

# Shareholder Letter

July 26, 2004

**KellerFurniture**

The Keller Manufacturing Company, Inc.  
1010 Keller Drive, New Salisbury, Indiana 47161

Dear Fellow Shareholders,

I have not had the pleasure of meeting most of you. My name is Keith Williams and I am the Chief Executive Officer of Keller Furniture, the "Company".<sup>1</sup> The new management team, including me, David T. Richardson, Chief Operating Officer, Kenneth B. Fonville, President of our Design Center, and Victor P. Roos, Vice President of Sales and Marketing, have been on board at the Company for three full quarters now, and we have made significant changes to our business model. I believe these changes will increase the Company's ability to satisfy its customers, offer unique and valued product to the marketplace, and create positive cash flows. The market conditions of the furniture industry are turbulent and the industry has seen more change in the last five years than at any other time in recent memory. It is our belief that this turbulence will continue and that the Company's strategy must remain flexible in order to allow the Company to meet new challenges as they arise.

This letter is not intended to interpret the financial results of the Company, but to provide shareholders with management's perspective on the current business prospects of the Company. For information on the Company's financial results, we have provided Selected Quarterly Data at the end of this letter, as well as the Consolidated Financial Statements for the Years Ended December 31, 2003 and 2002 and Independent Auditors' Report, Consolidated Unaudited Financial Statements for the three months ending March 31, 2004 and 2003, as well as the Consolidated Unaudited Financial Statements for the three months and six months ending June 30, 2004 and 2003, which are being provided to shareholders with this letter in anticipation of the Company's 2004 annual meeting. The Company plans to provide quarterly summary financial statements to our shareholders along with a shareholder letter from me. Management knows that it is important to communicate to our shareholders, but we do not intend to regularly update shareholders outside of these quarterly reports and our annual meeting.

Three changes in our industry are currently influencing furniture companies' decision making processes. These three major trends are the consolidation of distribution in our industry, the movement of case goods manufacturing to Asia, and the recent anti-dumping petition and resulting tariff. All three trends are addressed below.

### **Consolidation of Distribution in the Furniture Industry**

Distribution in the U.S. has consolidated at a rapid rate. In many markets, independent retailers are currently struggling while regional chains such as Havertys, Rooms To Go, the Berkshire Hathaway Group (consisting of RC Wiley's, Jordan's, Star Furniture, and Nebraska Furniture Mart) and Art Van are gaining market share. Recent market statistics illustrate this point well. In 2003, the furniture retail market ended flat for the year, while the Top 100 retailers and chains increased sales by approximately 8%. The second significant distribution trend relates to dedicated or brand-specific stores. Ethan Allen, Thomasville, Bassett Furniture, La-Z-Boy and Ashley are among the leaders in dedicated stores. Many of these stores are franchised to independent operators. The bottom line for the Company is that there will be fewer, not more, furniture retailers in the coming years, and choosing the right retailers is extremely

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<sup>1</sup> The Keller Manufacturing Company, Inc. is referred to as "Keller Furniture", "Keller" or the "Company".

important. These retailers will offer more volume to the Company, thus reducing the total supply chain cost to the consumer or end user.

### **Furniture Manufacturing Moves to Asia**

This letter aims to describe some of the challenges facing the Company at this time, both as a result of general market conditions and circumstances which are unique to the Company. More specifically, in reaction to certain economic realities, management no longer believes that the Company can profitably manufacture the vast majority of its products domestically. To that end, the Company began last fall pursuing profitable relationships with manufacturers in China. As discussed below, production in China will create new challenges, but management is confident that this is the best course of action for the future health of the Company.

Keller Furniture is a case goods company. Case goods (generally defined as wood household, bedroom and dining room furniture) are manufactured in Asia, South America, and Eastern Europe at lower prices than can be achieved in the U.S. and with higher quality. One indicator of the magnitude of this shift is the recent announcement made by Industry Canada that China is now the largest supplier of all household furniture categories to Canada - larger than Canada and the U.S combined. In the words of Fred Scheurmann, a director of Haverty Furniture Companies, Inc. and the former CEO of LADD Furniture (a large case goods manufacturer which was acquired by La-Z-Boy in 2000) "If you are in the case goods business domestically, you are insane."

In August of 2003, at the time of the arrival of the current management team, the Company employed approximately 400 people and operated two manufacturing facilities, one in Corydon, Indiana, and one seven miles away in New Salisbury, Indiana. The Company also owned a facility in Culpeper, Virginia that was for sale and unoccupied. In the fourth quarter of 2003 the Culpeper facility was sold and we ceased operations at our Corydon facility. All production was consolidated into our New Salisbury plant by December 2003. Throughout the first and second quarters of 2004 the Corydon plant and equipment were sold.

The Company was ceasing operations at its Corydon facility in late 2003. Management continued to explore opportunities to enter into relationships with Chinese manufacturers. In September 2003, we began sampling our first products from overseas. Our first overseas offering was shown at the October 2003 International Home Furnishings Market in High Point, North Carolina (a trade show for furniture companies). Additionally, members of management began extensive travel throughout Asia developing new products in early 2004. The Company currently has purchase orders outstanding with two manufacturers in China. Although we have maintained a portion of our domestic production capability, including the ability to assemble, finish, package, warehouse and ship, soon we will no longer have the capability to produce component parts.

### **Anti-Dumping Petition and Resulting Tariff on Bedroom Furniture**

Although the price and quality of the Chinese products are good, production in China has recently presented a new challenge to the Company – anti-dumping tariffs. Specifically, anti-dumping tariffs have recently been imposed on bedroom furniture imported from China as a

result of a petition filed with the U.S. Department of Commerce (the "DOC") by certain domestic manufacturers. This anti-dumping petition is the largest anti-dumping case in dollars ever reviewed by the Department of Commerce and directly involves more companies in China (125 in total) than any anti-dumping case in history.

The petition states that Chinese companies are selling below their cost or "dumping" bedroom goods on the U.S. market. The petition also alleges that Chinese entities are supported financially and in some cases managed by the Chinese government. In June, a preliminary ruling was released by the DOC on the bedroom furniture anti-dumping petition. The preliminary ruling imposed various tariff rates based upon information provided to the DOC. Outside of a group of Chinese companies that participated in the initial investigation, the remaining companies were permitted to apply for a "separate rate." The "separate rate" of 10.92% was given to Chinese companies that properly completed a Department of Commerce questionnaire and were able to convince our government that their export activities were not controlled by the Chinese government. All other Chinese companies were given a tariff of 198.02%. The rate of 198.02% applies to Chinese companies that either did not apply for the separate rate or had errors or omissions in their paperwork or were unable to demonstrate that they are not under Chinese government control.

We currently use two plants in China that manufacture all of our new products. Both plants submitted questionnaire responses to the DOC and requested the rate of 10.92%. Both were denied the 10.92% rate based on their preliminary applications, and have been placed in the "all China" rate of 198.02%. This is a preliminary ruling and both plants have filed documents with the Department of Commerce seeking to remedy this preliminary ruling. The Company's position is that these Chinese factories are privately owned and managed and exist to generate profits from their manufacturing activities. The final ruling from the DOC is expected sometime by the end of 2004 and we will continue to work with our Chinese suppliers to obtain the lower rate. This tariff matter is very important to the Company as approximately 60% of our sales are generated from bedroom furniture.

### **Summary of Events**

In addition to the information provided above, the following summarizes significant events occurring over the past three quarters. A schedule of Selected Quarterly Data for 2001, 2002, 2003 and 2004 is attached to this letter for your review.

