

OBSIDIAN ENTERPRISES INC
Form 10-Q
September 19, 2005

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JULY 31, 2005; 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)

(I.R.S. Employer Identification No.)

**111 MONUMENT CIRCLE, SUITE 4800
INDIANAPOLIS, INDIANA**

46204

(Address of principal executive offices)

(Zip code)

(317) 237-4122

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by checkmark whether the registrant is an accelerated filer (as defined by Rule 12b-2 of the Exchange Act). Yes No

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock \$.0001 par value	Outstanding at September 16, 2005 3,109,333 shares
-----------------------------------	--

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

INDEX

	PAGE(S)
PART I FINANCIAL INFORMATION:	
Item 1 Condensed Consolidated Financial Statements:	
Condensed Consolidated Balance Sheets July 31, 2005 and October 31, 2004	3
Condensed Consolidated Statements of Operations Three and Nine Months Ended July 31, 2005 and 2004	5
Condensed Consolidated Statement of Changes of Stockholders' Deficit And Comprehensive Loss	6
Condensed Consolidated Statements of Cash Flows Nine Months Ended July 31, 2005 and 2004	7
Notes to Condensed Consolidated Financial Statements	9
Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations	23
Item 3 Quantitative and Qualitative Disclosures About Market Risk	37
Item 4 Controls and Procedures	37
PART II OTHER INFORMATION:	
Item 1 Legal Proceedings	39
Item 3 Defaults Upon Senior Securities	39
Item 6 Exhibits	39

Item 1. Financial Statements

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	July 31, 2005	October 31, 2004
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 798	\$ 688
Marketable securities	93	74
Accounts receivable, net of allowance for doubtful accounts of \$734 for 2005 and \$494 for 2004	5,124	5,190
Accounts receivable, related parties (Note 8)	90	71
Inventories, net (Note 2)	10,693	8,971
Prepaid expenses and other assets	690	600
Deferred income tax assets	640	635
Total current assets	18,128	16,229
Property, plant and equipment, net	22,543	23,730
Other assets:		
Intangible assets:		
Goodwill not subject to amortization	7,055	7,055
Noncompete agreements, less accumulated amortization of \$1,027 for 2005 and \$783 for 2004	627	871
Trade name and customer relations, less accumulated amortization of \$478 for 2005 and \$390 for 2004	803	891
Deferred debt costs, less accumulated amortization of \$379 for 2005 and \$289 for 2004	312	277
Idle equipment	353	353
Other	43	13
	\$ 49,864	\$ 49,419

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

	July 31, 2005	October 31, 2004
(unaudited)		
Liabilities and Stockholders' Deficit		
Current liabilities:		
Current portion of long-term debt	\$ 9,986	\$ 18,383
Accounts payable, trade	5,384	5,242
Accounts payable, related parties (Note 8)	2,183	1,268
Accrued compensation	907	830
Accrued expenses and customer deposits	1,260	1,010
Total current liabilities	19,720	26,733
Accounts payable, related parties	556	556
Long-term debt, net of current portion	14,756	8,547
Long-term debt, related parties (Note 8)	28,934	20,299
Deferred income tax liabilities	941	936
Commitments and contingencies:		
Minority interest	175	244
Redeemable stock:		
Common stock, 324,933 shares outstanding for 2005 and 2004	1,344	1,567
Stockholders' equity (deficit):		
Common stock, par value \$.0001 per share; 10,000,000 shares authorized; 3,109,333 in 2005 and 2004	1	1
Additional paid-in capital	13,538	13,315
Accumulated other comprehensive loss	(21)	(40)
Accumulated deficit	(30,080)	(22,739)
Total stockholders' deficit	(16,562)	(9,463)
	\$ 49,864	\$ 49,419

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

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

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

	Three Months Ended		Nine Months Ended	
	July 31, 2005	July 31, 2004	July 31, 2005	July 31, 2004
Net sales	\$ 17,591	\$ 18,227	\$ 50,180	\$ 46,578
Cost of sales	16,104	15,418	46,103	41,602
Gross profit	1,487	2,809	4,077	4,976
Selling, general and administrative expenses	2,360	2,307	7,738	7,666
Income (loss) from operations	(873)	502	(3,661)	(2,690)
<i>Other income (expense):</i>				
Interest expense, net	(1,303)	(1,187)	(3,756)	(3,138)
Other income	19	16	61	41
Loss before income taxes	(2,157)	(669)	(7,356)	(5,787)
Income tax expense	(18)	(17)	(54)	(17)
Loss before minority interest	(2,175)	(686)	(7,410)	(5,804)
Minority interest	28	(9)	69	(33)
Net loss	\$ (2,147)	\$ (695)	\$ (7,341)	\$ (5,837)
Basic and diluted loss per share attributable to common shareholders from continuing operations:	\$ (0.69)	\$ (0.13)	\$ (2.36)	(2.45)
Weighted average common shares outstanding basic and diluted	3,109,333	3,109,333	3,109,333	1,922,908

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

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT AND COMPREHENSIVE LOSS

(dollars in thousands)

(unaudited)

	Comprehensive Loss	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total
Balance at October 31, 2004		3,109,333	\$ 1	\$ 13,315	\$ (40)	\$ (22,739)	\$ (9,463)
Gain on available-for-sale marketable securities	\$ 19				19		19
Fair value adjustment on redeemable Preferred Stock				223			223
Net loss	(7,341)					(7,341)	(7,341)
Total comprehensive loss	(7,322)						
Balance at July 31, 2005		3,109,333	\$ 1	\$ 13,538	\$ (21)	\$ (30,080)	\$ (16,562)

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

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended	
	July 31, 2005	July 31, 2004
Cash flow from operating activities:		
Loss from continuing operations	\$ (7,341)	\$ (5,837)
Adjustments to reconcile loss from continuing operations to net cash used in operating activities:		
Depreciation and amortization	2,615	2,386
Other	310	290
Changes in operating assets and liabilities:		
Accounts receivable, net	66	(149)
Inventories, net	(1,722)	(1,026)
Other, net	222	1,807
Net cash used in operating activities	(5,850)	(2,529)

	Nine Months Ended	
Cash flows from investing activities:		
Purchase of Classic Manufacturing, net of cash acquired		(2,063)
Capital expenditures	(1,538)	(944)
Proceeds from sale of equipment	442	60
Net cash used in investing activities	(1,096)	(2,947)
Cash flows from financing activities:		
Advances from (repayments to) related parties, net	(893)	1,167
Net repayments on lines of credit	(223)	(658)
Proceeds on debt for the purchase of Classic Manufacturing		1,937
Borrowings on long-term debt, including related parties	8,172	2,340
Net cash provided by financing activities	7,056	4,786
Increase (decrease) in cash and cash equivalents	110	(690)
Cash and cash equivalents, beginning of period	688	1,148
Cash and cash equivalents, end of period	\$ 798	\$ 458
Interest paid	\$ 1,983	\$ 1,232
Taxes paid	\$ 55	\$ 57

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

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (in thousands)
 (unaudited)

Nine Months Ended	
July 31, 2005	July 31, 2004

Nine Months Ended

Supplemental disclosure of noncash operating, investing and financing activities:

Fair value change on redeemable preferred stock	\$ 223	\$ 1,094
Assignment and assumption of redeemable preferred stock	\$	\$ 337
Issuance of redeemable stock in conjunction with the acquisition of Classic	\$	\$ 1,250

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

8

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share and share data)

(unaudited)

1. BASIS OF PRESENTATION, DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS:

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

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

Butyl-Rubber Reclaiming

- » U.S. Rubber Reclaiming, Inc. which is engaged in reclaiming scrap butyl rubber into butyl reclaim for resale to manufacturers of rubber products.

Coach Leasing

- » 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), formed December 1, 2002, 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 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*. 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.

Trailer Manufacturing

- » United Acquisition, Inc., which we operate as United Expressline, Inc. ("United"), manufactures and sells general use cargo trailers and specialty trailers used in the racing industry and for other special purposes.
- » Danzer Industries, Inc. ("Danzer"), which is principally engaged in the design, manufacture and sale of truck bodies and cargo trailers.
- » Classic Manufacturing, Inc. ("Classic") was acquired in May 2004. Classic manufactures steel-framed cargo, fifth wheel, gooseneck, motorcycle, race, snowmobile and stacker/lift trailers and open trailers used in the landscape industry.

9

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except per share and share data)
(unaudited)

1. BASIS OF PRESENTATION, DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

The accompanying financial data for the three months ended July 31, 2005 and 2004 and for the nine months ended July 31, 2005 and 2004 has been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. The October 31, 2004 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the period ended October 31, 2004. The Company follows the same accounting policies in preparation of interim reports.

In the opinion of management, all adjustments (which include normal recurring adjustments except as disclosed herein) necessary to present a fair statement of financial position as of July 31, 2005 and results of operations, cash flows and stockholders' deficit for the three and nine months ended July 31, 2005 have been made. The results of operations for the three and nine months ended July 31, 2005 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

BASIS OF PRESENTATION:

The Company's financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. In the period since June 2001, Obsidian Enterprises and its subsidiaries have incurred losses and reductions in equity on a consolidated basis. Historically, losses and certain third-party debt repayments have been financed through loans from DC Investments and its subsidiary Fair Holdings, Inc. (Fair Holdings), entities controlled by the Company's Chairman, on terms that may not have been available from other sources. As of July 31, 2005, total debt outstanding to DC Investments and Fair Holdings was \$28,934.

In view of these matters, realization of assets and satisfaction of liabilities in the ordinary course of business are 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 has taken actions as described below. Although management believes these actions will improve operations and liquidity, there can be no assurance that these actions will improve operations or liquidity, or occur on terms acceptable to the Company.

