

# Shareholder Letter

August 16, 2006

## KellerFurniture

The Keller Manufacturing Company, Inc.  
124 North First Street, Louisville, KY 40202  
502/814-1450 [www.kellerfurniture.com](http://www.kellerfurniture.com)

The purpose of this shareholder letter is to provide an update on what has happened at Keller since our last shareholder letter dated May 26, 2006 and to provide unaudited financial statements for the second quarter of 2006. We have posted this letter, other shareholder letters, press releases, and financial statements on our web site [www.kellerfurniture.com](http://www.kellerfurniture.com) (click on "About Us") for your reference.

As you know, Keller acquired an 85.3% equity interest in Louisville-based Paragon Door Designs, Inc. ("Paragon") in January 2006. Keller's equity interest in Paragon decreased slightly in the second quarter (from 85.3% to 83.9%) because Paragon's Chief Executive Officer exercised stock options during the period. Keller paid \$420,000 for its equity interest in Paragon and contributed an additional \$720,000 to Paragon for debt repayment, for a total investment of \$1,140,000. After the closing of the Paragon transaction, Paragon obtained a \$600,000 credit facility from a commercial bank. In order to obtain this working capital credit facility, the bank required Paragon to obtain the personal guarantees of certain individuals (all of whom are Keller shareholders and some of whom are on the Keller Board of Directors) for the entire \$600,000 credit facility. In order to compensate these individuals during 2006 for granting such personal guarantees, Keller issued warrants to them pursuant to which they have the right to purchase shares of Keller's common stock at \$.01 per share. These warrants, in the aggregate, are exercisable into 60,000 shares of Keller's common stock at any time during the next 10 years and are fully vested. During the second quarter of 2006, warrants covering 50,000 shares were exercised which increased the total number of issued and outstanding shares from 4,870,224 to 4,920,224 (accordingly, 10,000 warrants issued to the guarantors remain unexercised). A former employee of Keller holds warrants exercisable into 308,750 shares of Keller's common stock (none of which have been exercised), as disclosed in the footnotes to the 2005 audited financial statements.

Founded in 1993, Paragon manufactures custom steel and fiberglass residential entry doors and storm doors with a variety of glass styles and finishes. Paragon sells through a network of window and door dealers, remodelers, and home improvement companies in 20 states. Paragon has 27 employees and has been profitable for many years with \$3,670,436 of sales and net income of \$20,271 in 2005. Paragon reported second quarter 2006 net sales of \$1,143,527 and net income of \$85,605. For the first half of 2006, Paragon reported net sales of \$2,089,918 and net income of \$56,102. At June 30, 2006, Paragon had total assets of \$1,125,659 and total liabilities of \$685,115. Paragon's founder, President, and Chief Executive Officer is David N. Burks, an industry veteran with over 25 years of experience. Mr. Burks owns the balance of the equity of Paragon not acquired by Keller. For more information about the products offered by Paragon, please visit [www.paragondoor.com](http://www.paragondoor.com).

In April of 2006, Keller announced publicly that it had initiated formal action with the Pension Benefit Guaranty Corporation ("PBGC") to terminate The Keller Manufacturing Company, Inc. Employees' Pension Plan ("Plan") in what is known as a "distress termination" (the press release issued by Keller is posted on our website). Keller's board of directors has determined that Keller can no longer afford to maintain the Plan. Further, Keller's board has determined that the business associated with Paragon cannot support the ongoing liabilities associated with the Plan. Accordingly, Keller asked the PBGC to approve termination of the Plan. Keller is hopeful that it

will be able to work with the PBGC to finally resolve all Plan liabilities pursuant to terms which are acceptable to the PBGC and affordable for Keller and its new subsidiary, Paragon. However, there can be no assurance that the PBGC will approve the termination of the Plan or that the PBGC will be willing to work with Keller and Paragon to resolve this liability in a manner which will allow Keller to continue to own a significant interest in Paragon. It is possible that the PBGC will require Keller to liquidate its business and sell its controlling interest in Paragon and contribute the proceeds towards settlement of the Keller pension liability.

The Plan's actuaries have calculated an accrued pension liability of \$3,957,368 at December 31, 2005, up from \$3,881,320 at December 31, 2004. However, based on the alternative actuarial methodology used by the PBGC for calculating the pension plan liability on a "termination basis", this accrued pension liability may be substantially higher. Keller plans to make the formal distress termination filing with the PBGC by filing Form 601 sometime later this year.