### **Fourth Quarter 2003 Events**

- We began meeting with Havertys on a regular basis during the fourth quarter. At one time Havertys was the Company's largest customer. Our goal was to place at least one "private-label" collection with Havertys by the summer of 2004. For Havertys, "private-label" product is defined as furniture branded with the Havertys name and without Keller branding.
- Highlights from our show at the October 2003 International Home Furnishings Market in High Point, North Carolina are as follows:
  - o The Company transitioned its sales force from employees to independent sales representatives at this market;

- o We introduced two new collections, Summer Place, a new collection from the ground-up in four finishes, and Cherry Creek, an extension of our successful Chestnut Creek collection, in a cherry finish;
- o Orders placed for new product, as a result of the October market show in High Point, were over three times greater than orders placed as a result of the 2003 April market; and
- o We made the decision to double our showroom space from 7,100 feet to 15,500 feet for the April 2004 High Point market. We based this decision on our plan to offer six new bedroom collections and six new dining room collections all imported from Asia.
- We began discussions with BB&T Capital Markets on a possible going-private transaction in late October.

### **First Quarter 2004 Events**

- The Company closed on the sale of unimproved land in Corydon to the YMCA of Harrison County in January.
- We met with our new Dealer Council members in January. Our Dealer Council is comprised of major retailers, industry analysts, and marketing leaders. The Company's Dealer Council is charged with assisting the Company in matters concerning product, marketing, and distribution strategies.
- The management team spent extensive time with designers, customers, and sales representatives throughout the first quarter in the development of new product.
- The Company management began meeting with banks in February to explore securing a credit facility.
- Keller became a private company in March by de-registering with the Securities and Exchange Commission.

### **Second Quarter 2004 Events**

- The Company presented its new bedroom and new dining room collections at the April 2004 International Home Furnishing Market in High Point, North Carolina. A few of the highlights are as follows:
  - o The Company introduced its six new imported bedroom collections and six new imported dining room collections, all but one of the collections were well received.
  - o Production is almost complete on the five new collections, both bedroom and dining room.
  - o Havertys attended the April market in High Point and reviewed their two new private-label collections, two imported bedrooms and two imported dining rooms. Production is essentially complete on these collections.
  - o We received market orders in April well in excess of the October 2003 market.
  - o Our showroom attendance at market in April increased approximately 60% over the October 2003 market.

- In June, we received a purchase order from Havertys for two private-label bedroom and dining room collections.

### **Current State of Keller in July of 2004**

The following section outlines changes in the Company by comparing the state of the Company in August 2003 to July 2004.

(1) **Employees.** As of August 2003, the Company employed approximately 400 people. As of the writing of this letter, The Company employs approximately 120 people. Of these 120 employees, 74 employees have been given a layoff date under the WARN Act. The WARN Act is a Federal law requiring employers to formally warn employees at least 60 days before their termination date. The termination of these employees will bring our employment level to approximately 40 full-time employees in the next 60-90 days. These reductions are driven almost entirely by the exodus of production in the New Salisbury facility and the importation of product from China.

(2) **Revenue.** Revenue has been declining since 2000. In August 2003 Keller's revenue decline increased in magnitude. This is particularly apparent in the second quarter of 2003 where revenue dropped approximately 38% from the previous quarter and approximately 51% compared to the second quarter of 2002. Revenue continues to decline. In response, we have pruned our product line and retained only those items that our dealers will display on their retail floors. Our new product from Asia has not reached retail floors as yet and we do not anticipate an increase in revenue until that product is available to consumers on the retail floors.

(3) **Losses.** Even though there have been large reductions in operating expenses since August 2003, declining revenue has negated most of the effects of expense reductions at the operating income level.

(4) **Product Line Revenue.** In August 2003, revenue from all full product lines was in decline. All of those product lines are still in decline. Our two new lines, Cherry Creek and Summer Place, however, show increased revenues, primarily due to the fact that there was no previous sales history. Both of these groups have been domestically produced and have now been successfully sampled in Asia for future importation.

(5) **Customers.** As of August 2003, customer attrition mirrored the drop in revenue, as almost every customer account was in decline. Major accounts such as Havertys in Atlanta and Benchmark Furniture in Kansas City, had removed Keller product from their floors entirely, or had begun discounting and closing out the remaining product. As of July 2004, we have been able to regain Havertys, Benchmark Furniture, and other top accounts.

(6) **Company Cost Structure.** In August of 2003, the Company had a cost structure that could not be successful. The Company is now building a cost structure that is capable of generating positive cash flows.

## **Current Challenges, Risks, and Outlook**

We believe that there are two primary challenges currently facing the Company. First, the Chinese manufacturers which are producing our Company's products must obtain a favorable ruling on their application to the DOC to have the 10.92% tariff applied to their products, rather than the current 198.02% tariff. In the alternative, Keller must retrench by entering into relationships with new Chinese manufacturers. Our niche, solid wood bedroom and dining room furniture has steady demand that does not appear to be decreasing. We have greatly reduced our cost structure and are confident in our ability to continue to manage and reduce costs. We have been able to increase our orders for new product at our Fall and Spring High Point markets and believe we can continue to offer products and services that the marketplace will reward.

The second challenge the Company faces is finding sources to provide working capital financing. At this time, we still have some cash available and no debt. Securing a credit facility, however, is very important to our strategy moving forward, as additional working capital will be required to purchase our imported product. Although the Company has approached several banks regarding a credit facility, no commitments have been made and no guarantee exists regarding our ability to obtain financing.

The primary goal of Keller Furniture is to generate positive cash flows and provide returns for our shareholders. As noted in the audit report dated April 15, 2004, Deloitte & Touche LLP, the auditor of the Company's 2003 annual financial statements, has given the Company an unqualified opinion, but expressed doubt about the ability of the company to continue as a going concern due to recurring losses.

Our management team looks forward to your questions at the shareholder meeting on August 18, 2004. We also would like to thank every shareholder for their investment. We do not take your commitment lightly.

**THE KELLER MANUFACTURING COMPANY, INC.**  
**SELECTED QUARTERLY DATA**

	<b>1st Quarter <u>2001</u></b>	<b>2nd Quarter <u>2001</u></b>	<b>3rd Quarter <u>2001</u></b>	<b>4th Quarter <u>2001</u></b>	<b>1st Quarter <u>2002</u></b>	<b>2nd Quarter <u>2002</u></b>	<b>3rd Quarter <u>2002</u></b>	<b>4th Quarter <u>2002</u></b>
Net Sales	11,459,954	10,943,962	11,674,459	9,284,689	9,682,467	9,859,784	8,302,862	8,023,775
% Increase (Decrease) From Previous Qtr	-9.2%	-4.5%	6.7%	-20.5%	4.3%	1.8%	-15.8%	-3.4%
Operating Income (Loss)	560,892	876,114	1,020,678	(6,060,659)	(1,118,531)	(971,316)	(1,273,361)	(3,527,572)
% Increase (Decrease) From Previous Qtr	202.1%	56.2%	16.5%	-693.8%	-81.5%	-13.2%	31.1%	177.0%
Total Stockholders' Equity	35,656,865	35,984,574	35,921,334	31,794,867	30,913,299	30,139,908	29,190,568	24,756,461
% Increase (Decrease) From Previous Qtr	0.7%	0.9%	-0.2%	-11.5%	-2.8%	-2.5%	-3.1%	-15.2%
Chestnut Creek Product Line	5,316,170	5,227,193	5,593,275	4,132,021	4,136,222	4,083,547	3,127,195	3,362,592
% Increase (Decrease) From Previous Qtr	-27.3%	-1.7%	7.0%	-26.1%	0.1%	-1.3%	-23.4%	7.5%
Transitions Product Line	1,509,599	1,916,621	2,245,385	2,508,102	2,575,775	2,856,594	1,701,780	2,027,308
% Increase (Decrease) From Previous Qtr	100.0%	27.0%	17.2%	11.7%	2.7%	10.9%	-40.4%	19.1%