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except per share and share data)
(unaudited)

1. **BASIS OF PRESENTATION, DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

- >> Obsidian Enterprises has secured a financial commitment from Fair Holdings to provide additional borrowings under a \$15,000 line of credit agreement, which expires on January 1, 2007. Approximately \$2,833 is currently available under the agreement.
- >> United, U.S. Rubber, and Pyramid traditionally had borrowing agreements with Obsidian Enterprises which was funded using Obsidian Enterprises' agreement with Fair Holdings discussed above. During the quarter ended April 30, 2005, these agreements were redocumented between Fair Holdings and United, U.S. Rubber, and Pyramid which allowed for borrowings up to \$3,000, \$3,700, and \$750, respectively, and expire on April 15, 2012. Approximate availability under these agreements is \$839, \$127, and \$142, respectively.
- >> United's line of credit and term loan with First Indiana matured during the fiscal year and the Company refinanced its line and term loan with LaSalle Business Credit, LLC (LaSalle) in July 2005. Under the revolving loan with LaSalle, United can borrow up to 85% of the value of its eligible accounts, plus up to 60% of its eligible raw materials and finished goods up to \$3,000, plus up to 25% of its eligible work in process up to \$150, less reserves of up to \$75; provided that the loan does not exceed \$5,000. The revolving loan matures in July 2008. United also entered into a term loan with LaSalle for \$500 which matures in July 2013. Amount available as of July 31, 2005 under the revolving loan is \$868.
- >> In November 2004, Obsidian Leasing's credit facility with Old National Bank matured and Obsidian Leasing now has current debt obligations due of \$3,062. The Company obtained a forbearance agreement with Old National Bank, which expired August 31, 2005, and is in the process of negotiating an amendment to the forbearance agreement which would extend the expiration date for 90 days, increase the interest rate on the outstanding balance to 15% and require that Obsidian Leasing sell additional coaches. Management is actively working to refinance this debt with other banks in the last quarter of fiscal 2005. Additionally, in November 2004, management sold two older coaches, reducing Obsidian Leasing's debt by \$209.
- >> U.S. Rubber has a balloon payment on its debt which will be due October 24, 2005. The amount outstanding on this debt as of July 31, 2005 is \$5,057. Management is in the initial stages of negotiating and refinancing this debt prior to October 2005.
- >> Management is actively working to restructure or refinance portions of its high interest rate debt on more favorable terms. Approximately \$21,395 of our consolidated debt bears interest from rates ranging from 10% to 15%.
- >> Obsidian Enterprises has an agreement with the investors of Obsidian Capital Partners, a significant shareholder of Obsidian Enterprises, that gives Obsidian Enterprises the right to mandate capital contributions 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 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.

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share and share data)

(unaudited)

1. **BASIS OF PRESENTATION, DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

- >> Cost reduction and other initiatives are being put in place at various Obsidian subsidiaries including the use of alternative materials and additional discounts through volume purchasing by pooling purchasing power from all affiliated companies. Any additional increases in raw material costs are expected to be passed through to customers through price increases to the extent that the market will allow.
- >> Management also continues to look for ways to strengthen liquidity, equity and working capital through ongoing evaluations of merger and acquisition candidates and other recapitalization methods.

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 under Guarantees of Obsidian Capital Partners.

Significant financial covenants in our credit agreements are the maintenance of minimum ratios, levels of earnings to funded debt and fixed charge coverage rate.

SIGNIFICANT ACCOUNTING POLICIES:

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.

GUARANTEES OF OBSIDIAN CAPITAL PARTNERS

We have an agreement with Obsidian Capital 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 Obsidian Capital 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.

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share and share data)

(unaudited)

1. **BASIS OF PRESENTATION, DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement No. 123R, Share-Based Payment, requiring that the compensation cost relating to stock options and other share-based compensation transactions be recognized at fair value in financial statements. Statement No. 123R is effective for the Company for its quarter ending January 31, 2006. The Company will then be required to record any compensation expense using the fair value method in connection with option grants to employees that have an exercise price at or above fair market value at the grant date and for shares issued under its employee stock purchase plan. Management is still evaluating but does not believe that its adoption will have a material impact on the Company's results of operations or financial position.

In March 2005, the Securities Exchange Commission (SEC) issued Staff Accounting Bulletin No. 107, Share-Based Payment (SAB 107). SAB 107 provides the SEC's view on the interaction between SFAS 123R and certain SEC rules and regulations. Specifically, SAB 107 provides guidance on share-based payment transactions with non-employees, valuation methods, accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non GAAP financial measures, capitalization of compensation costs related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS 123R, the modification of employee share options prior to adoption of SFAS 123R and disclosures in Management's Discussion and Analysis subsequent to adoption of SFAS 123R. The adoption of SAB 107 will not have a material impact on our implementation of SFAS 123R.

In May 2005, FASB issued Statement No. 154, Accounting Changes and Error Corrections. This statement replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 applies to all voluntary changes in accounting principle. Opinion No. 20 previously required that most voluntary changes in accounting principle be recognized by including in net income for the period of the change the cumulative effect of changing to the new accounting principle. Statement No. 154 requires retrospective application to prior periods' financial statement of a change in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. When it is impracticable to determine the cumulative effect of applying a change in accounting principle to all prior periods, Statement No. 154 requires that the new accounting principle be applied as if it were adopted prospectively from the earliest date practicable. Statement No. 154 also requires that a change in depreciation, amortization, or depletion method for long-lived, nonfinancial assets be account for as a change in accounting estimate effected by a change in accounting principle. Statement No. 154 is effective beginning after December 15, 2005. Adoption of this statement is not expected to materially impact the Company's results of operations or financial position.

INSURANCE RECOVERY

On December 1, 2004, U.S. Rubber had an electrical fire which damaged its equipment and facilities. The Company's claims, which included business interruption losses, did not result in a material gain or loss on involuntary conversion or business interruption as a result of this fire.

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share and share data)

(unaudited)

1. BASIS OF PRESENTATION, DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

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

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

dilutive.

All references in the financial statements related to share amounts, per share amounts and average shares outstanding have been adjusted retroactively to reflect the Company's 1-to-50 reverse stock split of its common stock effective February 16, 2004.

The Company has a note payable agreement which is convertible by the holder to common stock totaling 100,000 shares at a conversion rate of \$5.00 per share. However, because the Company incurred a loss for the periods ended July 31, 2005 and 2004, respectively, the inclusion of those potential common shares in the calculation of diluted loss per share would have an antidilutive effect.

Our Series C Preferred Stock and Series D Preferred Stock, which have all the rights and privileges of our common stock, were convertible into common stock at rates of .40-to-1 and 3.50-to-1, respectively. Following the effective date of the 50 to-1 reverse split of the common stock, on February 18, 2004, these shares were converted to common stock, and such shares are included in the weighted average common shares outstanding from the date of conversion. There were no shares of preferred stock outstanding as of July 31, 2005.

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

	Three Months Ended		Nine Months Ended	
	July 31, 2005	July 31, 2004	July 31, 2005	July 31, 2004
Loss before discontinued operations	\$ (2,147)	\$ (695)	\$ (7,341)	\$ (5,837)
Change in fair value of mandatory redeemable preferred stock	13	298	19	1,094
Net loss attributable to common shareholders	\$ (2,134)	\$ (397)	\$ (7,322)	\$ (4,743)
Weighted average common and common equivalent shares outstanding, basic and diluted	3,109,333	3,109,333	3,109,333	1,922,908
Net loss per share, basic and diluted, attributable to common shareholders from continuing operations:	\$ (0.69)	\$ (0.13)	\$ (2.36)	\$ (2.47)

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except per share and share data)
(unaudited)

1. **BASIS OF PRESENTATION, DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

STOCK OPTIONS

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 loss per share would remain the same. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. There were no stock options issued for the three and nine months ended July 31, 2005 and 2004. During fiscal 2004, certain options were extended. Their effect on pro forma net income was immaterial.

2. INVENTORIES

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

	July 31, 2005	October 31, 2004
Raw materials	\$ 6,673	\$ 5,346
Work-in-process	907	611
Finished goods	3,387	3,236
Valuation reserve	(274)	(222)
Total	\$ 10,693	\$ 8,971

3. FINANCING ARRANGEMENTS**UNITED**

United's line of credit and term loan with First Indiana matured during the fiscal year and the Company refinanced its line and term loan with LaSalle Business Credit, LLC (LaSalle) in July 2005. Under the revolving loan with LaSalle, United can borrow up to 85% of the value of its eligible accounts, plus up to 60% of its eligible raw materials and finished goods up to \$3,000, plus up to 25% of its eligible work in process up to \$150, less reserves of up to \$75; provided that the loan does not exceed \$5,000. The revolving loan matures in July 2008. United also entered into a term loan with LaSalle for \$500 which matures in July 2013. Amount available as of July 31, 2005 under the revolving loan is \$868.

OBSIDIAN LEASING

The Company obtained a forbearance agreement with Old National Bank, which expired August 31, 2005, and is in the process of negotiating an amendment to the forbearance agreement which would extend the expiration date for 90 days, increase the interest rate on the outstanding balance to 15% and require that Obsidian Leasing sell additional coaches. The total related debt of \$3,062 is classified as current. Management is currently exploring options with regard to refinancing the outstanding debt. Should refinancing or an extension of the current agreement not be obtained by the expiration date of the forbearance agreement, the debt will be repaid through current sources of availability including borrowings under the Company's line of credit and agreements with Fair Holdings. In March 2005, the line of credit with Fair Holdings was amended to increase the limit to \$1,000. In addition, Fair Holdings has informally indicated that it would make available additional financial support if necessary, although we currently do not have any commitment for such support.

3. FINANCING ARRANGEMENTS, CONTINUED

GUARANTEES OF OBSIDIAN CAPITAL PARTNERS

We have an agreement with Obsidian Capital Partners that gives us the right to mandate a capital contribution from Obsidian Capital 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 Obsidian Capital 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.

