used in communications infrastructure and computer markets; terminators used in computer and other high speed applications, switches, resistor networks, and potentiometers used to serve multiple markets.

The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies in the Company's annual report on Form 10-K. Management evaluates performance based upon segment operating earnings before restructuring and restructuring-related charges, goodwill impairment, interest expense, other non-operating income, and income tax expense.

Summarized financial information concerning CTS' reportable segments is shown in the following table:

($ in thousands)	EMS	Components and Sensors	Total
Second Quarter of 2010			
Net sales to external customers	$ 66,624	$ 72,227	$138,851
Segment operating (loss)/earnings	$ (201)	$ 7,942	$ 7,741
Total assets	$128,248	$319,199	$447,447
Second Quarter of 2009			
Net sales to external customers	$ 70,807	$ 49,591	$120,398
Segment operating earnings	$ 1,081	$ 2,088	$ 3,169
Total assets	$125,491	$268,864	$394,355
First Six Months of 2010			

Net sales to external customers	$122,583	$145,671	$268,254
Segment operating (loss)/earnings	$ (2,879)	$ 16,967	$ 14,088
Total assets	$128,248	$319,199	$447,447
First Six Months of 2009			
Net sales to external customers	$146,629	$ 91,900	$238,529
Segment operating earnings/(loss)	$ 4,345	$ (1,320)	$ 3,025
Total assets	$125,491	$268,864	$394,355

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Reconciling information between reportable segments' operating earnings and CTS' consolidated pre-tax income is shown in the following table:

	Three Months Ended		Six Months Ended	
($ in thousands)	July 4, 2010	June 28, 2009	July 4, 2010	June 28, 2009
Total segment operating earnings	$7,741	$3,169	$14,088	$3,025
Restructuring and related charges	—	—	—	(2,243)
Goodwill impairment	—	—	—	(33,153)
Interest expense	(228)	(471)	(463)	(1,359)
Interest income	81	31	134	101
Other expense	(337)	(25)	(821)	(346)
Earnings/(loss) before income taxes	$7,257	$2,704	$12,938	$(33,975)

NOTE H – Contingencies

Certain processes in the manufacture of CTS' current and past products create hazardous waste by-products as currently defined by federal and state laws and regulations. CTS has been notified by the U.S. Environmental Protection Agency, state environmental agencies and, in some cases, generator groups, that it is or may be a potentially responsible party regarding hazardous waste remediation at several non-CTS sites. In addition to these non-CTS sites, CTS has an ongoing practice of providing reserves for probable remediation activities at certain of its manufacturing locations and for claims and proceedings against CTS with respect to other environmental matters. In the opinion of management, based upon presently available information relating to all such matters, either adequate provision for probable costs has been made, or the ultimate costs resulting will not materially affect the consolidated financial position, results of operations, or cash flows of CTS.

CTS manufactures accelerator pedals for a number of automobile manufacturers, including subsidiaries of Toyota Motor Corporation ("Toyota"). In January 2010, Toyota initiated a recall of approximately 2.3 million vehicles in North America containing pedals manufactured by CTS. The pedal recall and associated events have led to the Company being named as a co-defendant with Toyota in certain litigation. In February 2010, CTS entered into an agreement with Toyota whereby Toyota agreed that it will indemnify, defend, and hold the Company harmless from, and the parties will cooperate in the defense of, third-party civil claims and actions that are filed or asserted in the United States or Canada and that arise from or relate to alleged incidents of unintended acceleration of Toyota and Lexus vehicles. The limited exceptions to indemnification restrict CTS' share of any liability to amounts collectable from its insurers.

Certain other claims are pending against CTS with respect to matters arising out of the ordinary conduct of the Company's business. For all other claims, in the opinion of management, based upon presently available information, either adequate provision for anticipated costs has been accrued or the ultimate anticipated costs will not materially affect CTS' consolidated financial position, results of operations, or cash flows.

NOTE I – Restructuring

In March 2009, CTS initiated certain restructuring actions to reorganize certain operations to further improve its cost structure. These actions resulted in the elimination of approximately 268 positions and were completed in the first quarter of 2009.

The following table displays the planned restructuring and restructuring-related charges associated with the realignment, as well as a summary of the actual costs incurred through March 29, 2009:

($ in millions)	March 2009 Plan	Planned Costs	Actual incurred through March 29, 2009
Workforce reduction		$1.9	$2.1
Asset impairments		—	0.1
Total restructuring and impairment charge		$1.9	$2.2

Of the restructuring and impairment costs incurred, $2.1 million relates to the Components and Sensors segment and $0.1 million relates to the EMS segment. Restructuring charges are reported on a separate line on the Unaudited Consolidated Statements of Earnings/ (Loss) and the restructuring-related costs are included in cost of goods sold.