**THE KELLER MANUFACTURING COMPANY, INC.**  
**SELECTED QUARTERLY DATA**

	<u>1st Quarter 2003</u>	<u>2nd Quarter 2003</u>	<u>3rd Quarter 2003</u>	<u>4th Quarter 2003</u>	<u>1st Quarter 2004</u>	<u>2nd Quarter 2004</u>
Net Sales	7,837,469	4,845,299	5,014,462	3,797,686	4,140,655	3,102,867
% Increase (Decrease) From Previous Qtr	-2.3%	-38.2%	3.5%	-24.3%	9.0%	-25.1%
Operating Income (Loss)	(513,933)	(1,672,451)	(5,468,721)	(5,399,797)	(2,113,610)	(4,014,258)
% Increase (Decrease) From Previous Qtr	-85.4%	225.4%	227.0%	-1.3%	-60.9%	89.9%
Total Stockholders' Equity	24,246,993	22,081,391	16,176,924	12,080,399	10,568,847	5,377,814
% Increase (Decrease) From Previous Qtr	-2.1%	-8.9%	-26.7%	-25.3%	-12.5%	-49.1%
Chestnut Creek Product Line	2,910,645	2,296,411	1,968,424	1,519,222	1,103,832	730,326
% Increase (Decrease) From Previous Qtr	-13.4%	-21.1%	-14.3%	-22.8%	-27.3%	-33.8%
Transitions Product Line	2,073,508	1,276,607	1,191,079	935,706	759,488	499,128
% Increase (Decrease) From Previous Qtr	2.3%	-38.4%	-6.7%	-21.4%	-18.8%	-34.3%

***The Keller Manufacturing  
Company, Inc. and  
Subsidiary***

*Consolidated Unaudited Financial Statements  
for the three months and the six months ending  
June 30, 2004 and 2003*

**THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY**

**CONSOLIDATED BALANCE SHEETS  
JUNE 30, 2004 AND 2003 AND DECEMBER 31, 2003**

	<u>2004</u>	<u>2003</u>	<u>2003</u>
	JUNE 30, (Unaudited)		DECEMBER 31, <u>2003</u>
<b>ASSETS</b>			
<b>CURRENT ASSETS:</b>			
Cash	\$ 1,974,804	\$ 1,295,506	\$ 2,648,818
Investments available for sale	250,158	3,776,309	2,760,013
Accounts receivable, less allowance for doubtful accounts of \$860,000 at June 30, 2004 , \$495,000 at June 30, 2003 and \$846,000 at December 31, 2003	1,446,878	3,069,016	1,672,656
Inventories	2,309,120	8,658,827	5,073,080
Deferred tax asset	-	724,646	-
Income taxes refundable	7,421	275,460	1,421
Other current assets	115,397	199,143	95,146
<b>Total Current Assets</b>	<b>6,103,778</b>	<b>17,998,907</b>	<b>12,251,134</b>
<b>PROPERTY, PLANT AND EQUIPMENT - net</b>	<b>4,325,874</b>	<b>8,130,104</b>	<b>4,740,884</b>
<b>OTHER ASSETS:</b>			
Net assets available for sale	-	661,048	371,163
Deferred tax asset	-	86,696	-
<b>Total Other Assets</b>	<b>-</b>	<b>747,744</b>	<b>371,163</b>
<b>TOTAL ASSETS</b>	<b>\$ 10,429,652</b>	<b>\$ 26,876,755</b>	<b>\$ 17,363,181</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
<b>CURRENT LIABILITIES:</b>			
Accounts payable	\$ 1,281,473	\$ 382,261	\$ 1,465,447
Accrued commissions, salaries & withholdings	153,566	383,108	193,702
Accrued vacation	315,000	553,556	393,746
Accrued pension liability	-	576,069	-
Allowance for sales returns	461,189	303,742	480,270
Restructuring reserve	-	-	-
Accrued health, life & workers comp. insurance	599,882	695,655	561,907
Accrued property taxes	180,000	430,899	180,000
Other current liabilities	301,733	22,929	313,715
<b>Total Current Liabilities</b>	<b>3,292,843</b>	<b>3,348,219</b>	<b>3,588,787</b>
<b>LONG-TERM LIABILITIES:</b>			
Accrued pension liability	1,720,415	1,339,255	1,655,415
Deferred income taxes	-	-	-
Other long-term liabilities	38,580	107,890	38,580
<b>Total Long-Term Liabilities</b>	<b>1,758,995</b>	<b>1,447,145</b>	<b>1,693,995</b>
<b>TOTAL LIABILITIES</b>	<b>5,051,838</b>	<b>4,795,364</b>	<b>5,282,782</b>
<b>STOCKHOLDERS' EQUITY:</b>			
Common stock - no par value, authorized 40,000,000 shares, issued and outstanding 4,869,474 (June 30, 2004), 5,177,180 (June 30, 2003) and 5,177,800 (December 31, 2003).	439,523	1,670,207	1,671,317
Deferred stock compensation	171,161	-	73,163
Accumulated other comprehensive loss	(1,655,106)	(1,874,914)	(1,650,088)
Retained earnings	6,422,236	22,286,098	11,986,007
<b>Total Stockholders' Equity</b>	<b>5,377,814</b>	<b>22,081,391</b>	<b>12,080,399</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 10,429,652</b>	<b>\$ 26,876,755</b>	<b>\$ 17,363,181</b>

**THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE THREE MONTHS AND THE SIX MONTHS ENDING JUNE 30, 2004 AND 2003**

	THREE MONTHS ENDING JUNE 30,		SIX MONTHS ENDING JUNE 30,	
	<u>2004</u> (Unaudited)	<u>2003</u> (Unaudited)	<u>2004</u> (Unaudited)	<u>2003</u> (Unaudited)
NET SALES	\$ 3,102,867	\$ 4,845,299	\$ 7,243,522	\$ 12,682,768
COST OF SALES	<u>5,888,525</u>	<u>5,311,466</u>	<u>10,604,638</u>	<u>12,330,208</u>
<b>GROSS PROFIT (LOSS)</b>	<b>(2,785,658)</b>	<b>(466,167)</b>	<b>(3,361,116)</b>	<b>352,560</b>
SELLING, GENERAL AND ADMINISTRATIVE	<u>1,228,600</u>	<u>1,206,284</u>	<u>2,766,752</u>	<u>2,538,944</u>
<b>OPERATING LOSS</b>	<b>(4,014,258)</b>	<b>(1,672,451)</b>	<b>(6,127,868)</b>	<b>(2,186,384)</b>
<b>OTHER INCOME (EXPENSE):</b>				
Interest income	21,525	13,274	39,262	22,001
Interest expense	(341)	-	(1,071)	(5,350)
Gain on sales of fixed assets	4,527	(29,149)	545,861	(29,149)
Other income (expense)	<u>(12,361)</u>	<u>(169,454)</u>	<u>(19,957)</u>	<u>(155,319)</u>
<b>Total Other Income (Expense), net</b>	<b>13,350</b>	<b>(185,329)</b>	<b>564,095</b>	<b>(167,817)</b>
<b>LOSS BEFORE INCOME TAXES</b>	<b>(4,000,908)</b>	<b>(1,857,780)</b>	<b>(5,563,773)</b>	<b>(2,354,201)</b>
INCOME TAX PROVISION (BENEFIT)	<u>-</u>	<u>-</u>	<u>-</u>	<u>(155,880)</u>
<b>NET LOSS</b>	<b>\$ (4,000,908)</b>	<b>\$ (1,857,780)</b>	<b>\$ (5,563,773)</b>	<b>\$ (2,198,321)</b>

**NET LOSS PER SHARE OF COMMON STOCK,  
BASIC AND DILUTIVE -**

Based on weighted average number of shares outstanding of 5,033,802 and 5,272,952 for the six months ending June 30, 2004 and 2003, respectively; and 4,889,803 and 5,246,217 for the three months ending June 30, 2004 and 2003 respectively.