4. MINORITY INTEREST IN AFFILIATE

As discussed in Note 1, DW Leasing and DC Investments Leasing, entities controlled by the Company's Chairman are included in consolidated financial statements and are subject to the provisions of FIN No. 46. Historically, these entities generated negative operating results and the operating model did not anticipate income in excess of losses previously recognized in the consolidated financial statements. During the nine month period ended July 31, 2005, DC Investments Leasing reported negative operating results. As a result, minority interest related to the loss of DC Investments Leasing in the amount of \$69 has been recorded as a benefit in the July 31, 2005 statement of operations and has been recognized on the balance sheet. Future operating results of DC Investments Leasing, if positive or negative, 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 the quarter ended and the nine months ended July 31, 2005, DW Leasing recorded income of \$6 and a loss of \$24, respectively. As of July 31, 2005, accumulated losses of DW Leasing recognized in consolidated statements of operations exceeded income by approximately \$386.

5. REDEEMABLE STOCK

In conjunction with financing of the acquisition of United in fiscal 2001, the Company issued 154,482 shares of common stock to Huntington Capital Investment Corporation (Huntington). The note purchase agreement includes a provision that gives Huntington the option to require the Company to repurchase these shares at 90% of market value upon the earlier of: a) the fifth anniversary of issuance of such shares, b) United's default under the subordinated debt agreement, or c) other factors related to a sale of substantially all assets of the Company as defined in the agreement. Increases in the value of the Company's stock will result in a corresponding increase to this repurchase requirement.

On May 1, 2004, the Company issued 170,451 shares of common stock as part of the acquisition of Classic. These shares are classified as redeemable stock. The purchase agreement for Classic included a provision that gives the sellers the right to have the Company redeem these shares at a price of \$6.5970 per share within five years of the date of issuance of the shares. The sellers have the right to partially redeem these shares in increments of 10,000 or more shares per transaction. The agreement also has an automatic termination provision if the Company's shares have traded at a closing price of greater than \$7.33 per share for any consecutive period of 60 trading days during the period of time commencing on the date there are no restrictions on the seller's sale of shares and ending on the fifth anniversary of the agreement.

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except per share and share data)
(unaudited)

6. STOCKHOLDERS DEFICIT

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

The Company's stockholders and Board of Directors approved a 50-to-1 reverse stock split. The reverse stock split was effective for trading purposes as of February 18, 2004. As a result, approximately 3,109,333 shares of common stock are now outstanding and the number of authorized shares of common stock has been reduced to 10,000,000.

On March 12, 2004, the preferred shares for Series C and D were converted to common, which increased common stock outstanding by 2,218,725 shares including 154,482 shares classified as redeemable stock. Preferred shares authorized remain five million shares with no preferred shares issued or outstanding as of April 30, 2005.

On December 31, 2003, the Company's Board of Directors approved the extension of the expiration date of 4,000 fixed stock options, exercisable at \$2.50. The original expiration date of December 31, 2003 was extended to June 30, 2004. The Company recognized \$40 of compensation expense related to the extension of the options during the three months ended January 31, 2004. The stock options were not exercised and expired June 30, 2004.

7. BUSINESS SEGMENT DATA AND GEOGRAPHIC DATA

The Company operates in three industry segments comprised of trailer and related transportation equipment manufacturing (trailer manufacturing); coach leasing; and butyl rubber reclaiming. All sales are in North and South America primarily in the United States, Canada and Brazil. Selected information by segment follows:

	Three Months Ended July 31, 2005					
	Trailer Manufacturing	Coach Leasing	Butyl Rubber Reclaiming	Total Segments	Corporate	Consolidated
Sales:						
Domestic	\$ 12,478	\$ 870	\$ 2,346	\$ 15,694	\$	\$ 15,694
Foreign	1,443		454	1,897		1,897
Total	\$ 13,921	\$ 870	\$ 2,800	\$ 17,591	\$	\$ 17,591
Cost of goods sold	\$ 12,600	\$ 537	\$ 2,967	\$ 16,104	\$	\$ 16,104
Loss before taxes and minority interest	\$ (753)	\$ (471)	\$ (656)	\$ (1,880)	\$ (277)	\$ (2,157)
Identifiable assets	\$ 24,679	\$ 13,390	\$ 11,285	\$ 49,354	\$ 510	\$ 49,864
Depreciation and amortization expense	\$ 249	\$ 195	\$ 445	\$ 889	\$ 37	\$ 926
Interest expense	\$ 497	\$ 347	\$ 182	\$ 1,026	\$ 277	\$ 1,303

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

7. BUSINESS SEGMENT DATA AND GEOGRAPHIC DATA, CONTINUED

Three Months Ended July 31, 2004

	Trailer Manufacturing	Coach Leasing	Butyl Rubber Reclaiming	Total Segments	Corporate	Consolidated
Sales:						
Domestic	\$ 12,570	\$ 1,713	\$ 2,513	\$ 16,796	\$	\$ 16,796
Foreign	1,265		166	1,431		1,431
Total	\$ 13,835	\$ 1,713	\$ 2,679	\$ 18,227	\$	\$ 18,227
Cost of goods sold	\$ 12,012	\$ 928	\$ 2,478	\$ 15,418	\$	\$ 15,418
Loss before taxes and minority interest	\$ (84)	\$ (160)	\$ (215)	\$ (459)	\$ (210)	\$ (669)
Identifiable assets	\$ 24,451	\$ 13,858	\$ 9,989	\$ 48,298	\$ 927	\$ 49,225
Depreciation and amortization expense	\$ 195	\$ 233	\$ 322	\$ 750	\$ 34	\$ 784
Interest expense	\$ 420	\$ 434	\$ 123	\$ 977	\$ 210	\$ 1,187

Nine Months Ended July 31, 2005

	Trailer Manufacturing	Coach Leasing	Butyl Rubber Reclaiming	Total Segments	Corporate	Consolidated
Sales:						
Domestic	\$ 35,661	\$ 2,186	\$ 7,158	\$ 45,005	\$	\$ 45,005
Foreign	4,190		985	5,175		5,175
Total	\$ 39,851	\$ 2,186	\$ 8,143	\$ 50,180	\$	\$ 50,180
Cost of goods sold	\$ 36,263	\$ 1,351	\$ 8,489	\$ 46,103	\$	\$ 46,103
Loss before taxes and minority interest	\$ (2,888)	\$ (1,809)	\$ (1,841)	\$ (6,538)	\$ (818)	\$ (7,356)
Identifiable assets	\$ 24,679	\$ 13,390	\$ 11,285	\$ 49,354	\$ 510	\$ 49,864
Depreciation and amortization expense	\$ 744	\$ 590	\$ 1,169	\$ 2,503	\$ 112	\$ 2,615
Interest expense	\$ 1,403	\$ 1,022	\$ 513	\$ 2,938	\$ 818	\$ 3,756

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share and share data)

(unaudited)

7. BUSINESS SEGMENT DATA AND GEOGRAPHIC DATA, CONTINUED

Nine Months Ended July 31, 2004

	Trailer Manufacturing	Coach Leasing	Butyl Rubber Reclaiming	Total Segments	Corporate	Consolidated
Sales:						
Domestic	\$ 31,425	\$ 3,727	\$ 6,985	\$ 42,137	\$	\$ 42,137
Foreign	3,413		1,028	4,441		4,441
Total	\$ 34,838	\$ 3,727	\$ 8,013	\$ 46,578	\$	\$ 46,578
Cost of goods sold	\$ 31,757	\$ 2,043	\$ 7,802	\$ 41,602	\$	\$ 41,602
Loss before taxes and minority interest	\$ (3,101)	\$ (994)	\$ (1,193)	\$ (5,288)	\$ (499)	\$ (5,787)
Identifiable assets	\$ 24,451	\$ 13,858	\$ 9,989	\$ 48,298	\$ 927	\$ 49,225
Depreciation and amortization expense	\$ 550	\$ 673	\$ 1,027	\$ 2,250	\$ 136	\$ 2,386
Interest expense	\$ 1,238	\$ 1,036	\$ 365	\$ 2,639	\$ 499	\$ 3,138

Obsidian Enterprises, Inc. (legal parent) allocates selling, general and administrative expenses to the respective companies primarily based on a percentage of sales. For the three and nine months ended July 31, 2005 and 2004, allocated corporate expenses by segment were as follows:

	Three Months Ended		Nine Months Ended	
	July 31, 2005	July 31, 2004	July 31, 2005	July 31, 2004
Trailer manufacturing	\$ 389	\$ 366	\$ 1,577	\$ 1,656
Coach leasing	34	57	136	256
Butyl rubber reclaiming	79	84	322	381
	\$ 502	\$ 507	\$ 2,035	\$ 2,293

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except per share and share data)
(unaudited)

8. RELATED PARTIES

The Company makes advances, receives loans and conducts other business transactions with affiliates resulting in the following amounts for the periods ended:

	<u>July 31, 2005</u>	<u>October 31, 2004</u>
Balance sheet:		
Current assets:		
Accounts receivable, Obsidian Capital Company ⁽²⁾	\$ 8	\$ 8
Accounts receivable, stockholders	5	11
Accounts receivable, other affiliated entities	77	52
	<hr/>	<hr/>
Total assets	\$ 90	\$ 71
	<hr/>	<hr/>
Current liabilities:		
Accounts payable, Obsidian Capital Company ⁽²⁾	\$ 35	\$ 35
Accounts payable, stockholders	3	3
Accounts payable, DC Investments and Fair Holdings ⁽²⁾	2,008	1,181
Accounts payable, other affiliated entities	137	49
Long-term portion:		
Accounts payable, Obsidian Capital Company ⁽²⁾	240	240
Accounts payable, stockholders	316	316
Notes payable, DC Investments ⁽²⁾	700	700
Notes payable, Fair Holdings ⁽²⁾	9,724	8,784
Line of credit, Fair Holdings ⁽²⁾	18,510	10,815
	<hr/>	<hr/>
Total liabilities	\$ 31,673	\$ 22,123
	<hr/>	<hr/>

<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
<u>July 31,</u>	<u>July 31,</u>	<u>July 31,</u>	<u>July 31,</u>
<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
<hr/>			

Statement of operations:

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

	Three Months Ended		Nine Months Ended	
Interest expense, DC Investments and Fair Holdings ⁽²⁾	\$ 705	\$ 497	\$ 1,931	\$ 1,337
Rent expense, Fair Holdings ⁽²⁾	\$ 13	\$ 13	\$ 40	\$ 39
Sales to Champion Trailer, Inc. ⁽²⁾	\$ 10	\$	\$ 60	\$
Purchases from Champion Trailer, Inc. ⁽²⁾	\$ 308	\$	\$ 851	\$
Rent expense, Roost Leasing ⁽¹⁾	\$ 36	\$ 36	\$ 108	\$ 36
Purchases from CCG, Parma ⁽²⁾	\$ 76	\$	\$ 124	\$

⁽¹⁾ A leasing company owned by the former owners of Classic

⁽²⁾ An entity controlled by Tim Durham, the Chairman of Obsidian Enterprises

Related-party amounts classified as current reflect those portions of the total receivable or payable that were currently due in accordance with the terms. Amounts classified as long term represent amounts not currently due.