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The following table displays the restructuring reserve activity related to the realignment for the period ended March 29, 2009:

($ in millions)	March 2009 Plan	
Restructuring liability at January 1, 2009	$	—
Restructuring and restructuring-related charges, excluding asset impairments and write-offs		2.1
Cost paid		(2.1)
Restructuring liability at December 31, 2009	$	—

NOTE J –Earnings/(Loss) Per Share

The table below provides a reconciliation of the numerator and denominator of the basic and diluted earnings/ (loss) per share ("EPS") computations. Basic earnings/ (loss) per share is calculated using the weighted average number of common shares outstanding as the denominator and net earnings/ (loss) as the numerator. Diluted earnings/ (loss) per share is calculated by adding all potentially dilutive shares to the weighted average number of common shares outstanding for the numerator. The if-converted method, whereby interest expense (on a net-of-tax basis) from the convertible senior subordinated debentures is added to net earnings/ (loss) for the numerator. All anti-dilutive shares are excluded from the computation of diluted earnings/ (loss) per share. The calculations below provide net earnings, average common shares outstanding, and the resultant earnings per share for both basic and diluted EPS for the three and six-month periods ended July 4, 2010 and June 28, 2009.

($ in thousands, except per share amounts)	Net Earnings (Numerator)	Shares (in thousands) (Denominator)	Per Share Amount
Second Quarter 2010			
Basic EPS	$ 5,892	34,048	$ 0.17
Effect of dilutive securities:			
Equity-based compensation plans	—	826	
Diluted EPS	$ 5,892	34,874	$ 0.17
Second Quarter 2009			
Basic EPS	$ (7,025)	33,779	$ (0.21)
Effect of dilutive securities:			
Equity-based compensation plans	—	—	
Diluted EPS	$ (7,025)	33,779	$ (0.21)
First Six Months of 2010			
Basic EPS	$ 10,323	34,001	$ 0.30
Effect of dilutive securities:			
Equity-based compensation plans	—	810	
Diluted EPS	$ 10,323	34,811	$ 0.30
First Six Months of 2009			
Basic EPS	$ (42,674)	33,762	$ (1.26)
Effect of dilutive securities:			
Equity-based compensation plans	—	—	
Diluted EPS	$ (42,674)	33,762	$ (1.26)

The following table shows the potentially dilutive securities which have been excluded from the three and six-month periods 2010 and 2009 dilutive earnings per share calculation because they are either anti-dilutive, or the exercise price exceeds the average market price.

	Three Months Ended		Six Months Ended	
(Number of Shares in Thousands)	July 4, 2010	June 28, 2009	July 4, 2010	June 28, 2009
Stock options where the assumed proceeds exceeds the average market price	602	1,197	602	1,241
Restricted stock units	—	637	—	566
Securities related to the subordinated convertible debt	—	786	—	1,476

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NOTE K – Treasury Stock

Common stock held in treasury totaled 20,320,759 shares with a cost of $297.0 million, at July 4, 2010 and December 31, 2009. Approximately 6.5 million shares are available for future issuances.

In May 2008, CTS' Board of Directors authorized a program to repurchase up to one million shares of its common stock in the open market at a maximum price of $13 per share. The authorization has no expiration. Reacquired shares will be used to support equity-based compensation programs and for other corporate purposes. No shares were repurchased under this program in 2009 and 2010 year-to-date.

NOTE L – Goodwill and Other Intangible Assets

CTS has the following other intangible assets and goodwill as of:

($ in thousands)	July 4, 2010 Gross Carrying Amount	July 4, 2010 Accumulated Amortization	December 31, 2009 Gross Carrying Amount	December 31, 2009 Accumulated Amortization
Amortized intangible assets:				
Customer lists/relationships	$ 51,084	$ (18,785)	$ 51,084	$ (17,544)
Patents	10,319	(10,319)	10,319	(10,319)
Other intangibles	500	(127)	500	(102)
Total	61,903	(29,231)	61,903	(27,965)
Goodwill	500	—	500	—
Total other intangible assets and goodwill	$ 62,403	$ (29,231)	$ 62,403	$ (27,965)

Of the net intangible assets at July 4, 2010, $7.8 million relates to the EMS segment and $25.4 million relates to the Components and Sensors segment. CTS recorded amortization expense of $0.6 million and $1.3 million during the three and six-month periods ended July 4, 2010, respectively. CTS recorded amortization expense of $0.8 million and $1.7 million during the three and six-month periods ended June 28, 2009, respectively. CTS estimates remaining amortization expense of $1.2 million in 2010, $2.4 million per year in years 2011 through 2014, and $21.9 million thereafter.

In light of a continuous decline in CTS' market capitalization in the first quarter of 2009, CTS determined that an interim impairment test was necessary at the end of the first quarter of 2009 for two of its reporting units. After completing step one of the prescribed test, CTS determined that the estimated fair values of both reporting units were less than their book values on March 29, 2009. CTS performed the step two test and concluded that the reporting units' goodwill were impaired. As a result, an impairment loss of $33.2 million was recorded in the first quarter of 2009. Of the $33.2 million impairment loss, $30.8 million was related to the EMS segment and $2.4 million was related to the Components and Sensors segment. This non-cash goodwill impairment had no impact on CTS' debt covenants.