The initial determination by the Plan's actuaries is that retirement benefits for approximately 98% of the Plan participants should be fully guaranteed by the PBGC and not reduced as a result of the distress termination (this is subject to review and approval by the PBGC). The Plan's actuaries also believe that a small portion of the retirement benefits for those Plan participants who had earnings over \$170,000 annually (less than 2% of the Plan participants) will not be fully guaranteed by the PBGC. The Plan's actuaries estimate that these higher wage earners will experience a reduction in their guaranteed benefits (expected to be less than \$100 per person per month). Keller has communicated directly with all Plan participants regarding the termination action and the impact it may have on their benefits, if any. More information about the funding status of the Plan can be found in the footnotes to the 2005 audited financial statements.

Keller held its annual Shareholders' meeting on June 29, 2006 in Louisville, Kentucky. Ron W. Humin, John C. Schenkenfelder and S. Oden Howell, Jr. were re-elected to the Board of Directors. There were no other actions taken at the Shareholder meeting. Keller's Board of Directors has elected the following officers: Ronald W. Humin, President and Chairman of the Board, S. Oden Howell, Jr., Secretary, and John C. Schenkenfelder, Pension Plan Administrator.

We have tried unsuccessfully to sell the "Keller Furniture" brand name. At this time, we do not believe the "Keller Furniture" brand name has any marketable value. During the second quarter of 2006, Keller entered into a contract to sell 30 acres of vacant land in New Salisbury, Indiana for an amount below the asking price. The land remains listed for sale at \$100,000 since the contract has multiple contingencies and there can be no guarantee the buyer will ultimately close on the purchase.

Several ex-employees continue to assist the Board on a contract basis. The members of the Keller Board of Directors do not receive any compensation for their services. At this time, Keller has no employees and no remaining compensation obligations to former employees. All of Keller's office and warehouse leases have terminated except for the lease covering the Company's corporate office in Louisville, which has been fully paid through December 31, 2006. There can be no guarantee that Keller will ever benefit from its approximate \$22 million of unused net operating losses (NOL's).

Given these factors, Keller shareholders should not expect a dividend or cash distribution in the near term or thereafter as our liabilities significantly exceed our assets.

Keller shares trade on the Pink Sheets over-the-counter market under the symbol “KMFI” or “KMFI.pk”. Shares can be bought or sold by contacting a licensed broker dealer since there are several market makers for Keller shares.

Sincerely,

Ronald W. Humin

Chairman of the Board of Directors  
The Keller Manufacturing Company, Inc.

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

*Unaudited Financial Statements for the three and six  
months ended June 30, 2006 and 2005.*

THE KELLER MANUFACTURING COMPANY, INC.