20

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share and share data)

(unaudited)

9. ACQUISITION OF CLASSIC MANUFACTURING, INC.

In May 2004, Obsidian Enterprises acquired all of the outstanding shares of capital stock of Classic, a Michigan-based manufacturer of open and enclosed trailers. The purchase was a strategic acquisition to complement other subsidiaries that manufacture similar trailers. The purchase price totaled \$3,598 of which \$2,348 consisted of cash and \$1,250 in Obsidian common stock or 170,451 shares. The value of the stock was determined by the average share price over the latest 30 days prior to closing.

The purchase price and purchase accounting was allocated to the assets and liabilities of Classic based on their fair values. The allocation to tangible assets included \$2,767 and liabilities assumed of \$963. The excess of the purchase price over the fair value of the identifiable tangible net assets of \$1,794 was allocated to goodwill and identifiable intangible assets. The allocation of purchase price to intangibles includes existing brand name and customer base, noncompete, and the backlog. Intangibles included \$354 for brand name and customer base, \$118 for noncompete, and \$51 for the backlog. The remaining \$1,271 was allocated to goodwill none of which is expected to be deductible for tax purposes.

Intangible assets, other than goodwill are amortized over their estimated useful lives, ranging from three months for the backlog, five years for non-compete and ten years for brand name and customer base, using the straight-line method and are reviewed for potential impairment whenever events or circumstances indicate that carrying amounts may not be recoverable.

The period for which the results of operations of Classic are included in the consolidated income statement is for the nine months ended July 31, 2005 and the three months ended July 31, 2004.

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

The following schedule is a description of acquisition costs of Classic and the purchase price allocation (in thousands):

Purchase Price:	
Common stock	\$ 1,250
Cash to seller	2,250
Acquisition costs	98
	<hr/>
Total purchase price	\$ 3,598
	<hr/>
Purchase Price Allocation:	
Current assets, including accounts receivable and inventory	\$ 1,962
Machinery and equipment	805
Goodwill	1,271
Intangibles	523
Liabilities assumed	(963)
	<hr/>
Total	\$ 3,598
	<hr/>

21

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except per share and share data)
(unaudited)

9. ACQUISITION OF CLASSIC MANUFACTURING, INC. CONTINUED

Supplemental cash flow disclosure related to acquisition:	
Net assets acquired	\$ 3,598
Less: Common stock issued	(1,250)
Less: Cash acquired	(626)
	<hr/>
Total cash paid	\$ 1,722
	<hr/>

PRO FORMA INFORMATION:

The unaudited condensed consolidated results of operations shown below are presented on a pro forma basis and represent the results of Classic as if the business combinations of these entities occurred at the beginning of the periods presented.

	Nine Months Ended
	July 31, 2004
	<hr/>
Net sales	\$ 50,394
Net loss	\$ (5,805)
	<hr/>

	Nine Months Ended
	July 31, 2004
Loss per share, basic and diluted, attributable to common shareholders from continuing operations:	\$ (2.43)

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 acquisition been consummated as of the above dates, nor are they necessarily indicative of future operating results.

10. COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company is liable for contract completion and product performance. In the opinion of management, such obligations will not significantly affect the Company's financial position or results of operations.

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

IMPORTANT NOTE ABOUT FORWARD-LOOKING STATEMENTS.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. The Company and its representatives may from time to time make written or oral forward-looking statements, including statements included in or incorporated by reference into this Quarterly Report on Form 10-Q and the Company's other filings made with the Securities and Exchange Commission. These forward-looking statements are based on management's views and assumptions and involve risks, uncertainties and other important factors, some of which may be beyond the control of the Company that could cause actual results to differ materially from those expressed or implied in the forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in this Item 2. Readers should carefully review the risks described in this and other documents that the Company files from time to time with the Securities and Exchange Commission and the risks described under "Risk Factors" at the end of this Item 2. The forward-looking statements speak only as of the date that they are made and the Company undertakes no obligation to update or revise any of the forward-looking statements.

Investors in Obsidian should be aware that a group of stockholders of Obsidian, some of whom are also officers and directors of Obsidian, have filed a Schedule 13E-3 with the Securities and Exchange Commission in which they disclose their intent to take Obsidian private. Readers are strongly encouraged to read the Schedule 13E-3 for a description of the plans and intentions of this group of shareholders, as well as the Schedule 13D disclosing their ownership of shares of Obsidian common stock and their intention to cause the Company to go private.

OVERVIEW

Obsidian Enterprises is a holding company headquartered in Indianapolis, Indiana. We conduct business through our subsidiaries, which operate in three principle segments:

Butyl Rubber Reclaiming

- >> U.S. Rubber., acquired in fiscal 2001, owns and operates butyl rubber reclaiming facilities;

Coach Leasing

- >> Pyramid, acquired in fiscal 2001, provides luxury coach leases for corporations and the entertainment industry;
- >> Obsidian Leasing, formed in fiscal 2002, owns some of the coaches operated by Pyramid;
- >> DW Leasing, LLC and DC Investments Leasing, formed in fiscal 2003, are controlled by individuals who are also controlling shareholders of Obsidian Enterprises 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*.

Trailer and Related Transportation Equipment Manufacturing

- >> United, acquired in fiscal 2001, manufactures steel-framed cargo, racing and specialty trailers;
- >> Danzer, the only subsidiary of the Company until fiscal 2001, manufactures metal parts and truck bodies for the service and utilities markets; and
- >> Classic, acquired in May 2004, manufactures steel-framed cargo, fifth wheel, gooseneck, motorcycle, race, snowmobile and stacker/lift trailers and open trailers used in the landscape industry.

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

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, and manufacturing and other operational efficiencies through each of the subsidiaries.

RESULTS OF OPERATIONS (in thousands)

OVERVIEW

The Company's financial statements have been presented on the basis that it is a going concern which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. In the period since June 2001, Obsidian Enterprises and its subsidiaries have incurred losses and reductions in equity on a consolidated basis. Historically, losses and certain third-party debt repayments have been financed with DC Investments and its subsidiary Fair Holdings, Inc. (Fair Holdings), entities controlled by the Company's Chairman, on terms that may not have been available from other sources. As of July 31, 2005, total debt outstanding to DC Investments and Fair Holdings was \$28,934.

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.

Our results of operations for the three and nine months ended July 31, 2005 were impacted by various events discussed below. We intend to continue to focus our efforts on generating positive cash flow and increasing our working capital through improved operations and pursuing significant strategic initiatives. Although management believes these actions will improve operations and liquidity, there can be no assurance that such actions will sufficiently improve operations or liquidity.

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

- >> In the trailer manufacturing segment we successfully completed the acquisition of Classic in Sturgis, Michigan in fiscal 2004. The addition of Classic enabled us to add synergistic products to our trailer line. The addition of Classic added revenues to this segment of \$274 and \$5,010 for the three and nine months ended July 31, 2005, respectively, resulting in an increase in revenues of 18%, for the segment. The acquisition of Classic also helped improve our gross margins in this segment. The segment was negatively affected by significant increases in raw material prices for the three and nine months ended July 31, 2005, which reduced our gross margins. We were able to pass some of the increases through to our customers through price increases of approximately 17%. Our price increases lagged behind the raw material price increases, which reduced our overall gross margins.

We expect market conditions to remain very competitive and raw material prices to remain somewhat volatile in the trailer manufacturing segment. As raw material prices begin to level off, we expect our price increases to return our margins to a more profitable level. During the nine months ended July 31, 2005, we began to see the improvement in gross margin which were reflective of our price increases and the acquisition of Classic. We are also implementing programs with a goal of reducing the costs of raw material. Our cost of materials percentage has historically been above the industry average. Our cost reduction initiatives for fiscal 2005 include combining the purchasing power of all our subsidiaries to negotiate better pricing through higher volume purchases. We also expect to be able to take advantage of purchase discounts with additional available working capital through a new line of credit. Additional strategies in the trailer manufacturing segment include building sales growth through market expansion, cross selling and additional geographical production with Classic. We continue to evaluate strategic acquisitions to determine whether they can improve the performance of this segment.