\$ (0.82)	\$ (0.35)	\$ (1.11)	\$ (0.42)
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**THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE THREE MONTHS AND THE SIX MONTHS ENDING JUNE 30, 2004 AND 2003**

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
	(Unaudited)		(Unaudited)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>				
Net Loss	\$ (4,000,908)	\$ (1,857,780)	\$ (5,563,773)	\$ (2,198,321)
<b>Adjustments to reconcile net loss to net cash provided by (used in) operating activities:</b>				
Depreciation	220,000	279,800	460,000	574,568
(Gain) Loss on fixed asset disposals	(4,527)	29,149	(545,861)	29,149
Bad debt expense	-	30,000	-	60,000
Deferred income taxes	-	180	-	(155,880)
Inventory reserve	1,168,936	-	1,168,936	-
Compensation for stock options granted	48,999	-	97,998	-
<b>Changes in Assets and Liabilities</b>				
Accounts receivable	364,501	954,904	225,778	678,801
Inventory	1,224,581	(19,035)	1,595,024	1,130,121
Income taxes refundable / payable	(5,000)	2,026,179	(6,000)	2,026,179
Other current assets	(38,488)	(13,155)	(20,251)	(16,366)
Prepaid pension costs / accrued pension liability	35,000	67,592	65,000	125,422
Accounts payable	(28,552)	(97,794)	(183,974)	(277,904)
Accrued commissions, salaries & withholdings & accrued vacation	(75,162)	(28,840)	(40,136)	(48,120)
Allowance for sales returns	-	-	(19,081)	(44,239)
Restructuring reserve	-	(57,330)	-	(242,299)
Accrued health, life & workers compensation insurance	(13,232)	(29,709)	37,975	(116,212)
Accrued property taxes	-	84,951	-	151,630
Other liabilities	(57,920)	(63,012)	(63,228)	(310,272)
<b>Total Adjustments</b>	<b>2,839,136</b>	<b>3,163,880</b>	<b>2,772,180</b>	<b>3,564,578</b>
<b>Net Cash Provided By (Used In) Operating Activities</b>	<b>(1,161,772)</b>	<b>1,306,100</b>	<b>(2,791,593)</b>	<b>1,366,257</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>				
Purchases of property, plant & equipment	(162,075)	(175,304)	(731,435)	(243,364)
Proceeds from sales of property, plant & equipment	573,754	-	1,575,971	-
Purchases of investments available for sale	(248,752)	(2,029,058)	(1,745,163)	(2,522,872)
Proceeds from disposal of investments available for sale	2,250,000	-	4,250,000	-
<b>Net Cash Provided By (Used In) Investing Activities</b>	<b>2,412,927</b>	<b>(2,204,362)</b>	<b>3,349,373</b>	<b>(2,766,236)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>				
Redemptions of common stock	(1,231,794)	(215,608)	(1,231,794)	(291,752)
Issuance of common stock	-	-	-	-
Dividends paid	-	(92,214)	-	(184,997)
<b>Net Cash Used In Financing Activities</b>	<b>(1,231,794)</b>	<b>(307,822)</b>	<b>(1,231,794)</b>	<b>(476,749)</b>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>19,361</b>	<b>(1,206,084)</b>	<b>(674,014)</b>	<b>(1,876,728)</b>
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	1,955,443	2,501,590	2,648,818	3,172,234
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 1,974,804</b>	<b>\$ 1,295,506</b>	<b>\$ 1,974,804</b>	<b>\$ 1,295,506</b>

***The Keller Manufacturing  
Company, Inc. and  
Subsidiary***

*Consolidated Unaudited Financial Statements  
for the three months ending March 31, 2004  
and 2003*

**THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY**

**CONSOLIDATED BALANCE SHEETS  
MARCH 31, 2004 AND 2003 AND DECEMBER 31, 2003**

	<u>2004</u>	<u>MARCH 31,</u> <u>2003</u> <u>(Unaudited)</u>	<u>DECEMBER 31,</u> <u>2003</u>
<b>ASSETS</b>			
<b>CURRENT ASSETS:</b>			
Cash	\$ 1,955,443	\$ 2,501,590	\$ 2,648,818
Investments available for sale	2,258,736	1,747,251	2,760,013
Accounts receivable, less allowance for doubtful accounts of \$841,000 at March 31, 2004, \$420,000 at March 31, 2003 and \$846,000 at December 31, 2003	1,811,379	4,053,920	1,672,656
Inventories	4,702,637	8,639,792	5,073,080
Deferred tax asset	-	991,607	-
Income taxes refundable	2,421	2,301,639	1,421
Other current assets	76,909	185,988	95,146
<b>Total Current Assets</b>	<b>10,807,525</b>	<b>20,421,787</b>	<b>12,251,134</b>
<b>PROPERTY, PLANT AND EQUIPMENT - net</b>	<b>4,814,867</b>	<b>8,263,749</b>	<b>4,740,884</b>
<b>OTHER ASSETS:</b>			
Net assets available for sale	138,159	661,048	371,163
Deferred tax asset	-	-	-
<b>Total Other Assets</b>	<b>138,159</b>	<b>661,048</b>	<b>371,163</b>
<b>TOTAL ASSETS</b>	<b>\$ 15,760,551</b>	<b>\$ 29,346,584</b>	<b>\$ 17,363,181</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
<b>CURRENT LIABILITIES:</b>			
Accounts payable	\$ 1,310,025	\$ 480,055	\$ 1,465,447
Accrued commissions, salaries & withholdings	119,849	420,292	193,702
Accrued vacation	380,531	545,212	393,746
Accrued pension liability	-	508,477	-
Allowance for sales returns	480,270	303,742	480,270
Restructuring reserve	-	57,330	-
Accrued health, life & workers comp. insurance	574,988	725,364	561,907
Accrued property taxes	180,000	345,948	180,000
Other current liabilities	422,046	85,941	313,715
<b>Total Current Liabilities</b>	<b>3,467,709</b>	<b>3,472,361</b>	<b>3,588,787</b>
<b>LONG-TERM LIABILITIES:</b>			
Accrued pension liability	1,685,415	1,339,255	1,655,415
Deferred income taxes	-	180,085	-
Other long-term liabilities	38,580	107,890	38,580
<b>Total Long-Term Liabilities</b>	<b>1,723,995</b>	<b>1,627,230</b>	<b>1,693,995</b>
<b>TOTAL LIABILITIES</b>	<b>5,191,704</b>	<b>5,099,591</b>	<b>5,282,782</b>
<b>STOCKHOLDERS' EQUITY:</b>			
Common stock - no par value, authorized 40,000,000 shares, issued and outstanding 5,177,800 (March 31, 2004), 5,269,111 (March 31, 2003) and 5,177,800 (December 31, 2003).	1,671,317	1,699,863	1,671,317
Deferred stock compensation	122,162	-	73,163
Accumulated other comprehensive loss	(1,647,776)	(1,874,914)	(1,650,088)
Retained earnings	10,423,144	24,422,044	11,986,007
<b>Total Stockholders' Equity</b>	<b>10,568,847</b>	<b>24,246,993</b>	<b>12,080,399</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 15,760,551</b>	<b>\$ 29,346,584</b>	<b>\$ 17,363,181</b>

**THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE THREE MONTHS ENDING MARCH 31, 2004 AND 2003**

	<b>THREE MONTHS ENDING MARCH 31,</b>	
	<b><u>2004</u></b>	<b><u>2003</u></b>
	<b>(Unaudited)</b>	
NET SALES	\$ 4,140,655	\$ 7,837,469
COST OF SALES	<u>4,716,113</u>	<u>7,018,742</u>
<b>GROSS PROFIT (LOSS)</b>	<b>(575,458)</b>	<b>818,727</b>
SELLING, GENERAL AND ADMINISTRATIVE	<u>1,538,152</u>	<u>1,332,660</u>
<b>OPERATING LOSS</b>	<b>(2,113,610)</b>	<b>(513,933)</b>
<b>OTHER INCOME (EXPENSE):</b>		
Interest income	17,737	8,727
Interest expense	(730)	(5,350)
Gain on sales of fixed assets	541,334	-
Other income (expense)	<u>(7,596)</u>	<u>14,135</u>
<b>Total Other Income (Expense), net</b>	<b>550,745</b>	<b>17,512</b>
<b>LOSS BEFORE INCOME TAXES</b>	<b>(1,562,865)</b>	<b>(496,421)</b>
INCOME TAX PROVISION (BENEFIT)	<u>-</u>	<u>(155,880)</u>
<b>NET LOSS</b>	<b><u>\$ (1,562,865)</u></b>	<b><u>\$ (340,541)</u></b>

**NET LOSS PER SHARE OF COMMON STOCK,  
BASIC AND DILUTIVE -**

Based on weighted average number of shares outstanding of 5,177,800 and 5,299,983 at March 31, 2004 and 2003, respectively.

\$ (0.30)    \$ (0.06)

**THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE THREE MONTHS ENDING MARCH 31, 2004 AND 2003**

	THREE MONTHS ENDING MARCH 31,	
	<u>2004</u>	<u>2003</u>
	(Unaudited)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net Loss	\$ (1,562,865)	\$ (340,541)
<b>Adjustments to reconcile net loss to net cash provided by (used in) operating activities:</b>		
Depreciation	240,000	294,768
(Gain) Loss on fixed asset disposals	(541,334)	-
Bad debt expense	-	30,000
Deferred income taxes	-	(156,060)
Compensation for stock options granted	48,999	-
<b>Changes in Assets and Liabilities</b>		
Accounts receivable	(138,723)	(276,103)
Inventory	370,443	1,149,156
Income taxes refundable / payable	(1,000)	-
Other current assets	18,237	(3,211)
Prepaid pension costs / accrued pension liability	30,000	57,830
Accounts payable	(155,422)	(180,110)
Accrued commissions, salaries & withholdings & accrued vacation	(87,068)	(19,280)
Allowance for sales returns	-	(44,239)
Restructuring reserve	-	(184,969)
Accrued health, life & workers compensation insurance	13,081	(86,503)
Accrued property taxes	-	66,679
Other liabilities	135,831	(247,260)
<b>Total Adjustments</b>	<b>(66,956)</b>	<b>400,698</b>
<b>Net Cash Provided By (Used In) Operating Activities</b>	<b>(1,629,821)</b>	<b>60,157</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property, plant & equipment	(569,360)	(68,060)
Proceeds from sales of property, plant & equipment	1,002,217	-
Purchases of investments available for sale	(1,496,411)	(493,814)
Proceeds from disposal of investments available for sale	2,000,000	-
<b>Net Cash Provided By (Used In) Investing Activities</b>	<b>936,446</b>	<b>(561,874)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Redemptions of common stock	-	(76,144)
Issuance of common stock	-	-
Dividends paid	-	(92,783)
<b>Net Cash Used In Financing Activities</b>	<b>-</b>	<b>(168,927)</b>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(693,375)</b>	<b>(670,644)</b>
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	2,648,818	3,172,234
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 1,955,443</b>	<b>\$ 2,501,590</b>

***The Keller Manufacturing  
Company, Inc. and  
Subsidiary***

*Consolidated Financial Statements for the  
Years Ended December 31, 2003 and 2002  
and Independent Auditors' Report*

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of  
The Keller Manufacturing Company, Inc. and Subsidiary  
New Salisbury, Indiana

We have audited the accompanying consolidated balance sheets of The Keller Manufacturing Company, Inc. and subsidiary (the "Company") as of December 31, 2003 and 2002, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements for the year ended December 31, 2003 have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company's recurring losses from operations raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

*Deloitte & Touche LLP*

April 15, 2004

# THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY

## CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2003 AND 2002

ASSETS	2003	2002
CURRENT ASSETS:		
Cash and cash equivalents	\$ 2,648,818	\$ 3,172,234
Investments available for sale	2,760,013	1,253,437
Accounts receivable, less allowance for doubtful accounts of \$846,000 (2003) and \$420,000 (2002)	1,672,656	3,807,817
Inventories	5,073,080	9,788,948
Current deferred tax asset	-	897,451
Income taxes receivable	1,421	2,301,639
Other current assets	<u>95,146</u>	<u>182,777</u>
Total	12,251,134	21,404,303
PROPERTY, PLANT AND EQUIPMENT—Net	4,740,884	8,490,457
NET PROPERTY, PLANT AND EQUIPMENT HELD FOR SALE	<u>371,163</u>	<u>661,048</u>
<b>TOTAL</b>	<b><u>\$ 17,363,181</u></b>	<b><u>\$ 30,555,808</u></b>
 <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
CURRENT LIABILITIES:		
Accounts payable	\$ 1,465,447	\$ 660,165
Commissions, salaries and withholdings	193,702	436,889
Accrued vacation	393,746	547,895
Accrued pension liability	-	450,647
Allowance for sales returns	480,270	347,981
Restructuring reserve	-	242,299
Accrued health, life & workers' compensation insurance	561,907	816,885
Accrued property taxes	180,000	279,269
Other current liabilities	<u>313,715</u>	<u>328,183</u>
Total	<u>3,588,787</u>	<u>4,110,213</u>
LONG-TERM LIABILITIES:		
Accrued pension liability	1,655,415	1,339,255
Deferred tax liability	-	241,989
Other long-term liabilities	<u>38,580</u>	<u>107,890</u>
Total	<u>1,693,995</u>	<u>1,689,134</u>
Total Liabilities	<u>5,282,782</u>	<u>5,799,347</u>
STOCKHOLDERS' EQUITY:		
Common stock—no par value, authorized, 40,000,000 shares	1,671,317	1,710,350
Deferred stock compensation	73,163	
Retained earnings	11,986,007	24,921,025
Accumulated other comprehensive loss:		
Minimum pension liability adjustment	(1,619,623)	(1,874,914)
Market value adjustment on investments held for sale	<u>(30,465)</u>	<u>-</u>
Total	<u>12,080,399</u>	<u>24,756,461</u>
<b>TOTAL</b>	<b><u>\$ 17,363,181</u></b>	<b><u>\$ 30,555,808</u></b>

See notes to consolidated financial statements.

# THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENTS OF OPERATIONS YEARS ENDED DECEMBER 31, 2003 AND 2002

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	2003	2002
NET SALES	\$ 21,494,916	\$ 35,868,888
COST OF SALES	<u>25,815,932</u>	<u>34,579,571</u>
GROSS (LOSS) PROFIT	(4,321,016)	1,289,317
SELLING, GENERAL AND ADMINISTRATIVE	6,272,206	7,484,338
IMPAIRMENT OF FIXED ASSETS	2,461,680	-
RESTRUCTURING CHARGE	<u>-</u>	<u>695,759</u>
OPERATING LOSS	<u>(13,054,902)</u>	<u>(6,890,780)</u>
OTHER INCOME:		
Interest income	125,425	57,307
Interest expense	(5,526)	(3,730)
Gain (loss) on sale of fixed assets	1,008,258	(15,214)
Other	<u>(234,670)</u>	<u>40,281</u>
Other income—net	<u>893,487</u>	<u>78,644</u>
LOSS BEFORE INCOME TAXES	(12,161,415)	(6,812,136)
INCOME TAXES (BENEFIT)	<u>337,000</u>	<u>(2,545,876)</u>
NET LOSS	<u>\$ (12,498,415)</u>	<u>\$ (4,266,260)</u>
NET LOSS PER SHARE OF COMMON STOCK—Basic and dilutive—based on weighted average number of shares outstanding of 5,224,699 (2003) and 5,385,493 (2002), respectively	<u>\$ (2.39)</u>	<u>\$ (0.79)</u>

See notes to consolidated financial statements.

# THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY YEARS ENDED DECEMBER 31, 2003 AND 2002

	Common Stock		Retained Earnings	Deferred Stock Compensation	Accumulated Other Comprehensive Loss, Net of Tax	Total
	Shares	Amount				
BALANCE, JANUARY 1, 2002	5,414,111	\$ 1,746,646	\$ 30,048,221			\$ 31,794,867
Net loss			(4,266,260)			(4,266,260)
Other comprehensive loss:						
Minimum pension liability adjustment, net of tax of \$1,099,724					\$ (1,874,914)	<u>(1,874,914)</u>
Total comprehensive loss						(6,141,174)
Cash dividends declared (\$.105 per share)			(567,197)			(567,197)
Redemptions of common stock	<u>(112,500)</u>	<u>(36,296)</u>	<u>(293,739)</u>			<u>(330,035)</u>
BALANCE, DECEMBER 31, 2002	5,301,611	1,710,350	24,921,025		(1,874,914)	24,756,461
Net loss			(12,498,415)			(12,498,415)
Other comprehensive loss:						
Minimum pension liability adjustment, net of tax of \$148,752					255,291	255,291
Market value adjustment on investments available for sale					(30,465)	<u>(30,465)</u>
Total comprehensive loss						(12,273,589)
Cash dividends declared (\$.035 per share)			(184,996)			(184,996)
Redemptions of common stock	(124,211)	(40,143)	(251,607)			(291,750)
Deferred stock compensation				73,163		73,163
Exercise of stock options	<u>400</u>	<u>1,110</u>				<u>1,110</u>
BALANCE, DECEMBER 31, 2003	<u>5,177,800</u>	<u>\$ 1,671,317</u>	<u>\$ 11,986,007</u>	<u>\$ 73,163</u>	<u>\$ (1,650,088)</u>	<u>\$ 12,080,399</u>

See notes to consolidated financial statements.

# THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2003 AND 2002

	2003	2002
OPERATING ACTIVITIES:		
Net loss	\$ (12,498,415)	\$ (4,266,260)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Loss (gain) on disposal of property, plant and equipment	(1,008,258)	15,214
Depreciation	1,184,761	1,333,504
Loss on impairment of fixed assets	2,461,680	-
Loss on impairment of inventory	1,125,822	-
Bad debt expense	267,433	100,000
Deferred income taxes	506,710	(295,533)
Compensation for stock options granted	73,163	-
Changes in assets and liabilities:		
Accounts receivable	1,867,728	1,569,997
Inventories	3,590,046	4,037,201
Income taxes receivable	2,300,218	(725,343)
Other current assets	87,631	(24,761)
Accrued pension liability	269,556	590,773
Accounts payable	805,282	135,246
Commissions, salaries and withholdings and accrued vacation	(397,336)	(172,042)
Restructuring reserve	(242,299)	242,299
Allowance for sales returns	132,289	102,981
Accrued health, life, & workers' compensation insurance	(254,978)	-
Accrued property taxes	(99,269)	-
Other liabilities	(83,778)	537,788
Net cash provided by operating activities	<u>87,986</u>	<u>3,181,064</u>
INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(436,425)	(450,473)
Proceeds from sale of property, plant and equipment	1,837,700	1,000
Purchases of investments available for sale	(2,439,141)	(1,253,437)
Proceeds from disposal of investments available for sale	902,100	-
Net cash used in investing activities	<u>(135,766)</u>	<u>(1,702,910)</u>
FINANCING ACTIVITIES:		
Redemptions of common stock	(291,750)	(330,035)
Issuance of common stock	1,110	-
Dividends paid	(184,996)	(567,197)
Net cash used in financing activities	<u>(475,636)</u>	<u>(897,232)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(523,416)	580,922
CASH AND CASH EQUIVALENTS—Beginning of year	<u>3,172,234</u>	<u>2,591,312</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 2,648,818</u>	<u>\$ 3,172,234</u>
CASH PAID DURING THE YEAR FOR:		
Interest	<u>\$ 5,500</u>	<u>\$ 3,700</u>
Income taxes refunded	<u>\$ (2,300,000)</u>	<u>\$ (1,525,000)</u>

See notes to consolidated financial statements.

# THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED DECEMBER 31, 2003 AND 2002

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### 1. BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation**—The consolidated financial statements include the accounts of The Keller Manufacturing Company, Inc. and its wholly-owned subsidiary, Keller Dedicated Transportation Company (the “Company”). All significant intercompany transactions and balances have been eliminated.

**Business**—The Company operates in one business segment, which is the manufacturing of dining room and bedroom furniture. Sales are made to retailers located in approximately 40 states across the United States on an unsecured basis.

**Restructuring Charge**—In November, 2002, the Company ceased operations at its Culpeper, Virginia facility. The product lines that were produced at Culpeper have been consolidated to New Salisbury, Indiana. In connection with the restructuring plan for the Culpeper facility, the Company recorded restructuring charges primarily for stay bonuses, severance, legal and other costs necessary to close the facility as follows:

Restructuring charges recorded in 2002	\$ 696,000
Amounts paid in 2002	(438,000)
Amounts charged against restructuring liability	<u>(16,000)</u>
Balance as of December 31, 2002	242,000
Amounts paid in 2003	<u>(242,000)</u>
 Balance as of December 31, 2003	 <u>\$ -</u>

The plant facility and some identified equipment totaling approximately \$661,000 have been classified as held for sale on the Consolidated Balance Sheets as of December 31, 2002. In November, 2003, the Culpeper plant was sold. Net proceeds from the sales were approximately \$1.8 million, which resulted in a gain from the sale of approximately \$1.3 million.

**Impairment of Fixed Assets**—In accordance with the Financial Accounting Standards Board (“FASB”) *Statement of Financial Accounting Standards* (“SFAS”) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company performs reviews for impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. An impairment loss would be recognized when estimated future cash flows expected to result from the use of the asset and its eventual disposition are less than its carrying amount.

In 2003, the Company ceased operations at its Corydon, Indiana facility and consolidated all production in the New Salisbury, Indiana facility. Equipment and improvements with an original cost of \$1.24 million were written off creating a loss of \$319,000. Also related to the Corydon plant closing, equipment and improvements with an original cost of \$6.2 million were adjusted to their net realizable values creating an impairment loss of \$2.5 million. Net realizable values were based on the estimated market values of the assets at September 30, 2003. Equipment totaling approximately \$371,000 has been classified as held for sale on the Consolidated Balance Sheets as of December 31, 2003.

**Significant Customers**—The Company had one significant customer, which accounted for approximately \$3,481,000 (10%) of net sales in 2002. At December 31, 2002, accounts receivable from the significant customer totaled approximately \$52,000. There were no significant customers which accounted for more than 10% of the company's net revenue for the year ending December 31, 2003.