NOTE M – Recent Accounting Pronouncements

ASU 2010-06, "Fair Value Measurements and Disclosures – Improving Disclosures about Fair Value Measurements"

In January 2010, the FASB issued ASU 2010-06, "Fair Value Measurements and Disclosures – Improving Disclosures about Fair Value Measurements" ("ASU 2010-06"), that amends ASC Subtopic 820-10, "Fair Value Measurements and Disclosures – Overall", and requires reporting entities to disclose (1) the amount of significant transfers in and out of

Level 1 and Level 2 fair value measurements and describe the reasons for the transfers, and (2) separate information about purchases, sales, issuance and settlements in the reconciliation of fair value measurements using significant unobservable inputs (Level 3). ASU 2010-06 also requires reporting entities to provide fair value measurement disclosures for each class of assets and liabilities and disclose the inputs and valuation techniques for fair value measurements that fall within Levels 2 and 3 of the fair value hierarchy. These disclosures and clarification are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuance, and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The Company adopted the provisions of ASU 2010-06 and the provisions of ASU 2010-06 did not have a material impact on CTS' consolidated financial statements.

ASU 2010-09, "Subsequent Events – Amendments to Certain Recognition and Disclosure Requirements"

In February 2010, the FASB issued ASU 2010-09, "Subsequent Events – Amendments to Certain Recognition and Disclosure Requirements" ("ASU 2010-09"), that amends ASC Subtopic 855-10, "Subsequent Events – Overall" ("ASC 855-10"). ASU 2010-09 requires an SEC filer to evaluate subsequent events through the date that the financial statements are issued but removed the requirement to disclose this date in the notes to the entity's financial statements. The amendments are effective upon issuance of the final update and accordingly, CTS has adopted the provisions of ASU 2010-09. The adoption of these provisions did not have a material impact on CTS' consolidated financial statements.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A")

Overview

CTS Corporation ("we", "our", "us") is a global manufacturer of components and sensors used primarily in the automotive, communications and defense and aerospace markets. We also provide electronic manufacturing solutions, including design and supply chain management functions, primarily serving the defense and aerospace, communications, industrial and medical markets under contract arrangements with original equipment manufacturers.

As discussed in more detail throughout the MD&A:

- Total sales in the second quarter of 2010 of $138.9 million were reported through two segments, Components and Sensors and EMS. Sales increased by $18.5 million, or 15.3%, in the second quarter of 2010 from the second quarter of 2009. Sales in the Components and Sensors segment increased by 45.6% versus the second quarter of 2009, while sales in the EMS segment decreased by 5.9%.

- Gross margin as a percent of sales was 21.9% in the second quarter of 2010 compared to 18.2% in the second quarter of 2009 due to favorable segment sales mix and improved absorption of fixed costs on higher sales volumes. Components and Sensors segment sales, which inherently generates a higher gross margin, increased to 52.0% of total company sales in the second quarter of 2010 compared to 41.2% of total sales in the same period of 2009.

- Selling, general and administrative ("SG&A") expenses were $18.3 million, or 13.2% of sales, in the second quarter of 2010 versus $15.2 million, or 12.7% of sales, in the second quarter of 2009. This increase of $3.1 million primarily relates to higher sales.

- Research and development ("R&D") expenses were $4.3 million, or 3.1% of sales, in the second quarter of 2010 compared to $3.5 million, or 2.9% of sales, in the second quarter of 2009. The slight increase as a percentage of sales was primarily to develop and launch new growth initiatives.

- The second quarter 2010 effective tax rate was 18.8% compared to 359.8% in the second quarter of 2009. The 2009 rate included a tax expense of $9.1 million related to cash repatriation. Excluding this item, the second quarter 2009 adjusted tax rate was 24.1%.

- Net earnings were $5.9 million, or $0.17 per diluted share, in the second quarter of 2010 compared with a loss of $7.0 million, or $0.21 per share, in the second quarter of 2009 which included a tax expense of $0.27 per share related to cash repatriation.

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Critical Accounting Policies

MD&A discusses our unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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.

Management believes that judgment and estimates related to the following critical accounting policies could materially affect our consolidated financial statements:

- Inventory valuation, the allowance for doubtful accounts, and other accrued liabilities
- Long-lived and intangible assets valuation, and depreciation/amortization periods
- Income taxes
- Retirement plans
- Equity-based compensation

In the second quarter of 2010, there were no changes in the above critical accounting policies.

Results of Operations

Comparison of Second Quarter 2010 and Second Quarter 2009

Segment Discussion

Refer to Note G, “Segments”, for a description of our segments.

The following table highlights the segment results for the quarters ending July 4, 2010 and June 28, 2009:

($ in thousands)	Components & Sensors	EMS	Consolidated Total
Second Quarter 2010			
Sales	$ 72,227	$ 66,624	$ 138,851
Segment operating earnings/(loss)	$ 7,942	$ (201)	$ 7,741
% of sales	11.0%	(0.3)%	5.6%
Second Quarter 2009			
Sales	$ 49,591	$ 70,807	$ 120,398
Segment operating earnings	$ 2,088	$ 1,081	$ 3,169
% of sales	4.2%	1.5%	2.6%

Sales in the Components and Sensors segment increased $22.6 million, or 45.6% from the second quarter of 2009, primarily attributable to an increase in automotive market sales of $13.1 million, reflecting strong growth in global light vehicle production, and higher electronic component sales of $9.6 million primarily as a result of generally improved economic trends.

The Components and Sensors segment operating earnings were $7.9 million in the second quarter of 2010 versus $2.1 million in the second quarter of 2009. The favorable earnings change resulted primarily from the impact of higher sales of approximately $7.0 million, partially offset by higher R&D costs of $0.9 million to develop and launch new growth initiatives.