BALANCE SHEETS

JUNE 30, 2006 AND 2005 AND DECEMBER 31, 2005

|   | <u>2006</u>         | <u>2005</u>         | <u>2005</u>         |
|---|---------------------|---------------------|---------------------|
|   | (Unaudited)         |                     |                     |
| <b>ASSETS</b>   |                     |                     |                     |
| <b>CURRENT ASSETS:</b>  |                     |                     |                     |
| Cash  | \$ 66,892           | \$ 349,799          | \$ 1,395,307        |
| Investments available for sale  | -                   | 1,345,000           | -                   |
| Accounts receivable, less allowance for doubtful accounts of<br>\$0 at June 30, 2006, \$38,000 at June 30,<br>2005 and \$0 at December 31, 2005                       | -                   | 60,107              | -                   |
| Inventories   | -                   | 282,117             | -                   |
| Other current assets  | -                   | -                   | 21,698              |
| <b>Total Current Assets</b>   | <b>66,892</b>       | <b>2,037,023</b>    | <b>1,417,005</b>    |
| <b>PROPERTY, PLANT AND EQUIPMENT - net</b>  | <b>1,222</b>        | <b>5,122</b>        | <b>4,222</b>        |
| <b>OTHER ASSETS</b>   |                     |                     |                     |
| Investment in subsidiary **   | 1,187,688           | -                   | -                   |
| <b>TOTAL ASSETS</b>   | <b>\$ 1,255,802</b> | <b>\$ 2,042,145</b> | <b>\$ 1,421,227</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>   |                     |                     |                     |
| <b>CURRENT LIABILITIES:</b>   |                     |                     |                     |
| Accounts payable  | \$ 3,876            | \$ 94,039           | \$ 29,076           |
| Accrued commissions, salaries & withholdings  | -                   | 17,676              | -                   |
| Allowance for sales returns   | -                   | 50,000              | -                   |
| Accrued health, life & workers compensation insurance   | -                   | 20,000              | -                   |
| Other current liabilities   | 10,000              | 13,095              | 16,585              |
| <b>Total Current Liabilities</b>  | <b>13,876</b>       | <b>194,810</b>      | <b>45,661</b>       |
| <b>LONG-TERM LIABILITIES:</b>   |                     |                     |                     |
| Accrued pension liability   | 3,957,368           | 3,881,320           | 3,957,368           |
| <b>Total Long-Term Liabilities</b>  | <b>3,957,368</b>    | <b>3,881,320</b>    | <b>3,957,368</b>    |
| <b>TOTAL LIABILITIES</b>  | <b>3,971,244</b>    | <b>4,076,130</b>    | <b>4,003,029</b>    |
| <b>STOCKHOLDERS' EQUITY (DEFICIT):</b>  |                     |                     |                     |
| Common stock - no par value, authorized 40,000,000 shares, issued<br>and outstanding 4,920,224 at June 30, 2006, 4,870,224 at June 30,<br>2005 and December 31, 2005. | 440,023             | 439,523             | 439,523             |
| Deferred stock compensation   | 510,519             | 362,813             | 510,519             |
| Accumulated other comprehensive loss  | (3,407,917)         | (3,286,497)         | (3,407,917)         |
| Retained earnings (deficit)   | (258,067)           | 450,176             | (123,927)           |
| <b>Total Stockholders' Equity (Deficit)</b>   | <b>(2,715,442)</b>  | <b>(2,033,985)</b>  | <b>(2,581,802)</b>  |
| <b>TOTAL LIABILITIES AND<br/>STOCKHOLDERS' EQUITY (DEFICIT)</b>   | <b>\$ 1,255,802</b> | <b>\$ 2,042,145</b> | <b>\$ 1,421,227</b> |

\*\*Keller's 85% equity investment in Paragon Door Designs, Inc. has been recorded using the equity method of accounting. This treatment is a departure from generally accepted accounting principles, which requires consolidation at this level of investment.

THE KELLER MANUFACTURING COMPANY, INC.

STATEMENTS OF OPERATIONS  
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2006 AND 2005

|   | THREE MONTHS ENDED<br>JUNE 30, |                            | SIX MONTHS ENDED<br>JUNE 30, |                            |
|---|--------------------------------|----------------------------|------------------------------|----------------------------|
|   | <u>2006</u><br>(Unaudited)     | <u>2005</u><br>(Unaudited) | <u>2006</u><br>(Unaudited)   | <u>2005</u><br>(Unaudited) |
| NET SALES   | \$ -                           | \$ 535,957                 | \$ -                         | \$ 1,796,711               |
| COST OF GOODS SOLD                                | -                              | 468,737                    | -                            | 1,640,233                  |
| <b>GROSS PROFIT</b>                               | -                              | <b>67,220</b>              | -                            | <b>156,478</b>             |
| SELLING, GENERAL AND<br>ADMINISTRATIVE EXPENSES   | 7,763                          | 373,411                    | 200,234                      | 909,570                    |
| <b>OPERATING LOSS</b>                             | <b>(7,763)</b>                 | <b>(306,191)</b>           | <b>(200,234)</b>             | <b>(753,092)</b>           |
| <b>OTHER INCOME (EXPENSE):</b>                    |                                |                            |                              |                            |
| Interest income                                   | -                              | 5,242                      | 2,165                        | 7,086                      |
| Interest expense                                  | -                              | (181)                      | -                            | (210)                      |
| Proportionate share in net income of subsidiary** | 72,764                         | -                          | 47,688                       | -                          |
| Other income (expense)                            | 11,375                         | 34,006                     | 16,241                       | 334,006                    |
| <b>Total Other Income (Expense), net</b>          | <b>84,139</b>                  | <b>39,067</b>              | <b>66,094</b>                | <b>340,882</b>             |
| <b>INCOME (LOSS) BEFORE INCOME TAXES</b>          | <b>76,376</b>                  | <b>(267,124)</b>           | <b>(134,140)</b>             | <b>(412,210)</b>           |
| INCOME TAX PROVISION (BENEFIT)                    | -                              | -                          | -                            | -                          |
| <b>NET INCOME (LOSS)</b>                          | <b>\$ 76,376</b>               | <b>\$ (267,124)</b>        | <b>\$ (134,140)</b>          | <b>\$ (412,210)</b>        |