**Cash and Cash Equivalents**—Cash and cash equivalents is defined as cash in banks and investment instruments having maturities of three months or less from their acquisition date.

**Investments**—The Company has evaluated its investment policies consistent with SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities*, which requires that the investment securities be classified as either held-to-maturity, available-for-sale or trading. The Company's investments in marketable debt securities are classified as available for sale and are recorded at fair value with any unrealized holding gains or losses, net of tax, included as a component of other comprehensive income. At December 31, 2003, the change in fair value of approximately \$30,000 was reported as a component of accumulated other comprehensive loss in the Consolidated Statement of Stockholders' Equity. At December 31, 2002, cost approximates fair value.

**Inventories**—Inventories are stated at the lower of cost (first-in, first-out method) or market. During 2003, an inventory obsolescence reserve of approximately \$1.1 million was established for slow moving and obsolete inventories. This amount has been reflected on the Consolidated Balance Sheet at December 31, 2003 as a reduction to the inventory balance, and is included in cost of sales for the year ending December 31, 2003.

**Property, Plant and Equipment**—Property, plant, and equipment are recorded at cost. Depreciation is provided by the straight-line method over the estimated useful lives of the depreciable assets. Estimated lives are 10-45 years for buildings and leasehold improvements, 3-20 years for land improvements and 3-15 years for machinery and equipment.

**Stock-Based Compensation**—The Company has a stock-based compensation plan, which is described more fully in Note 9. The Company measures compensation expense using the intrinsic-value-based method in accordance with Accounting Principle Board No. 25, *Accounting for Stock Issued to Employees*. No stock-based compensation expense is recorded upon the issuance of stock options as the exercise price of all options granted equals the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net loss and loss per share if the Company had applied the fair value recognition provisions of SFAS No. 123:

	<b>2003</b>	<b>2002</b>
Net loss, as reported	\$ (12,498,415)	\$ (4,266,260)
Add: stock-based employee compensation expense included in reported net income, net of related tax effects	73,163	-
Deduct: stock-based compensation determined under fair value based method, net of related tax effects	<u>(1,142,934)</u>	<u>(18,807)</u>
Pro forma net loss	<u>\$ (13,568,186)</u>	<u>\$ (4,285,067)</u>
Net loss per share of common stock:		
Basic and diluted loss per share:		
As reported	\$ (2.39)	\$ (0.79)
Additional stock option compensation, net of tax effects	<u>(0.21)</u>	<u>(0.01)</u>
Pro forma	<u>\$ (2.60)</u>	<u>\$ (0.80)</u>

Fair value was calculated using the Black-Scholes option pricing model. Assumptions used to determine the fair value are as follows:

	<b>2003</b>	<b>2002</b>
Weighted average fair value of options granted	\$ 1.91	\$ 0.74
Assumptions used to determine fair value:		
Dividend yield	0.33%	1 %
Expected volatility	32%	37 %
Risk-free rate of return	4.13%	2.30 %
Expected life of options	5 years	4 years

**Revenue Recognition**—Sales are recorded when goods are delivered to the customer. The Company provides for estimated customer returns and allowances by reducing sales in the period of the sale.

**Shipping Costs**—Shipping costs, billed to customers as revenue, are recorded in cost of sales.

**Research, Development, and Engineering**—Research, development, and engineering expenditures for the creation and application of new and improved products and manufacturing processes were approximately \$423,000 and \$503,000 in 2003 and 2002, respectively. Research, development and engineering costs are charged to operations as incurred.

**Income Taxes**—The Company follows SFAS No. 109 *Accounting for Income Taxes*, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the consolidated financial statements or income tax return.

**Fair Value of Financial Instruments**—The fair values of the Company's current assets and current liabilities approximate their reported carrying values, due to their short-term maturities.

**Disclosure of Certain Significant Risks and Uncertainties**—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

**Disclosure of Going Concern**— The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the accompanying consolidated financial statements, the Company incurred net losses before income taxes of approximately \$12,161,000 and \$6,812,000 for the years ended December 31, 2003 and 2002, respectively. These factors indicate that the Company may be unable to continue as a going concern.

The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. The Company's continuation as a going concern is dependent upon its ability to generate sufficient cash flows to meet its obligations on a timely basis.

Management plans to introduce new imported product lines offered at lower price points than the Company's domestically produced product lines. Management believes a broader product offering with new styles and new price points along with external production sources and other cost reductions will translate into increased revenue and profitability.

## 2. INVENTORIES

	2003	2002
Raw materials	\$ 2,253,040	\$ 3,122,773
Work in process	2,012,729	3,653,633
Finished goods	1,933,133	3,012,542
Inventory obsolescence reserve	<u>(1,125,822)</u>	<u>-</u>
Net	<u>\$ 5,073,080</u>	<u>\$ 9,788,948</u>

### 3. PROPERTY, PLANT AND EQUIPMENT

	<b>2003</b>	<b>2002</b>
Land	\$ 173,239	\$ 337,535
Land improvements	573,208	599,644
Buildings and leasehold improvements	5,497,649	5,740,162
Machinery and equipment	7,482,870	10,337,893
Construction in progress	<u>-</u>	<u>5,513</u>
Total	13,726,966	17,020,747
Less:		
Accumulated depreciation	(7,338,716)	(8,530,290)
Impairment reserve	<u>(1,647,366)</u>	<u>-</u>
Net	<u>\$ 4,740,884</u>	<u>\$ 8,490,457</u>

### 4. INCOME TAXES

Income tax expense (benefit) consists of:

	<b>2003</b>	<b>2002</b>
Currently receivable:		
Federal	\$ (169,710)	\$ (1,896,282)
State	<u>-</u>	<u>(354,061)</u>
Total currently receivable	<u>(169,710)</u>	<u>(2,250,343)</u>
Deferred:		
Federal	(4,027,630)	(258,305)
State	(640,563)	(37,228)
Valuation allowance	<u>5,174,903</u>	<u>-</u>
Total deferred	<u>\$ 506,710</u>	<u>\$ (295,533)</u>
Total	<u>\$ 337,000</u>	<u>\$ (2,545,876)</u>

The components of deferred tax assets and liabilities at December 31 are as follows:

	<b>2003</b>	<b>2002</b>
Deferred tax current assets:		
Allowance for sales returns	\$ 186,067	\$ 63,815
Accrued vacation	118,066	169,813
Accrued severance	39,625	97,539
Restructuring accrual	-	93,872
Allowance for doubtful accounts	327,776	159,331
Reserve for inventory obsolescence	436,167	-
Other	214,057	313,081
Valuation allowance	<u>(1,321,758)</u>	<u>-</u>
Total deferred tax current assets	<u>\$ 0</u>	<u>\$ 897,451</u>
Deferred tax noncurrent assets:		
Pension costs	\$ 612,504	\$ 518,856
Federal and state net operating loss carryforwards	2,906,437	-
Reserve for impairment of fixed assets	953,707	-
Other	<u>71,127</u>	<u>54,494</u>
Total deferred tax noncurrent assets	<u>4,543,775</u>	<u>573,350</u>
Deferred tax long-term liabilities:		
Depreciation	594,661	700,524
Other	<u>95,968</u>	<u>114,815</u>
Total deferred tax long-term liabilities	<u>690,629</u>	<u>815,339</u>
Net total deferred tax long-term assets	(3,853,146)	241,989
Less: valuation allowance	<u>3,853,146</u>	<u>-</u>
Net deferred tax long-term assets	<u>\$ 0</u>	<u>\$ 241,989</u>

The Company has Federal and state net operating loss carryforwards of approximately \$7,266,000 which begins to expire in the year 2023.

A valuation allowance of approximately \$5,175,000 has been recorded to offset the deferred tax assets since the realization of these assets is uncertain.