Sales in the EMS segment decreased $4.2 million, or 5.9%, in the second quarter of 2010 from the second quarter of 2009. The decrease in sales was primarily attributable to $5.8 million lower sales to our customer Hewlett-Packard due to a product that essentially reached end-of-life in the second quarter of 2009. End-of-life typically means that the product is no longer required by the customer due to a design change or technological advancement. Further, EMS sales were negatively impacted by $7.0 million in the defense and aerospace market and by $1.8 million in the medical market due to lower customer demand while sales were positively impacted by $7.4 million in the communications market and by $2.6 million to other customers due to generally improved economic conditions.

EMS segment operating loss was $0.2 million in the second quarter of 2010 versus earnings of $1.1 million in the second quarter 2009. The unfavorable earnings change was primarily due to lower sales.

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Total Company Discussion

The following table highlights changes in significant components of the Unaudited Condensed Consolidated Statements of Earnings for the quarters ended July 4, 2010 and June 28, 2009:

	Quarter ended		
($ in thousands, except net earnings per share)	July 4, 2010	June 28, 2009	Increase (Decrease)
Net sales	$ 138,851	$ 120,398	$ 18,453
Gross margin	$ 30,340	$ 21,878	$ 8,462
% of net sales	21.9%	18.2%	3.7%
Selling, general and administrative expenses	$ 18,283	$ 15,243	$ 3,040
% of net sales	13.2%	12.7%	0.5%
Research and development expenses	$ 4,316	$ 3,466	$ 850
% of net sales	3.1%	2.9%	0.2%
Operating earnings	$ 7,741	$ 3,169	$ 4,572
% of net sales	5.6%	2.6%	3.0%
Income tax expense	$ 1,365	$ 9,729	$ (8,364)
Net earnings/(loss)	$ 5,892	$ (7,025)	$ 12,917
% of net sales	4.2%	(5.8)%	10.0%
Net earnings/(loss) per diluted share	$ 0.17	$ (0.21)	$ 0.38

Sales of $138.9 million in the second quarter of 2010 increased $18.5 million, or 15.3%, from the second quarter of 2009. The increase was attributable to the Components and Sensors segment, with higher sales of $22.6 million primarily in the automotive market. EMS segment sales decreased $4.2 million from lower sales to our customer Hewlett-Packard due to a product that essentially reached end-of-life in the second quarter of 2009. End-of-life typically means that the product is no longer required by the customer due to a design change or technological advancement. Further, EMS sales were negatively impacted by $7.0 million in the defense and aerospace market and by $1.8 million in the medical market due to lower customer demand while sales were positively impacted by $7.4 million in the communications market and by $2.6 million to other customers due to generally improved economic conditions.

Gross margin as a percent of sales was 21.9% in the second quarter of 2010 compared to 18.2% in the second quarter of 2009 due to favorable segment sales mix and improved absorption of fixed costs on higher sales volumes. Components and Sensors segment sales, which inherently generates a higher gross margin, increased to 52.0% of total company sales in the second quarter of 2010 compared to 41.2% of total sales in the same period of 2009.

SG&A expenses were $18.3 million, or 13.2% of sales, in the second quarter of 2010 versus $15.2 million, or 12.7% of sales, in the second quarter of 2009. This increase of $3.1 million reflects increased spending of approximately $2.5 million related to higher sales and approximately $0.6 million resulting from the reinstatement of certain compensation-related items that were temporarily suspended during the second quarter of 2009 due to the recessionary economic environment.

R&D expenses were $4.3 million, or 3.1% of sales, in the second quarter of 2010 compared to $3.5 million, or 2.9% of sales, in the second quarter of 2009. The slight increase as a percentage of sales was primarily to develop and launch new growth initiatives. R&D expenses are incurred by the Components and Sensors segment and are primarily focused on expanded applications of existing products and new product development, as well as current product and process enhancements.

Operating earnings were $7.7 million in the second quarter of 2010 compared to $3.2 million in the second quarter of 2009.

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Interest and other expense was $0.5 million in the second quarter of both 2010 and 2009.

The effective tax rate for second quarter 2010 was 18.8% compared to 359.8% in the second quarter of 2009. The 2009 rate included a tax expense of $9.1 million related to cash repatriation. Excluding this item, the adjusted tax rate for second quarter 2009 was 24.1%.

Net earnings were $5.9 million, or $0.17 per diluted share, in the second quarter of 2010 compared with a loss of $7.0 million, or $0.21 per share, in the second quarter of 2009 which included a tax expense of $0.27 per share related to cash repatriation.

Reconciliation of Effective Tax Rate to Adjusted Tax Rate

	For the Quarter Ended June 28, 2009
Calculation of effective tax rate	
Pretax earnings	$ 2,704
Income tax expense	9,729
Effective tax rate	359.8%
Calculation of adjusted tax rate	
Pretax earnings	$ 2,704
Income tax expense	$ 9,729
Tax expense related to repatriation	(9,077)
Adjusted tax expense	$ 652
Adjusted tax rate	24.1%

Adjusted tax expense and adjusted tax rate are non-GAAP financial measures. The most directly comparable GAAP financial measures are income tax expense and effective tax rate, respectively. We calculate adjusted tax expense and adjusted tax rate in the second quarter of 2009 to exclude the tax impact related to our cash repatriation. We exclude the impact of this item as it has a significant impact on comparable GAAP financial measures and could distort an evaluation of our normal operating performance.