24

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

- >> In our butyl rubber reclaiming segment we continue to search for new market sources of butyl raw material. We are continuing to expand our recycling program with the chapters of The National FFA Organization. We implemented a new fine grind process that increases our ability to use other types of rubber in our butyl reclaim process. Also during the third quarter we started the production of material through a cryogenic process. This process will enable the Company to expand its product lines of natural rubber in new markets. Full implementation is expected to be completed in the last quarter of fiscal 2005. Additional costs were incurred to maintain the equipment in this very capital intensive operation. We also incurred significant increases in energy costs. During January 2005, we implemented a five percent price increase as our cost to obtain raw materials and maintain equipment increased. The Company implemented an additional five percent increase during May 2005. However, during the second quarter of fiscal 2005, the Company began experiencing the effects of price competition as it began losing customers to a competitor due to lower pricing. The total impact is unknown at this time. For fiscal 2005 we expect the market demand for our product to be high due to our current order backlog. The availability of raw material for butyl rubber reclaiming to meet the market demands continues to be a concern.
- >> Our luxury coach leasing segment was negatively affected by a decrease in sales from a lower utilization of our fleet. The lower utilization is due to increased market competition in the industry and a significant decrease in the number of entertainers touring. Utilization of our fleet decreased approximately 3% and 6% for the three and nine months ended July 31, 2005 as compared to the three and nine months ended July 31, 2004, which in turn had a significant negative impact on the earnings of this segment. As noted in Part II, Item 1 of this report, the Company filed a law suit in December 2004 against the former owners of Pyramid for violation of their non-compete agreement. This segment was also negatively affected by the turnover in management. During the three months ended April 30, 2005, certain improprieties were revealed on behalf of the segment's management. The total estimated loss is approximately \$165. Collection of this loss is not known at this time and no account receivable has been recorded. In addition, as many of the coaches are becoming older, there is the need for a much more proactive service schedule in order to try and avoid major breakdowns. There has been an elevated level of repair expense during the three months ended July 31, 2005 in order to bring many of the older coaches back up to their required maintenance schedule. The hiring of new management in the service area will help maintain a proactive schedule of maintenance on a consistent basis.
- >> We will continue to pursue strategic acquisition opportunities that include targets both in our traditional, basic industries and manufacturing sectors, as well as targets that possess assets (including cash) that are outside our traditional areas of focus, and available on terms that our management believes to be attractive. This strategy resulted in a traditional acquisition of Classic Manufacturing. While no material negotiations are currently active with respect to any targets, we anticipate that over the course of fiscal 2005 we will pursue acquisition opportunities that we deem attractive in a variety of industry sectors. Ultimately, these

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

acquisitions may (but cannot be guaranteed to) result in our having increased financial resources and potentially a broader asset base and more diversified sources of revenue.

25

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

The following table shows net sales by product segment:

	Three Months Ended		Nine Months Ended	
	July 31, 2005	July 31, 2004	July 31, 2005	July 31, 2004
Trailer manufacturing	\$ 13,921	\$ 13,835	\$ 39,851	\$ 34,838
Coach leasing	870	1,713	2,186	3,727
Butyl rubber reclaiming	2,800	2,679	8,143	8,013
Net Sales	\$ 17,591	\$ 18,227	\$ 50,180	\$ 46,578

The following is a discussion of the major elements impacting the Company's operating results by segment for the three and nine months ended July 31, 2005 compared to the three and nine months ended July 31, 2004. The comments that follow should be read in conjunction with the Company's condensed consolidated financial statements and related notes contained in this Form 10-Q.

TRAILER MANUFACTURING

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

	Three Months Ended		Nine Months Ended	
	July 31, 2005	July 31, 2004	July 31, 2005	July 31, 2004
Net Sales	\$ 13,921	\$ 13,835	\$ 39,851	\$ 34,838
Cost of Sales	12,600	12,012	36,263	31,757
Gross Profit	\$ 1,321	\$ 1,823	\$ 3,588	\$ 3,081
Gross Profit %	9.5%	13.2%	9.0%	8.8%
Loss before taxes and minority interest	\$ (753)	\$ (84)	\$ (2,888)	\$ (3,101)

Three Months Ended July 31, 2005 Compared to Three Months Ended July 31, 2004

Sales

Net sales in this segment for the three months ended July 31, 2005 were \$13,921, an increase of \$86 or 0.6%, compared to net sales of \$13,835 for the three months ended July 31, 2004. The increase was primarily due to the acquisition of Classic, which increased for the three months ended July 31, 2005 by \$274. Additionally, there was an increase in Danzer's sales of \$472 for cargo trailers and \$223 for truck bodies, which

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

was due the addition of new customers on the East coast for cargo trailers and a modest increase in orders from the telecommunications industry. Sales of United products decreased for the three months ended July 31, 2005 by \$883 compared to sales of \$10,054 for the three months ended July 31, 2004, primarily due to the increased sales of the economy line trailers, which sell at a lower price and a decrease in order volume and production levels.

26

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

Gross Profit

The gross profit in this segment for the three months ended July 31, 2005 decreased by 3.7% to \$1,321 or 9.5% of revenues as compared to \$1,823 or 13.2% of revenues for the same period in fiscal 2004. The segment was negatively affected by the significant increases in raw material prices during the three months ended July 31, 2005, which reduced our gross margins. We were able to pass some of the increases through to our customers through price increases of approximately 5% for the three months ended July 31, 2005. Our price increases lagged behind the raw material price increases, which reduced our overall gross margins.

Loss before taxes and minority interest

For the three months ended July 31, 2005, loss before taxes and minority interest was \$753, an increase of \$669 when compared to the three months ended July 31, 2004 where the loss before taxes and minority interest was \$84. The trend is primarily due to raw material price increases as further described in our gross profit analysis.

Nine Months Ended July 31, 2005 Compared to Nine Months Ended July 31, 2004

Sales

Net sales in this segment for the nine months ended July 31, 2005 were \$39,851, an increase of \$5,013 or 14.4% compared to net sales of \$34,838 for the nine months ended July 31, 2004. The increase was primarily due to Classic, which increased for the nine months ended July 31, 2005 by \$4,939. Additionally, there was an increase in Danzer's sales of \$1,782 for cargo trailers and \$565 for truck bodies, which was due the addition of new customers on the East coast for cargo trailers and a modest increase in orders from the telecommunications industry. Sales of United products decreased for the nine months ended July 31, 2005 by \$2,273, primarily due to the increased sales of the economy line trailers, which sell at a lower price and a decrease in order volume and production levels.

Gross Profit

The gross profit in this segment for the nine months ended July 31, 2005 was \$3,588, a slight increase of 0.2% to 9.0% of revenues, compared to \$3,081, or 8.8% of revenues for the same period in fiscal 2004. The acquisition of Classic contributed to the improvement of the segment's gross profit by enabling us to add synergistic products to our trailer line product line which, historically, has had higher gross margins than our comparable products. This increase in the gross margin from Classic is offset by the significant increase in raw materials during the first nine months of fiscal 2005. Although we raised our selling prices an average of 17% to offset the significant price increases, we were not able to pass all the cost increases through to our customers during the first nine months of fiscal 2005 on a timely basis.

Loss before taxes and minority interest

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

For the nine months ended July 31, 2005, loss before taxes and minority interest was \$2,888, an improvement of \$213 when compared to the nine months ended July 31, 2004 where the loss before taxes and minority interest was \$3,101. The positive trend is primarily due to the acquisition of Classic and our price increases as further described in our gross profit analysis.

27

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

Future improvement in this segment will depend on our ability to continue to pass through our raw material cost increases to our customers. We also expect the addition of Classic will continue to improve our gross margin as Classic's product line historically had higher gross margins than our comparable products. We are also implementing a process to pool all of our related purchasing together for our trailer manufacturing subsidiaries to increase our purchasing power and obtain volume discounts.

BUTYL RUBBER RECLAIMING

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

	Three Months Ended		Nine Months Ended	
	July 31, 2005	July 31, 2004	July 31, 2005	July 31, 2004
Net Sales	\$ 2,800	\$ 2,679	\$ 8,143	\$ 8,013
Cost of Sales	2,967	2,478	8,489	7,802
Gross Profit (Loss)	\$ (167)	\$ 201	\$ (346)	\$ 211
Gross Profit %	(6.0%)	7.5%	(4.3%)	2.6%
Loss before taxes and minority interest	\$ (656)	\$ (215)	\$ (1,841)	\$ (1,193)

Three Months Ended July 31, 2005 Compared To Three Months Ended July 31, 2004

Sales

Net sales in this segment for the three months ended July 31, 2005 were \$2,800, as compared to the net sales of \$2,679 for the three months ended July 31, 2004, and increase of \$121 or 4.5%, primarily due to price increases. Sales in this segment remain relatively flat due to the limited availability of raw materials; additional increases in sales will depend on finding new sources of butyl inner tubes and developing other natural rubber products. We continue to work with the National FFA Association to implement a reclamation program to increase our resources in the agricultural industries. In addition, alternative sources of material, including overseas sources, are being pursued to provide a consistent supply of material. We continue to utilize our fine grind and other processes to increase our ability to process other types of products for our butyl reclaim process as well as other natural rubber products.

Gross Profit

Gross profit as a percentage of sales decreased by 13.5% to \$(167) for three months ended July 31, 2005 as compared to \$201 for the three months ended July 31, 2004. The primary reason for this decrease is lower production because a major piece of production equipment was taken out of commission for a maintenance overhaul. During the downtime, we relied on backup equipment for our production needs, which increased our cost to produce material and reduced our throughput efficiency. As a result of having to use less than optimum raw material mix in the

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

reclaiming process, additional processing time was incurred to ensure delivery of quality product. Our processes require significant amounts of natural gas and electricity, the cost of which increased significantly during the three months ended July 31, 2005.

28

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

Loss before taxes and minority interest

For the three months ended July 31, 2005, the loss before taxes and minority interest was \$(656), an increase of \$441 as compared to the three months ended July 31, 2004 where the loss before taxes and minority interest was \$(215). The decrease in profitability and negative trend as more fully described above is primarily due to the lower production as a result of maintenance of equipment.

Nine months Ended July 31, 2005 Compared to Nine months Ended July 31, 2004

Sales

Net sales in this segment for the nine months ended July 31, 2005 were \$8,143 as compared to net sales of \$8,013 for the nine months ended July 31, 2004, representing an increase of \$130 or 1.6%. Sales in this segment remain relatively flat due to the limited availability of raw materials. The same factors as described in the three month discussion will affect our ability to find new sources of raw materials.

Gross Profit

Gross profit as a percentage of sales decreased by 6.9% to \$(346) for nine months ended July 31, 2005 as compared to \$211 for the nine months ended July 31, 2004. The primary reason for this decrease is due to lower production because of an electrical fire that closed the plant for seven days in December 2004. In addition, the maintenance of a major piece of production equipment and requirements for significant amounts of natural gas and electricity, each as described in further detail above, affected gross profit. During January 2005, we initiated price increases of 5% to partially offset increasing costs of production and materials.