The difference between taxes computed at the Federal statutory tax rate and the Company's effective tax rate are as follows:

	<b>2003</b>	<b>2002</b>
Statutory Federal income tax rate (benefit)	(34.0)%	(34.0)%
State taxes - net of Federal income tax benefit	(3.8)	(3.8)
Other	0.4	0.4
Effect of valuation allowance	<u>40.2</u>	<u>0.0</u>
Effective income tax rate	<u>2.8</u> %	<u>(37.4)</u> %

## 5. PENSION PLANS

The Company has a defined benefit plan that provides retirement benefits for substantially all employees. Annual contributions to the plan are sufficient to satisfy legal funding requirements. The changes in benefit obligations and plan assets, as well as the funded status of the plan as of December 31, 2003 and 2002, were as follows:

	<b>2003</b>	<b>2002</b>
Benefit obligation at December 31	\$ 12,524,664	\$ 13,591,616
Fair value of plan assets at December 31	<u>10,774,531</u>	<u>10,363,354</u>
Funded status	<u>\$ (1,750,133)</u>	<u>\$ (3,228,262)</u>
Accrued pension liability—current		<u>\$ (450,647)</u>
Accrued pension liability—long term	<u>\$ (1,655,415)</u>	<u>\$ (1,339,255)</u>
Accumulated other comprehensive loss	<u>\$ 2,570,195</u>	<u>\$ 2,974,638</u>
Benefit cost	\$ 720,603	\$ 591,714
Employer contributions	\$ 450,647	-
Benefits paid	\$ 1,018,175	\$ 624,058

In 2003 the plan was frozen resulting in a reduction in the benefit obligation of approximately \$1,300,000.

No contributions were required for 2002.

The plan assets consist primarily of debt and equity securities.

The following weighted-average assumptions were used to determine the Company's obligations under the plan:

	<b>2003</b>	<b>2002</b>
Weighted-average assumptions as of December 31:		
Discount rate	6.25%	6.50%
Expected return on plan assets	7.50%	7.50%
Rate of compensation increase	3.50%	3.50%

The Company has implemented a defined contribution savings plan under the provisions of Section 401(k) of the Internal Revenue Code that provides retirement benefits to substantially all employees. The Company's contributions, which are based upon the salary redirection contributions of the eligible employees, totaled approximately \$22,000 and \$25,000 in 2003 and 2002, respectively.

## **6. LEASE COMMITMENTS**

The Company has operating lease agreements for marketing showroom space and trucking equipment. The equipment leases require additional rentals based upon miles driven at varying fixed rates per mile and require the Company to pay for maintenance, tires, taxes, licenses and permits.

Minimum annual rental payments are as follows:

<b>Year Ended December 31</b>	
2004	\$ 624,206
2005	460,935
2006	244,249
2007	229,586
2008	168,470
	<hr/>
Total	<u>\$ 1,727,446</u>

Total rental expense was approximately \$752,000 (including \$124,000 of contingent rentals) for 2003 and \$787,000 (including \$121,000 of contingent rentals) for 2002.

## **7. EMPLOYEE INCENTIVE AND AWARD PROGRAMS**

During 2002, the Company had incentive programs for executives and key middle management personnel. The programs provide for payment of profit sharing, in cash and common stock, in amounts not to exceed 12% of the annual pre-tax profits of the Company before interest expense and incentive expense. As the Company experienced a net loss in 2002, there was no profit sharing accrued. These incentive programs were terminated during 2003.

Additionally, the Company has award programs which involve the distribution of common stock to employees based on outstanding service. No such awards were given in 2003 or 2002.

## 8. EMPLOYEE HEALTH PLAN

The Company has a medical indemnity plan providing comprehensive major medical benefits for eligible employees and members of their immediate families (“participants”). The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974. The Company’s contributions, which are based upon the contributions of currently employed participants and any additional amounts required to pay benefits for participants, totaled approximately \$1,124,000 and \$1,190,000 in 2003 and 2002, respectively.

## 9. STOCK OPTION PLAN

In January 1999, a stock option plan for eligible employees was approved by the Company. Under the terms of the plan, the Company is authorized to grant options of common shares, not to exceed 200,000 shares, to eligible employees and members of the Board of Directors. Options outstanding are generally exercisable immediately upon grant date. All options expire four years after the date of the grant. This plan expired in 2004.

In August 2003, the Board approved The Keller Manufacturing Company, Inc. 2003 Stock Option Plan. Under the terms of the plan, the Company is authorized to grant options of common shares, not to exceed 585,000 shares, to certain key management employees. In connection with the plan, the Company issued 560,000 options on common shares in August 2003 at an exercise price less than market value with vesting periods over the next four years. The Company recorded approximately \$73,000 of deferred stock compensation expense with a credit to shareholders’ equity during 2003. This amount represents the intrinsic value of stock options earned during the year. Future vesting is contingent upon the continued employment of those executives by the Company. All options under the 2003 Stock Option Plan expire ten years after the date of grant.

The following is a summary of the option transactions under the plans:

	Shares	Weighted Average Exercise Per Share
Balance at December 31, 2001	89,550	\$ 4.78
Granted	25,300	2.55
Forfeited	<u>(23,300)</u>	4.59
Balance at December 31, 2002	91,550	4.21
Granted	560,000	1.00
Exercised	(400)	2.78
Expired	(20,450)	8.00
Forfeited	<u>(31,400)</u>	3.30
Balance at December 31, 2003	<u>599,300</u>	\$ 1.13

A total of 39,300 and 86,700 shares at an average option price per share of \$2.99 and \$4.31 were exercisable at December 31, 2003 and 2002, respectively. At December 31, 2003, 185,700 shares were available for future grants.

Stock options totaling 599,300 and 91,550 in 2003 and 2002, respectively, were excluded from the computation of diluted earnings per share due to their antidilutive effect.

The following table summarizes information about stock options outstanding at December 31, 2003:

<b>Options Outstanding</b>			<b>Options Exercisable</b>	
<b>Exercise Price</b>	<b>Number Outstanding at 12/31/2003</b>	<b>Remaining Contractual Life (Years)</b>	<b>Exercise Price</b>	<b>Number Exercisable at 12/31/2003</b>
\$ 3.50	11,850	0.71	\$ 3.50	11,850
\$ 3.00	13,000	1.71	\$ 3.00	13,000
\$ 2.55	14,450	2.70	\$ 2.55	14,450
\$ 1.00	560,000	4.62	-	-

#### **10. RELATED PARTY TRANSACTIONS**

Beginning in September 2003, the Company leased an apartment for the benefit of a key employee. Rent payments made in 2003 by the Company were \$6,900.

During 2003, the Company paid \$7,500 to key employees for directors' fees.

At December 31, 2002, the Company had a payable of approximately \$90,000 to a board member for consulting services.

#### **11. SUBSEQUENT EVENT – GOING PRIVATE TRANSACTION**

On November, 20 2003, the Company announced a going private transaction in which the Company planned to affect a 1-for-500 reverse stock split of its common stock immediately followed by a 500-for-1 forward stock split. On March 29, 2004 the transaction was effective, reducing the number of shareholders below 300 and terminating the Company's registration with the Securities and Exchange Commission. All shareholders holding less than 500 shares on March 29, 2004 were paid \$4 per share and all shareholders holding 500 or more shares at the time of the transaction held the same number of shares following the transaction. The Company purchased 308,326 shares totaling \$1,233,304 and paid approximately \$200,000 for fees and expenses associated with the transaction.

#### **12. SUBSEQUENT EVENT**

In January 2004, the Company sold real estate property in Corydon, Indiana to a tax exempt organization for \$500,000, which resulted in a gain of \$500,000.

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