Comparison of First Six Months 2010 and First Six Months 2009

Segment Discussion

The following table highlights the segment results for the six-month periods ending July 4, 2010 and June 28, 2009:

($ in thousands)	Components & Sensors	EMS	Consolidated Total
First Six Months 2010			
Sales	$ 145,671	$ 122,583	$ 268,254
Segment operating earnings/(loss)	$ 16,967	$ (2,879)	$ 14,088
% of sales	11.6%	(2.3)%	5.3%
First Six Months 2009			
Sales	$ 91,900	$ 146,629	$ 238,529
Segment operating (loss)/earnings	$ (1,320)	$ 4,345	$ 3,025

% of sales	(1.4)%	3.0%	1.3%

Sales in the Components and Sensors segment increased $53.8 million, or 58.5% from the first six months of 2009, primarily attributed to increased automotive product sales of $37.4 million, reflecting strong growth primarily in global light vehicle production and higher electronic component sales of $16.4 million as a result of generally improved economic trends and new product introductions.

The Components and Sensors segment operating earnings were $17.0 million in the first six months of 2010 versus an operating loss of $1.3 million in the first six months of 2009. The favorable earnings change resulted primarily from the net impact of higher sales partially offset by higher R&D costs of $2.1 million to develop and launch new growth initiatives.

Sales in the EMS segment decreased $24.0 million, or 16.4 %, in the first six months of 2010 versus the first six months of 2009. The decrease in sales was primarily attributable to $18.9 million lower sales in the defense and aerospace market due to reduced customer demand. Further, EMS sales in the computer market were negatively impacted by $13.3 million primarily attributable to lower sales to our customer Hewlett-Packard due to a product that reached end-of-life in the second quarter of 2009 while sales in the communications market were positively impacted by $10.7 million due to generally improved economic conditions.

EMS segment operating losses were $2.9 million in the first six months of 2010 versus earnings of $4.3 million in the first six months of 2009. The unfavorable earnings change was primarily due to lower sales.

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Total Company Discussion

The following table highlights changes in significant components of the Unaudited Condensed Consolidated Statements of Earnings for the six-month periods ended July 4, 2010 and June 28, 2009:

($ in thousands, except net earnings per share)	Six months ended July 4, 2010	June 28, 2009	Increase (Decrease)
Net sales	$ 268,254	$ 238,529	$ 29,725
Gross margin	$ 60,819	$ 41,707	$ 19,112
% of net sales	22.7%	17.5%	5.2%
Selling, general and administrative expenses	$ 37,832	$ 31,863	$ 5,969
% of net sales	14.1%	13.4%	0.7%
Research and development expenses	$ 8,899	$ 6,819	$ 2,080
% of net sales	3.3%	2.9%	0.4%
Restructuring charge	$ —	$ 2,243	$ (2,243)
% of net sales	—%	0.9%	(0.9)%
Goodwill impairment	$ —	$ 33,153	$ (33,153)
% of net sales	—%	13.9%	(13.9)%
Operating earnings/(loss)	$ 14,088	$ (32,371)	$ 46,459
% of net sales	5.3%	(13.6)%	18.9%
Income tax expense	$ 2,615	$ 8,699	$ (6,084)
Net earnings/(loss)	$ 10,323	$ (42,674)	$ 52,997
% of net sales	3.8%	(17.9)%	21.7%
Net earnings/(loss) per diluted share	$ 0.30	$ (1.26)	$ 1.56

Sales of $268.3 million in the first six months of 2010 increased $29.7 million, or 12.5%, from the first six months of 2009. The increase was primarily attributable to the Components and Sensors segment, with higher sales of $53.8 million primarily in the automotive market. EMS segment sales decreased $24.0 million primarily from lower defense and aerospace market sales.

Gross margin as a percent of sales was 22.7% in the first six months of 2010 compared to 17.5% in the first six months of 2009 due to higher absorption of fixed costs on higher sales volumes and favorable segment sales mix. Sales in the Components and Sensors segment, which inherently generates a higher gross margin, increased to 54.3% of total company sales in the first six months of 2010 compared to 38.5% of total sales in the same period of 2009.

SG&A expenses were $37.8 million, or 14.1% of sales, in the first six months of 2010 versus $31.9 million, or 13.4% of sales, in the first six months of 2009. This increase of $6.0 million reflects increased spending of approximately

$5.5 million related to higher sales and approximately $1.2 million resulting from the reinstatement of certain compensation-related items that were temporarily suspended during the second quarter of 2009 due to the recessionary economic environment.

R&D expenses were $8.9 million, or 3.3% of sales, in the first six months of 2010 versus $6.8 million, or 2.9% of sales, in the first six months of 2009. The slight increase as a percentage of sales was primarily to develop and launch new growth initiatives. R&D expenses are incurred by the Components and Sensors segment and are primarily focused on expanded applications of existing products and new product development, as well as current product and process enhancements.

Operating earnings were $14.1 million in the first six months of 2010 compared to a loss was $32.4 million in the first six months of 2009. The first six months of 2009 included a $33.2 million goodwill impairment charge and $2.2 million of restructuring costs associated with the restructuring actions announced in March 2009. No such costs were incurred in the first six months of 2010.