Loss before taxes and minority interest

For the nine months ended July 31, 2005, the loss before taxes and minority interest was \$(1,841), an increase of \$648 as compared to the nine months ended July 31, 2004 where the loss before taxes and minority interest was \$(1,193). The decrease in profitability and negative trend as noted above has been primarily due to the lower production due to the plant fire and inefficiencies in production due to the maintenance of equipment and increases in the prices of natural gas and electricity.

Looking ahead, sales are expected to increase moderately. Sales growth will depend on the 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 and Cryogenic grinding processes will increase the ability to utilize some additional rubber products in our Butyl reclaim process and add new products. Gross profit improvement will depend greatly on the success of finding consistent sources of raw material and improved efficiencies in our operations through our new cryogenic and fine grind processes.

COACH LEASING

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

Three Months Ended	Nine Months Ended
---------------------------	--------------------------

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

	Three Months Ended		Nine Months Ended	
	July 31, 2005	July 31, 2004	July 31, 2005	July 31, 2004
Net Sales	\$ 870	\$ 1,713	\$ 2,186	\$ 3,727
Cost of Sales	537	928	1,351	2,043
Gross Profit	\$ 333	\$ 785	\$ 835	\$ 1,684
Gross Profit %	38.3%	45.9%	38.2%	45.2%
Loss before taxes and minority interest	\$ (471)	\$ (160)	\$ (1,809)	\$ (994)

29

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

Three Months Ended July 31, 2005 Compared to Three Months Ended July 31, 2004

Sales

Net sales for the three months ended July 31, 2005 were \$870, a decrease of \$843 or 49.2% compared to net sales of \$1,713 for the three months ended July 31, 2004. The decrease in sales relates to a lower utilization of our fleet in addition to a decrease in sublease revenue due to a decrease in sublease contracts. Management believes the lower utilization is due to increased market competition in the industry and to a significant decrease in the number of professional acts touring. Utilization of our fleet decreased 3% for the three months ended July 31, 2005 as compared to the three months ended July 31, 2004 which had a negative impact on our operations. We also experienced turnover in management which also contributed to the loss of several tours. At this time, we cannot estimate when tours for the entertainment industry will return to previous historical levels.

Gross Profit

Gross profit for this segment was \$333 or 38.3% of net sales for the three months ended July 31, 2005 compared to \$785 or 45.9% of net sales for the three months ended July 31, 2004. The decrease is attributable to lower sales and lower utilization of our fleet.

Loss before taxes and minority interest

For the three months ended July 31, 2005, the loss before taxes and minority interest was \$(471), an increase of \$311 from the three months ended July 31, 2004 where the loss before taxes and minority interest was \$(160). The decrease in profitability and negative trend as noted above has been primarily due to increased market competition and to the significant decrease in the number of professional acts touring. The touring industry in general decreased 30% in fiscal 2004 and the decrease has continued for the three months ended July 31, 2005, which in turn reduced the utilization of our coaches. We also operated a larger fleet than prior years, which increased our maintenance, depreciation and interest costs.

Nine months Ended July 31, 2005 Compared to Nine months Ended July 31, 2004

Sales

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

Net sales for the nine months ended July 31, 2005 were \$2,186, a decrease of \$1,541 or 41.4% compared to net sales of \$3,727 for the nine months ended July 31, 2004. Utilization of our fleet decreased significantly for the nine months ended July 31, 2005 as compared to the nine months ended July 31, 2004 which had a negative impact on our operations. The same factors addressed above in the three month discussion effected sales in this period.

Gross Profit

Gross profit was \$835 for this segment, or 38.2% as a percentage of net sales for the nine months ended July 31, 2005 compared to \$1,684 or 45.2% for the nine months ended July 31, 2004. The decrease is attributable primarily to the increase of costs for maintaining a larger fleet while revenues per coach have decreased. Some of our increased costs as a percentage of revenue were offset, however, by the mix of utilization of the coaches owned in our fleet and a lower need to sublease additional buses from third parties to meet demand which existed in the first nine months of 2004. Coaches which we must sublease from third parties are typically leased to our customers at lower gross margins for us. As demand has decreased, our need for third party coaches has also decreased. Since November 2004, we have sold a total of three older coaches at no material gain or loss. The sale of our older coaches is expected to reduce our fleet maintenance expenses as the older coaches require a higher level of maintenance. We plan to sell two other older coaches in the last quarter of fiscal 2005 pursuant to the terms of the amended forbearance agreement with Old National Bank. Following the acquisition of Pyramid in fiscal 2001, certain actions taken by the former owners in violation of their non-competition agreements have negatively affected the performance of the segment. Obsidian filed suit against these former owners in December 2004 for these violations. In addition, since the acquisition there has been significant turnover of managers at Pyramid who were hired by the former owners and the loss of these employees has also negatively affected the performance of the segment. Finally, the Company believes that a former employee may have misappropriated up to \$165 from Pyramid. Although the Company is seeking the return of this amount, no receivable has been recorded since the likelihood of collection cannot be determined at this time.

30

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

Loss before taxes and minority interest

Loss before taxes and minority interest increased by \$815 to \$(1,809) for the nine months ended July 31, 2005, compared to the nine months ended July 31, 2004 where the loss before taxes and minority interest was \$(994). The decrease in profitability and negative trend as noted above has been primarily due to increased market competition and to the significant decrease in the number of professional acts touring. The touring industry in general decreased 30% in fiscal 2004 and the decrease has continued for the nine months ended July 31, 2005, which in turn reduced the utilization of our coaches. We also operated a larger fleet than prior years, which increased our maintenance, depreciation and interest costs.

Looking ahead, segment sales, gross profits and segment profitability in fiscal 2005 will depend on the industry market conditions and a continued effort to upgrade the management of this segment. We are continually working to improve our utilization of our owned coaches to increase our revenues and minimize additional costs from leasing third party buses. In addition, we continue to explore other non-traditional uses for our coaches to improve the utilization and therefore increase our cash flow and working capital in this segment. We are also evaluating our coaches and, as noted above, selling the older coaches in our fleet to reduce our costs.

SELLING, GENERAL AND ADMINISTRATIVE (SG&A) EXPENSES

The Company's SG&A expenses increased by \$53, or 2.3%, and by \$72, or 0.9%, for the three and nine months ended July 31, 2005 compared to the three and nine months ended July 31, 2004, respectively. The increase in SG&A in both periods was primarily due to an increase in Classic's SG&A related to show and marketing expenses, an increase in compensation and other general and administrative expenses, offset by the decrease in professional fees and other expenses related to the unsuccessful exchange offer for Net Perceptions, Inc. during the nine months ended July 31, 2004 of approximately \$600.

INTEREST EXPENSE

Interest expense was \$1,303 and \$3,756 for the three and nine months ended July 31, 2005, respectively, as compared to \$1,187 and \$3,138 for the same periods of fiscal 2004. Interest expense for the three months ended July 31, 2005 as a percentage of average debt borrowings of \$52,451 was 2.5% (10.0% on an annual basis). Interest expense for the three months ended July 31, 2004 as a percentage of average debt borrowings of \$43,785 was 2.7% (10.8% on an annual basis). The decrease is primarily due to additional borrowings from Fair Holdings at

better interest rates. Interest expense for the nine months ended July 31, 2005 as a percentage of average debt borrowings of \$50,453 was 7.4% (10.0% on an annual basis). Interest expense for the nine months ended July 31, 2004 as a percentage of average debt borrowings of \$43,202 was 7.2% (9.7% on an annual basis). The increase is primarily due to additional borrowings from Fair Holdings at higher interest rates. As discussed in Liquidity and Capital Resources, the Company will fund potential cash shortages through existing lines of credit with Fair Holdings, which would continue to increase interest expense.

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

INCOME TAX PROVISION

Income tax expense for the three months ended July 31, 2005 and 2004 was \$18 and \$17, respectively. Income tax expense for the nine months ended July 31, 2005 and 2004 was \$54 and \$17, respectively. There was no federal income tax benefit recorded for the three or nine months ended July 31, 2005 and 2004. Income tax benefits are created primarily through NOL carry forwards recognized to the extent they are available to offset the Company's net deferred tax liability. Operating losses during the three and nine months ended July 31, 2005 have been reserved with a valuation allowance. Any quarterly tax benefits are based on the estimated effective tax rate for the full year.

**LIQUIDITY AND CAPITAL RESOURCES
OVERVIEW**

As discussed in Results of Operations Overview, above, the Company's financial statements have been presented on the basis that it is a going concern which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company's realization of its assets and satisfaction of its liabilities in the normal course of business is dependent upon our ability to generate sufficient cash flow to meet our financial obligations, to comply with the terms of our debt financing agreements, to obtain refinancing of certain obligations and to continue to receive financial support under its line of credit with Fair Holdings.

We are continuing to address our liquidity and working capital issues through various means including operational changes and financing matters which are discussed below. During the remainder of fiscal 2005, we expect to refinance additional current debt of \$8,100 on a long-term basis. Any potential cash shortage is expected to be supported through our existing lines of credit and other agreements with Fair Holdings. In addition, Fair Holdings has informally indicated that it would make available additional financial support if necessary, although we currently do not have any commitment for such support.

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 has a separate revolving credit agreement and term loan borrowings through which the subsidiary finances its operations, together with cash generated from operations. Our consolidated working capital position (current assets over current liabilities) was negative at July 31, 2005 by \$1,592. For the fiscal year ended October 31, 2004 our working capital position was negative by \$10,504. The increase in working capital is primarily attributable to the refinancing of the Company's debt during the nine-month period ended July 31, 2005 in addition to the refinancing of United's loans. We are currently working to refinance loans for Obsidian Leasing in the amount of \$3,100 and U.S. Rubber in the amount of \$5,000, as noted in further detail below. Management anticipates that the successful refinancing of these obligations will improve our working capital to a positive position upon completion.