\*\*Keller's 85% equity investment in Paragon Door Designs, Inc. has been recorded using the equity method of accounting. This treatment is a departure from generally accepted accounting principles, which requires consolidation at this level of investment.

THE KELLER MANUFACTURING COMPANY, INC.

STATEMENTS OF CASH FLOWS  
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2006 AND 2005

|   | THREE MONTHS ENDED<br>JUNE 30, |                    | SIX MONTHS ENDED<br>JUNE 30, |                            |
|---|--------------------------------|--------------------|------------------------------|----------------------------|
|   | <u>2006</u><br>(Unaudited)     | <u>2005</u>        | <u>2006</u><br>(Unaudited)   | <u>2005</u><br>(Unaudited) |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                                |                    |                              |                            |
| Net Income (Loss)   | \$ 76,376                      | \$ (267,124)       | \$ (134,140)                 | \$ (412,210)               |
| <b>Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:</b> |                                |                    |                              |                            |
| Depreciation  | 1,500                          | 450                | 3,000                        | 900                        |
| Increases (decreases) to inventory reserve  | -                              | 55,994             | -                            | (244,006)                  |
| Proportionate share in net (income) of subsidiary**   | (72,764)                       | -                  | (47,688)                     | -                          |
| Compensation for stock options granted  | -                              | 30,711             | -                            | 61,422                     |
| <b>Changes in Assets and Liabilities:</b>   |                                |                    |                              |                            |
| Accounts receivable   | -                              | 444,768            | -                            | 496,048                    |
| Inventory   | -                              | 452,309            | -                            | 1,504,699                  |
| Other current assets  | -                              | -                  | 21,698                       | -                          |
| Accounts payable  | (1,874)                        | 34,053             | (25,200)                     | (594,421)                  |
| Accrued commissions, salaries & withholdings & accrued vacation   | -                              | (7,904)            | -                            | (7,504)                    |
| Allowance for sales returns   | -                              | (20,000)           | -                            | (50,000)                   |
| Accrued health, life & workers compensation insurance   | -                              | (3,524)            | -                            | (34,909)                   |
| Other liabilities   | -                              | 809                | (6,585)                      | (118,954)                  |
| <b>Total Adjustments</b>  | <b>(73,138)</b>                | <b>987,666</b>     | <b>(54,775)</b>              | <b>1,013,275</b>           |
| <b>Net Cash Provided By (Used In) Operating Activities</b>  | <b>3,238</b>                   | <b>720,542</b>     | <b>(188,915)</b>             | <b>601,065</b>             |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                                |                    |                              |                            |
| Purchases of investments available for sale   | -                              | (1,345,000)        | -                            | (1,345,000)                |
| Investment in subsidiary**  | -                              | -                  | (1,140,000)                  | -                          |
| <b>Net Cash Provided By (Used In) Investing Activities</b>  | <b>-</b>                       | <b>(1,345,000)</b> | <b>(1,140,000)</b>           | <b>(1,345,000)</b>         |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                                |                    |                              |                            |
| Issuance of common stock  | 500                            | -                  | 500                          | -                          |
| <b>Net Cash Provided By (Used In) Financing Activities</b>  | <b>500</b>                     | <b>-</b>           | <b>500</b>                   | <b>-</b>                   |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>   | <b>3,738</b>                   | <b>(624,458)</b>   | <b>(1,328,415)</b>           | <b>(743,935)</b>           |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD  | 63,154                         | 974,257            | 1,395,307                    | 1,093,734                  |
| <b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>   | <b>\$ 66,892</b>               | <b>\$ 349,799</b>  | <b>\$ 66,892</b>             | <b>\$ 349,799</b>          |

\*\*Keller's 85% equity investment in Paragon Door Designs, Inc. has been recorded using the equity method of accounting. This treatment is a departure from generally accepted accounting principles, which requires consolidation at this level of investment.