Interest and other expense in the first six months of 2010 was $1.2 million versus $1.6 million in the same period of 2009. The lower expense in 2010 primarily resulted from $0.9 million lower net interest expense due to lower outstanding debt partially offset by higher foreign currency exchange losses of $0.4 million.

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The effective tax rate for the first six months of 2010 was 20.2%. Comparatively, the effective tax rate for the first six months of 2009 was (25.6)%. On a year-to-date basis, income tax expense of $2.6 million was recorded during the first six months of 2010 compared to $8.7 million during the first six months of 2009. The 2009 expense included a tax expense of $9.1 million related to cash repatriation and a tax benefit of $0.2 million related to goodwill impairment. Excluding these items, the adjusted tax rate for the first six months of 2009 was 21.0%.

Net earnings of $10.3 million, or $0.30 per diluted share, in the first six months of 2010 compared with a loss of $42.7 million, or $1.26 per share, in the first six months of 2009 which included $0.97 per share for non-cash goodwill impairment, a tax expense of $0.27 per share related to cash repatriation and $0.05 per share of restructuring charges.

Reconciliation of Effective Tax Rate to Adjusted Tax Rate

For the Six-month Period Ended June 28, 2009

Pre-tax (loss)	$	(33,975)
Income tax expense	$	8,699
Effective tax rate		(25.6)%
Pre-tax (loss)	$	(33,975)
Add:		
Goodwill impairment charges		33,153
Adjusted Pre-tax (loss)	$	(822)
Income tax expense	$	8,699
Subtract:		
Tax expense related to cash repatriation and goodwill impairment charges		(8,872)
Adjusted tax (benefit)	$	(173)
Adjusted tax rate		21.0%

Adjusted pre-tax (loss), adjusted tax expense and adjusted tax rate are non-GAAP financial measures. The most directly comparable GAAP financial measures are pre-tax (loss), income tax expense and effective tax rate, respectively. We calculate adjusted pre-tax (loss) to exclude the impact of our goodwill impairment charge. We calculate our adjusted tax expense and adjusted tax rate to exclude the tax impact of our goodwill impairment charge and the tax impact related to our cash repatriation. We exclude the impacts of these items as they have significant impacts on comparable GAAP financial measures and could distort an evaluation of our normal operating performance.

Toyota Recall

We manufacture accelerator pedals for a number of automobile manufacturers, including subsidiaries of Toyota Motor Corporation (“Toyota”). In January 2010, Toyota initiated a recall of approximately 2.3 million vehicles in North America containing pedals manufactured by us. We responded to an inquiry from the National Highway Traffic Safety Administration, which has since closed, and subpoenas from a United States Attorney and the Securities and Exchange Commission related to this event. The pedal recall and associated events also led to our being named as a co-defendant with Toyota in certain litigation. In February 2010, we entered into an agreement with Toyota whereby Toyota agreed that it will indemnify, defend, and hold us harmless from, and the parties will cooperate in the defense of, third-party civil claims and actions that are filed or asserted in the United States or Canada and that arise from or relate to alleged incidents of unintended acceleration of Toyota and Lexus vehicles. The limited exceptions to indemnification restrict our share of any liability to amounts collectible from our insurers.

To date, costs related to the Toyota recall have been immaterial.

Outlook

Based on our first half results and current outlook, and assuming no new economic weakness, management anticipates full-year 2010 diluted earnings per share in the range of $0.55 to $0.62 compared to the previous range of $0.52 to $0.60. Full-year 2010 sales are estimated to increase 10%-15% over 2009 compared to the previous guidance of 12%-20% increase year-over-year.

Liquidity and Capital Resources

Overview

Cash and cash equivalents were $65.2 million at July 4, 2010 and $51.2 million at December 31, 2009. Total debt on July 4, 2010 was $65.9 million, compared to $50.4 million at the end of 2009, as we increased debt primarily to support higher sales. Total debt as a percentage of total capitalization was 20.4% at the end of the second quarter of 2010, compared with 16.9% at the end of 2009. Total debt as a percentage of total capitalization is defined as the sum of notes payable, current portion of long-term debt and long-term debt as a percentage of total debt and shareholders' equity.

Working capital increased $26.2 million in the first six months of 2010 versus year-end 2009, primarily due to increases in cash and cash equivalents of $14.1 million, inventory of $14.4 million and accounts receivable of $12.9 million, partially offset by an increase in accounts payable of $15.8 million.

Cash Flow

Operating Activities

Net cash provided by operating activities was $6.3 million during the first six months of 2010. Components of net cash provided by operating activities included net earnings of $10.3 million and depreciation and amortization expense of $8.8 million, partially offset by net changes in assets and liabilities of $13.0 million. The changes in assets and liabilities, which include the impact of foreign exchange, were primarily due to increased inventories of $14.7 million and increased accounts receivable of $13.8 million partially offset by increased accounts payable and accrued liabilities of $17.1 million, all to support higher sales.

Net cash provided by operating activities was $15.7 million during the first six months of 2009. Components of net cash provided by operating activities include a net loss of $42.7 million, restructuring and asset impairment charges of $35.4 million, depreciation and amortization expense of $10.5 million and net changes in assets and liabilities of $13.1 million. The changes in assets and liabilities were primarily due to decreased accounts payable and accrued liabilities of $27.6 million, decreased accounts receivable of $21.9 million, decreased inventory of $9.5 million and decreased other assets of $8.6 million.