We continue to address liquidity and working capital issues in a number of ways. At July 31, 2005, net cash used in continuing operations was \$5,850 compared to \$929 at October 31, 2004. The use of cash and working capital was primarily related to funding operating losses and business seasonality. We expect our operations to begin to generate positive cash and expect to increase our overall working capital through improved operations as follows:

- » We secured a financial commitment from Fair Holdings to provide, additional borrowings under a \$15,000 line of credit agreement, which expires on January 1, 2007. Approximately \$2,833 is available to us under the agreement as of July 31, 2005.
- » United, U.S. Rubber, and Pyramid traditionally had borrowing agreements with Obsidian Enterprises which was funded using Obsidian Enterprises' agreement with Fair Holdings discussed above. During the quarter ended April 30, 2005, these agreements were redocumented between Fair Holdings and United, U.S. Rubber, and Pyramid which allowed for borrowings up to \$3,000, \$3,700, and \$750, respectively, and expire on April 15, 2012. Approximate availability under these agreements as of July 31,

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

2005 are \$839, \$127, and \$142, respectively. Amount available as of July 31, 2005 under the revolving loan is \$868.

32

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

- » United's line of credit and term loan with First Indiana matured during the fiscal year and the Company refinanced its line and term loan with LaSalle Business Credit, LLC (LaSalle) in July 2005. Under the revolving loan with LaSalle, United can borrow up to 85% of the value of its eligible accounts plus up to 60% of its eligible raw materials and finished goods up to \$3,000 plus up to 25% of its eligible work in process up to \$150 less reserves of up to \$75 provided that the loan does not exceed \$5,000. The revolving loan matures in July 2008. United also entered into a term loan with LaSalle for \$500 which matures in July 2013.
- » In November 2004, Obsidian Leasing's credit facility with Old National Bank matured and Obsidian Leasing now has current debt obligations due of \$3,062. The Company obtained a forbearance agreement with Old National Bank, which expired August 31, 2005, and is in the process of negotiating an amendment to the forbearance agreement which would extend the expiration date for 90 days, increase the interest rate on the outstanding balance to 15% and require that Obsidian Leasing sell additional coaches. Management is actively working to refinance this debt with other banks in the last quarter of fiscal 2005. Since November 2004, management sold two older coaches, reducing Obsidian Leasing's debt by \$209. Management is also in negotiations to sell two additional coaches, which will further reduce debt by an estimated \$224.
- » US Rubber has a balloon payment on its debt which will be due October 24, 2005, which is our fourth fiscal quarter. The amount outstanding on this debt as of July 31, 2005 is \$5,057. We are in the initial stages of preparing to negotiate and refinance this debt prior to October 2005.
- » We are actively working to restructure or refinance our high interest rate debt on more favorable terms. Approximately \$21,395 of our debt bears interest from rates ranging from 10% to 15%.
- » As fully described under Guarantees of Obsidian Capital Partners , we have an agreement that gives us the right to mandate a capital contribution 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 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.
- » Cost reduction and other initiatives are being put in place for raw materials in the trailer and related transportation manufacturing segment, with the use of alternative materials and additional discounts through volume purchasing by pooling our purchasing power from all affiliated companies. We have passed through increases in raw material costs to our customers through price increase surcharges and expect to continue to do so with future significant increases in raw material costs
- » We continue to look for ways to strengthen our liquidity, equity and working capital through ongoing evaluations of merger and acquisition candidates and other recapitalization methods. We purchased Classic, which provided positive cash from operations, additional working capital and additional liquidity under its line of credit.

Management believes the steps taken to improve operations will positively impact our liquidity and working capital. However, success is dependent on our ability to restore gross profits and capitalize on new markets in the trailer manufacturing segment, obtain consistent material supply in the butyl rubber reclaiming segment and restore our market share in the coach leasing segment. Moreover, improvement in our liquidity and working capital position is substantially dependent upon our ability to successfully refinance approximately \$8,100 of debt at Obsidian Leasing, and U.S. Rubber. Failure to complete the refinancing on a timely basis could have a material adverse effect on our liquidity and working capital position and could impair the ability of our subsidiaries to continue operations.

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

FINANCIAL COVENANT WAIVERS

Significant financial covenants in our credit agreements include the maintenance of minimum financial ratios, such as levels of earnings to funded debt and fixed charge coverage ratios. We did not meet requirements and covenants in certain debt agreements.

In November 2004, Obsidian Leasing's credit facility with Old National Bank matured and Obsidian Leasing now has current debt obligations due of \$3,062. The Company obtained a forbearance agreement with Old National Bank, which expired August 31, 2005, and is in the process of negotiating an amendment to the forbearance agreement which would extend the expiration date for 90 days, increase the interest rate on the outstanding balance to 15% and require that Obsidian Leasing sell additional coaches. Management is actively working to refinance this debt with other banks in the last quarter of fiscal 2005.

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 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 Obsidian Capital Partners.

FUNDS AVAILABILITY

On a consolidated basis, as of July 31, 2005, the Company had approximately \$798 of cash and cash equivalents. Danzer Industries, U.S. Rubber, United, Obsidian Enterprises and Classic 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 July 31, 2005, 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⁾	\$ 70	\$ 70
U.S. Rubber ⁽¹⁾	127	127
United ⁽¹⁾	1,707	1,707
Obsidian Enterprises ⁽¹⁾	2,833	2,833
Classic Manufacturing	364	364
Pyramid ⁽¹⁾	142	142

⁽¹⁾Additional borrowings through Fair Holdings, a Related Party, under existing lines of credit.

The Company incurred negative net cash flow of \$(5,850) from operations during the nine months ended July 31, 2005. Cash used in operations during the nine month period ended July 31, 2005 is primarily due to operating losses and increases in inventories offset by increases in accounts payable. The Company has increased inventories during the first nine months of fiscal 2005 primarily in the trailer manufacturing segment. Inventories were increased during this period to provide an increase in the Company's ability to deliver orders during the fourth quarter when sales have historically been higher than in the first nine months of the fiscal year. Funding during the third quarter was provided through borrowings on lines of credit and from related parties.

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

We have commercial commitments as described below:

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

Commercial Commitments	Total Amount Committed	Outstanding at July 31, 2005	Date of Expiration
Line of credit, related party	\$ 3,000	\$ 2,930	April 1, 2006
Line of credit	5,500	3,543	July 19, 2008
Line of credit	4,000	2,476	October 1, 2005
Line of credit, related party	15,000	2,833	January 1, 2007
Line of credit	1,000	636	May 1, 2006
Line of credit, related party	3,000	2,161	April 15, 2012
Line of credit, related party	3,700	3,573	April 15, 2012
Line of credit, related party	750	608	April 15, 2012

Our net cash used in continuing operations for the nine months ended July 31, 2005 was \$5,850. This is comprised of a loss from continuing operations of \$7,341, offset by noncash depreciation and amortization of \$2,615, increases in inventories of \$1,722, customer deposits of \$252, accrued expenses of \$74, accounts payable of \$142, and other assets of \$157, with decreases in accounts receivable of \$66. In addition, we had minority interest of \$69, and accretion of interest of \$290.

Net cash flow provided from financing activities for the nine months ended July 31, 2005 was \$7,056. This is comprised of borrowings of long-term debt of \$8,172 offset by repayments to related parties of \$893 and on lines of credit of \$223.

Cash flow was used in investing activities for the nine months ended July 31, 2005 of \$1,096. This is comprised of purchases of equipment of \$1,538 offset by proceeds from the sale of equipment of \$442.

The total decrease in cash is summarized as follows:

	Nine Months Ended	
	July 31, 2005	July 31, 2004
Net cash used in operations	\$ (5,850)	\$ (2,529)
Net cash used in investing activities	(1,096)	(2,947)
Net cash provided by financing activities	7,056	4,786
Increase (decrease) in cash and cash equivalents	\$ 110	\$ (690)

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are summarized in Note 2 to the consolidated financial statements in the Annual Report on Form 10-K for the fiscal year ended October 31, 2004 and describe the significant accounting policies and methods used in the preparation of the consolidated 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 fiscal 2002 of a customer resulted in a bad debt charge of \$379. However, we believe our reserve for doubtful accounts of \$734 should be adequate for any exposure to loss in our July 31, 2005 accounts receivable. We have also established reserves for slow-moving and obsolete inventories and believe the reserve of \$274 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. During fiscal 2004, certain equipment became idle due to the realignment of the plant at U.S. Rubber. The equipment will be used in the future for replacement of existing equipment as needed. Due to the uniqueness of the equipment and the high cost to buy new similar pieces, the net book value of \$353 was transferred to other assets under idle equipment and is subject to impairment valuation. Accordingly, we continue to analyze the Danzer and US Rubber assets for impairment in conjunction with our analysis of the continuing operations of these facilities. In assessing the recoverability of our property and equipment, 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 related assumptions change in the future, we may be required to record impairment charges for these assets in future periods. Any such resulting impairment charges could be material to our results of operations. As of July 31, 2005 we determined there is no impairment of our property and equipment.

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

Goodwill and intangibles are reviewed annually for impairment as of the first day of the fourth quarter or more frequently when events and circumstances indicate potential impairment factors are present. The realization of goodwill of \$7,055 is primarily dependent on the future operations of the operating entities where the goodwill is allocated. Historical operating results, current product demand and estimated future results indicate the results of operations should be adequate to continue to realize this amount. However, future results may not meet expectations due to economic or other factors, including the ability to pass through material cost increases to our customers, to maintain revenues and to improve gross margins. Failure to meet expectations may result in the goodwill not being fully realizable and accordingly result in impairment charge which could be material to our operating results.

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 one year to ten years, with an average age of approximately five 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 recently disposed of three coaches that did not result in a material gain or loss. 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.

In conjunction with financing of the acquisition of United, the Company issued 154,482 shares of common stock to Huntington Capital Investment Corporation (Huntington). The note purchase agreement includes a provision that gives Huntington the option to require the Company 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 assets of the Company as defined in the agreement. Increases in the value of the Company's 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 the Company's liquidity.