Investing Activities

Net cash used in investing activities for the first six months of 2010 was $5.7 million, of which $6.2 million was for capital expenditures, partially offset by proceeds of $1.0 million received from the sales of assets.

Net cash used in investing activities for the first six months of 2009 was $1.5 million of which $2.9 million was for capital expenditures, partially offset by proceeds of $1.1 million received from the sale of an idle facility.

Financing Activities

Net cash provided by financing activities for the first six months of 2010 was $13.5 million, consisting primarily of a net increase in long-term debt of $15.5 million, offset by $2.0 million in dividend payments. The additional debt was primarily used to meet working capital requirements to support higher sales.

Net cash used by financing activities for the first six months of 2009 was $32.4 million, primarily from paying off the remaining aggregate principal amount of senior subordinated debentures in May 2009. We used cash to fund this debt repayment.

Capital Resources

Refer to Note E, “Debt,” for further discussion.

On June 27, 2006, we entered into a $100 million, unsecured revolving credit agreement. Under the terms of the revolving credit agreement, we can expand the credit facility to $150 million, subject to participating banks’ approval. There was $65.9 million and $50.4 million outstanding under the revolving credit agreement at July 4, 2010 and December 31, 2009, respectively. At July 4, 2010 and December 31, 2009, We had $31.3 million and $46.8 million available under this agreement, net of standby letters of credit of $2.8 million, respectively. Interest rates on the revolving credit agreement fluctuate based upon LIBOR and our quarterly total leverage ratio. We pay a commitment fee on the undrawn portion of the revolving credit agreement. The commitment fee varies based on the quarterly leverage ratio and was 0.15 percent per annum at July 4, 2010. The revolving credit agreement requires, among other things, that we comply with a maximum total leverage ratio and a minimum fixed charge coverage ratio. Failure to comply with these covenants could reduce the borrowing availability under the revolving credit agreement. We were in compliance with all debt covenants as of July 4, 2010. The revolving credit agreement also requires us to deliver quarterly financial statements, annual financial statements, auditor’s certifications and compliance certificates within a specified number of days after the end of a quarter and year-end. Additionally, the revolving agreement contains restrictions limiting our ability to: dispose of assets; incur certain additional debt; repay other debt or amend subordinated debt instruments; create liens on assets; make investments, loans or advances; make acquisitions or engage in mergers or consolidations; engage in certain transactions with our subsidiaries and affiliates; and the amounts allowed for stock repurchases and dividend payments. The revolving credit agreement expires in June 2011. We have the intent and ability to renew our revolving credit agreement for a period extending beyond one year from the balance sheet date on or before the expiration date.

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In May 2008, our Board of Directors authorized a program to repurchase up to one million shares of our common stock in the open market at a maximum price of $13.00 per share. The authorization has no expiration. Reacquired shares will be used to support equity-based compensation programs and for other corporate purposes. No shares were repurchased under this program in 2009 or for the six-month period ended July 4, 2010.

We have historically funded our capital and operating needs primarily through cash flows from operating activities, supported by available credit under our bank credit agreements. We believe that expected positive cash flows from operating activities and available borrowings under current and future credit agreements will be adequate to fund our working capital, capital expenditures and debt service requirements for at least the next twelve months.

Recent Accounting Pronouncements

ASU 2010-06, “Fair Value Measurements and Disclosures – Improving Disclosures about Fair Value Measurements”

In January 2010, the FASB issued ASU 2010-06, “Fair Value Measurements and Disclosures – Improving Disclosures about Fair Value Measurements” (“ASU 2010-06”), that amends ASC Subtopic 820-10, “Fair Value Measurements and Disclosures – Overall”, and requires reporting entities to disclose (1) the amount of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers, and (2) separate information about purchases, sales, issuance and settlements in the reconciliation of fair value measurements using significant unobservable inputs (Level 3). ASU 2010-06 also requires reporting entities to provide fair value measurement disclosures for each class of assets and liabilities and disclose the inputs and valuation techniques for fair value measurements that fall within Levels 2 and 3 of the fair value hierarchy. These disclosures and clarification are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuance, and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. We adopted the provisions of ASU 2010-06 and the provisions of ASU 2010-06 did not have a material impact on our consolidated financial statements.

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Forward-Looking Statements

This document contains statements that are, or may be deemed to be, forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, any financial or other guidance, statements that reflect our current expectations concerning future results and events, and any other statements that are not based solely on historical fact. Forward-looking statements are based on management's expectations, certain assumptions and currently available information. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. These forward-looking statements are made subject to certain risks, uncertainties and other factors, which could cause our actual results, performance or achievements to differ materially from those presented in the forward-looking statements. For more detailed information on the risks and uncertainties associated with our business, see our reports filed with the SEC. Examples of factors that may affect future operating results and financial condition include, but are not limited to: rapid technological change; general market conditions in the automotive, communications, and computer industries, as well as conditions in the industrial, defense and aerospace, and medical markets; reliance on key customers; the ability to protect our intellectual property; pricing pressures and demand for our products; and risks associated with our international operations, including trade and tariff barriers, exchange rates and political and geopolitical risks. We undertake no obligation to publicly update our forward-looking statements to reflect new information or events or circumstances that arise after the date hereof, including market or industry changes.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no other material changes in our market risk since December 31, 2009.