With the acquisition of Classic effective May 1, 2004, we issued 170,451 shares of our common stock to the former owners of Classic. The purchase agreement for Classic included a provision that gives the sellers the right to have us redeem these shares at a price of \$6.5970 per share within five years of the date of issuance of the shares. The sellers have the right to partially redeem these shares in increments of 10,000 or more shares per transaction. The agreement also has an automatic termination provision if the Company's shares have traded at a closing price of greater than \$7.33 per share for any consecutive period of 60 trading days during the period of time commencing on the date there are no restrictions on the seller's sale of shares and ending on the fifth anniversary of the agreement.

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

RISK FACTORS

There are a number of risk factors related to the future results of the Company. The Company wishes to caution readers that the following important factors among others, in some cases have affected, and in the future could affect, the Company's actual results and could differ materially from those expressed in any forward-looking statements made by, or on behalf of the Company:

1. Our financial statements have been presented on the basis that the Company will continue as a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company's independent auditor has included a going concern qualification in its audit report relating to the Company's audited financial statements for the fiscal year ended October 31, 2004, based on concerns regarding debt covenant violations, working capital deficit and losses from operations. The Company's realization of its assets and satisfaction of its liabilities in the normal course of business is dependent upon the Company's ability to generate sufficient cash flow to meet its financial obligations, to comply with the terms of its debt financing agreements, to obtain refinancing of certain obligations and to continue to receive financial support under its line of credit with Fair Holdings.

2. Our inability to obtain additional financing may prevent additional expansion in our current business or acquiring new businesses. Additional financing may not be available to us on advantageous terms or at all, if, for example the interest rates are unattractive or we do not have sufficient collateral available to secure the desired increase in debt. Currently all of our assets are being used to secure outstanding debt, so unless we acquire unsecured assets or obtain a partial release from our secured creditors of their security interests, we will not have available additional collateral to pledge to new debtors.
3. We may issue equity to finance any future acquisitions or refinance existing debt. This would dilute the proportionate ownership of our current shareholders and may reduce per share value. Acquisitions may also lead to increased levels of borrowing. This would result in increased interest expense. Acquisitions are also likely to increase our depreciation and amortization expense. These factors may incur losses or reduced profits in the future.
4. The prices of the raw materials we utilize are subject to fluctuation, as occurred in the three and nine months ended July 31, 2005. We may not be able to pass along any or all of these increases to our customers. As a result, increases in the price of raw materials may decrease the profit margin from sales of our products.
5. Our overall strategy includes increasing revenue and reducing/controlling operating expenses. We have concentrated our efforts in ongoing, company-wide efficiency activities intended to increase productivity and reduce costs, including personnel reductions, reduction or elimination of non-personnel expenses and realigning and streamlining operations. We cannot assure that our efforts will result in increased profitability for any meaningful period of time.
6. We face significant competition in connection with the products and services we provide. The level of competition has increased recently and is expected to continue at increasing levels in the future. There are many other companies engaged in the manufacture of cargo trailers, luxury coach leasing and butyl rubber reclaiming, and many of these companies have greater financial and other business resources than those possessed by us. Furthermore, other companies may enter our area of business in the future. If competition increases, our sales and profits are likely to decline.
7. We may have difficulty receiving our requirements for butyl rubber tubes, our principle raw material in this segment. In recent years, the number of sources of supply has been reduced. We continue to search for additional sources and to make purchases from foreign suppliers. However, if the number of suppliers is further reduced, or if we are otherwise unable to obtain butyl raw material requirements on a timely basis and on favorable terms, our operations may be harmed.

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

8. There is a limited market for our Common Stock. There can be no assurance that a broader market for the Common Stock will develop. Selling shares of the Common Stock may be difficult because smaller quantities of shares are bought and sold and security analysts and news media coverage about the Company is limited. These factors could result in lower prices and larger spreads in the bid and asked prices for the shares of Common Stock.
9. Recently, there have been significant regulatory changes, including the Sarbanes-Oxley Act of 2002, and there may be new accounting pronouncements or regulatory rulings that will have an impact on our future consolidated financial position and results of operations. The Sarbanes-Oxley Act of 2002 and other rule changes and proposed legislative initiatives following several highly publicized corporate accounting and corporate governance failures are likely to increase general and administrative costs.

ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk related to interest rate changes. Approximately 56% of our primary debt at July 31, 2005 bore interest at a variable rate. An interest rate increase of one percentage point would increase our interest expense over a one-year period by approximately \$300,000 at current debt levels. Approximately \$21,395 of our consolidated debt bears interest from rates ranging from 10% to 15%.

ITEM 4 CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports we file pursuant to the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. The Company's management recognizes that, because the design of any system of controls is based in part upon certain assumptions about the likelihood of future events and also is subject to other inherent limitations, disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable, and not absolute, assurance of achieving the desired objectives.

Under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of the Company's disclosure controls and procedures as of July 31, 2005. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, for the reasons more fully set forth below, the Company's disclosure controls and procedures were not effective on July 31, 2005 in providing reasonable assurance that information required to be disclosed in the reports we file pursuant to the Securities Exchange Act of 1934 was recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

More specifically, the Company's management has concluded that (i) additional accounting personnel were needed both at the parent company level and at certain subsidiaries at July 31, 2005 to ensure that certain disclosure controls and procedures were operating effectively; (ii) greater segregation of duties was needed in the accounting functions; and (iii) certain procedures should be documented to ensure that personnel turnover does not result in a failure of those procedures. The Company is evaluating how best to utilize the time of all employees. The Company will continue to evaluate the need for additional staff at the parent and subsidiary levels, but given the size and location of the Company's subsidiaries the Company believes it will continue to face challenges in attracting and retaining qualified personnel. Additionally, the Company is also in the process of evaluating ways in which the impact of personnel turnover on the implementation of disclosure controls and procedures can be reduced. Management continues to evaluate the effectiveness of this segregation and the need for additional enhancements, including, but not limited to, the addition of accounting personnel.

There have been no other significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to the date of the July 31, 2005 evaluation.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is also 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.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

In November 2004, Obsidian Leasing's credit facility with Old National Bank matured and Obsidian Leasing now has current debt obligations due of \$3,062. The Company is in the process of negotiating a forbearance agreement with Old National Bank, and management is actively working to refinance this debt with other banks in the last quarter of fiscal 2005. Should refinancing or an extension of the current agreement not be obtained by the expiration date of the forbearance agreement, the debt will be repaid through current sources of availability including borrowings under the Company's line of credit and agreements with Fair Holdings. In addition, Fair Holdings has informally indicated that it would make available additional financial support if necessary, although we currently do not have any commitment for such support. Since November 2004, management sold two older coaches, reducing Obsidian Leasing's debt by \$209. Management is also in negotiations to sell two additional coaches, which will further reduce debt by an estimated \$224.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

Exhibits

The exhibits filed as part of this Form 10-Q are listed in the Exhibit Index, which is incorporated herein by reference.

40

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.

OBSIDIAN ENTERPRISES, INC.

September 19, 2005

By: /s/ Timothy S. Durham

Date

Timothy S. Durham, Chairman and Chief Executive Officer

September 19, 2005

By: /s/ Rick D. Snow

Date

Rick D. Snow, Executive Vice President/Chief Financial Officer

Exhibit Index

<u>Exhibit No.</u>	<u>Description</u>	
3.1	Articles of Incorporation	Incorporated by reference to Exhibit 3.3 to Amendment No. 1 to the Registration Statement on Form S-4 filed on December 17, 2003
3.2	By-laws	Incorporated by reference to Exhibit 3.1 to the Registrant's Annual Report on Form 10K for the Year Ended October 31, 2002
10.1	Loan and Security Agreement by and between United Expressline, Inc. and LaSalle Business Credit, LLC dated July 19, 2005	Attached
10.2	Revolving Note by and between United Expressline, Inc. and LaSalle Business Credit, LLC dated July 19, 2005	Attached
10.3	Term Note by and between United Expressline, Inc. and LaSalle Business Credit, LLC dated July 19, 2005	Attached
10.4	Continuing Unconditional Guarantee by and between United Expressline, Inc. and LaSalle Business Credit, LLC dated July 19, 2005	Attached
10.5	Subordination Agreement by and between The Huntington Capital Investment Company, United ExpressLine, Inc. and LaSalle Business Credit, LLC dated July 19, 2005	Attached
10.6	Subordination Agreement by and between Fair Holdings, Inc., United ExpressLine, Inc. and LaSalle Business Credit, LLC dated July 19, 2005	Attached
10.7	Subordination Agreement by and between UX, Inc., United ExpressLine, Inc. and LaSalle Business Credit, LLC dated July 19, 2005	Attached
10.8	Second Amendment to Forbearance Agreement by and between Old National Bank, Obsidian Leasing Company, Inc., Obsidian Enterprises, Inc., Pyramid Coach, Inc., Timothy S. Durham, Terry Whitesell and Julia Whitesell effective as of July 22, 2005	Attached
10.9	Third Amended Promissory Note (Line of Credit) by and between DW Leasing Company, LLC and Fair Holdings, Inc. dated June 15, 2005	Attached
10.10	Second Amended Promissory Note (Line of Credit) by and between DC Investments Leasing, LLC and Fair Holdings, Inc. dated June 15, 2005	Attached
10.11		Attached

Edgar Filing: OBSIDIAN ENTERPRISES INC - Form 10-Q

Amendment No. 3 to Note Purchase Agreement and Limited Waiver by and between United Expressline, Inc. and The Huntington Capital Investment Company dated July 19, 2005

42

<u>Exhibit No.</u>	<u>Description</u>	
31.1	Sarbanes-Oxley Act Section 302 Certification	Attached
31.2	Sarbanes-Oxley Act Section 302 Certification	Attached
32	Sarbanes-Oxley Act Section 906 Certification	Attached

43