Item 4. Controls and Procedures

Pursuant to Rule 13a-15(e) of the Securities and Exchange Act of 1934, management, under the direction of our Chief Executive Officer and Chief Financial Officer, evaluated our disclosure controls and procedures. Based on such evaluation our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of July 4, 2010.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting for the quarter ended July 4, 2010 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We manufacture accelerator pedals for a number of automobile manufacturers, including subsidiaries of Toyota Motor Corporation ("Toyota"). In January 2010, Toyota initiated a recall of approximately 2.3 million vehicles in North America containing pedals manufactured by CTS. The pedal recall and associated events have led to us being named as a co-defendant with Toyota in certain litigation.

In February 2010, we entered into an agreement with Toyota whereby Toyota agreed that it will indemnify, defend, and hold us harmless from, and the parties will cooperate in the defense of, certain third-party civil claims and actions that are filed or asserted in the United States or Canada and that arise from or relate to alleged incidents of unintended acceleration of Toyota and Lexus vehicles. If it is determined that CTS acted negligently in selecting materials or processes where we had sole control over the selection process, in failing to meet Toyota's specifications, or in making unapproved changes in component design or materials, and such negligence caused or contributed to a claim, we will be responsible for any judgment that may be rendered against us individually, or any portion of a judgment that may be allocated to us, but limited only to the extent of insurance collected from our insurers. Toyota would remain responsible to defend CTS in these actions and would remain responsible for any balance of the remaining liability over amounts recovered by insurance. The agreement also does not cover costs or liabilities in connection with government investigations, government hearings, or government recalls.

Presently, we have been served process and named as co-defendant with Toyota in approximately forty four open lawsuits. The claims brought generally fall into two categories, those that allege sudden unintended acceleration of Toyota vehicles led to injury or death, and those that allege economic harm to owners of Toyota vehicles related to vehicle defects. Some suits combine elements of both. Claims include demands for compensatory and special damages. To date, the only actions filed where we are aware we have been named as a co-defendant are civil actions filed in the Unites States or Canada. All currently open lawsuits are subject to the indemnification agreement described above. Some of these lawsuits arise out of incidents involving models for which we do not manufacture the pedal, such as all Lexus models, the Toyota Prius, and the Toyota Tacoma, or for which we manufacture only a portion of the pedals, such as the Toyota Camry. We anticipate we will be dismissed from those lawsuits where it is found we did not supply the pedal assembly for the particular vehicle at issue. Most lawsuits have been consolidated to be heard in the United States District Court, Southern District of California, though some remain in various other courts.

Certain processes in the manufacture of our current and past products create hazardous waste by-products as currently defined by federal and state laws and regulations. We have been notified by the U.S. Environmental Protection Agency, state environmental agencies, and in some cases, generator groups, that we are or may be a potentially responsible party regarding hazardous waste remediation at several non-CTS sites. In addition to these non-CTS sites, we have an ongoing practice of providing reserves for probable remediation activities at certain of our manufacturing locations and for claims and proceedings against us with respect to other environmental matters. In the opinion of management, based upon all present available information relating to all such matters, either adequate provisions for probable costs has been made, or the ultimate costs resulting will not materially affect our consolidated financial position, results of operations, or cash flows.

Certain other claims are pending against us with respect to matters arising out of the ordinary conduct of our business. For all other claims, in the opinion of management, based upon presently available information, either adequate provision for anticipated costs has been accrued or the ultimate anticipated costs will not materially affect our consolidated financial position, results of operations, or cash flows.

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Item 1A. Risk Factors

There have been no significant changes to our risk factors since December 31, 2009.

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

The Annual Meeting of Shareholders of CTS Corporation was held on May 26, 2010. At the meeting, the following matters were submitted to a vote of the stockholders of CTS:

The following individuals were nominated in 2010 to serve until the next Annual Meeting of Shareholders in 2011. All nominees were elected. The results were as follows:

Director Nominee	For	Withheld	Broker Non-Vote
Walter S. Catlow	28,540,371	790,779	1,967,841
Lawrence J. Ciancia	28,628,407	702,743	1,967,841
Thomas G. Cody	28,538,631	792,519	1,967,841
Patricia K. Collawn	26,671,764	2,659,386	1,967,841
Roger R. Hemminghaus	28,744,320	586,830	1,967,841
Michael A. Henning	28,635,327	695,823	1,967,841
Vinod M. Khilnani	28,399,892	931,258	1,967,841
Robert A. Profusek	28,651,133	680,017	1,967,841

Ratification of Grant Thornton LLP as the Company’s independent registered public accounting firm for the fiscal year ending December 31, 2010:

For	Against	Abstained	Broker Non-Vote
31,216,051	62,253	20,687	------

Item 6. Exhibits

(31)(a) Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

(31)(b) Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

(32)(a) Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(32)(b) Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

CTS Corporation	CTS Corporation
/s/ Richard G. Cutter III Richard G. Cutter III Vice President, Secretary and General Counsel	/s/ Donna L. Belusar Donna L. Belusar Senior Vice President and Chief Financial Officer
Dated: July 27, 2010	Dated: July 27, 2010