
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

**[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended December 31, 2003

OR

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

For the transition period from _____ to _____

Commission file number: 333-31282

O'Sullivan Industries, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

43-0923022

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

1900 Gulf Street, Lamar, Missouri

(Address of principal executive offices)

64759-1899

(ZIP Code)

(417) 682-3322

(Registrant's telephone number, including area code)

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

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

As of February 10, 2004, 100 shares of common stock of O'Sullivan Industries, Inc., par value \$1.00 per share, were outstanding.

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PART I

ITEM 1. FINANCIAL STATEMENTS.

O'SULLIVAN INDUSTRIES, INC. AND SUBSIDIARIES
(a wholly owned subsidiary of O'Sullivan Industries Holdings, Inc.)
UNAUDITED CONSOLIDATED BALANCE SHEETS
(in thousands, except for share data)

<u>Assets</u>	<u>December 31, 2003</u>	<u>June 30, 2003</u>
Current assets:		
Cash and cash equivalents	\$ 11,373	\$ 7,977
Trade receivables, net of allowance for doubtful accounts of \$2,755 and \$2,978, respectively	29,324	25,032
Inventories, net	50,381	52,426
Prepaid expenses and other current assets	<u>2,371</u>	<u>2,772</u>
Total current assets	93,449	88,207
Property, plant and equipment, net	65,855	71,867
Other assets	8,998	8,982
Goodwill, net of accumulated amortization	<u>38,088</u>	<u>38,088</u>
Total assets	<u>\$ 206,390</u>	<u>\$ 207,144</u>
<u>Liabilities and Stockholder's Deficit</u>		
Current liabilities:		
Accounts payable	\$ 10,675	\$ 10,006
Current portion of long-term debt	—	4,039
Accrued advertising	10,924	9,493
Accrued liabilities	11,684	11,463
Payable to parent - tax sharing agreement	<u>4,655</u>	<u>6,798</u>
Total current liabilities	37,938	41,799
Long-term debt, less current portion	197,199	189,970
Other liabilities	3,581	2,439
Payable to parent - tax sharing agreement	67,412	65,269
Other payable to parent	<u>1,698</u>	<u>1,190</u>
Total liabilities	307,828	300,667
Commitments and contingent liabilities (Notes 9, 10 and 11)		
Stockholder's deficit:		
Common stock, \$1.00 par value; 100 shares authorized, issued and outstanding	—	—
Retained deficit	(102,712)	(93,819)
Accumulated other comprehensive income	<u>1,274</u>	<u>296</u>
Total stockholder's deficit	<u>(101,438)</u>	<u>(93,523)</u>
Total liabilities and stockholder's deficit	<u>\$ 206,390</u>	<u>\$ 207,144</u>

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

O'SULLIVAN INDUSTRIES, INC. AND SUBSIDIARIES
(a wholly owned subsidiary of O'Sullivan Industries Holdings, Inc.)
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands)

	Three months ended December 31,		Six months ended December 31,	
	2003	2002	2003	2002
Net sales	\$ 65,234	\$ 79,111	\$ 136,698	\$ 150,668
Cost of sales	<u>50,645</u>	<u>59,384</u>	<u>107,801</u>	<u>110,968</u>
Gross profit	<u>14,589</u>	<u>19,727</u>	<u>28,897</u>	<u>39,700</u>
Operating expenses:				
Selling, marketing and administrative	11,479	11,538	21,836	23,536
Casualty loss	<u>250</u>	<u>—</u>	<u>250</u>	<u>—</u>
Operating income	2,860	8,189	6,811	16,164
Other income (expense):				
Interest expense	(6,963)	(5,506)	(13,057)	(11,281)
Interest income	8	42	31	94
Other financing income (expense), net	<u>616</u>	<u>—</u>	<u>(2,678)</u>	<u>—</u>
Income (loss) before income tax provision	(3,479)	2,725	(8,893)	4,977
Income tax provision	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net income (loss)	<u>\$ (3,479)</u>	<u>\$ 2,725</u>	<u>\$ (8,893)</u>	<u>\$ 4,977</u>

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

O'SULLIVAN INDUSTRIES, INC. AND SUBSIDIARIES
(a wholly owned subsidiary of O'Sullivan Industries Holdings, Inc.)
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Six months ended December 31,	
	<u>2003</u>	<u>2002</u>
Cash flows provided by operating activities:		
Net income (loss)	\$ (8,893)	\$ 4,977
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	6,595	6,572
Amortization of debt issuance cost	826	786
Amortization of debt discount and accrued interest on senior note	396	181
Interest rate collar	—	(1,308)
Bad debt expense	101	579
Loss on disposal of assets	6	25
Debt extinguishment costs, net	2,678	—
Accrual of special payment on options to purchase Series A junior preferred stock	686	599
Changes in assets and liabilities:		
Trade receivables	(4,292)	(1,306)
Inventories	2,045	3,369
Other assets	436	(434)
Payable to RadioShack	—	(6,195)
Accounts payable and accrued liabilities	3,915	(6,815)
Net cash provided by operating activities	<u>4,499</u>	<u>1,030</u>
Cash flows used for investing activities:		
Capital expenditures	<u>(540)</u>	<u>(2,704)</u>
Cash flows used for financing activities:		
Proceeds from borrowings	95,000	—
Repayment of borrowings	(92,265)	(5,819)
Debt issuance costs	(3,806)	—
Advances on intercompany loans	508	684
Net cash flows used for financing activities	<u>(563)</u>	<u>(5,135)</u>
Net increase (decrease) in cash and cash equivalents	3,396	(6,809)
Cash and cash equivalents, beginning of period	<u>7,977</u>	<u>15,777</u>
Cash and cash equivalents, end of period	<u>\$ 11,373</u>	<u>\$ 8,968</u>
Non-cash investing and financing activities:		
Capital expenditures included in accounts payable	\$ 17	\$ 1,077

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

O'SULLIVAN INDUSTRIES, INC. AND SUBSIDIARIES
(A wholly owned subsidiary of O'Sullivan Industries Holdings, Inc.)
UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDER'S DEFICIT
For the six months ended December 31, 2003
(in thousands)

	<u>Retained deficit</u>	<u>Accumulated other comprehensive income</u>	<u>Total stockholder's deficit</u>	<u>Comprehensive income (loss)</u>
Balance, June 30, 2003	\$ (93,819)	\$ 296	\$ (93,523)	
Net loss	(8,893)		(8,893)	\$ (8,893)
Cumulative translation adjustments		<u>978</u>	<u>978</u>	<u>978</u>
Balance, December 31, 2003	<u>\$ (102,712)</u>	<u>\$ 1,274</u>	<u>\$ (101,438)</u>	<u>\$ (7,915)</u>

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

O'SULLIVAN INDUSTRIES, INC.
(A wholly owned subsidiary of O'Sullivan Industries Holdings, Inc.)
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2003

Note 1—Basis of Presentation

The unaudited consolidated financial statements of O'Sullivan Industries, Inc. and subsidiaries ("O'Sullivan"), a wholly owned subsidiary of O'Sullivan Industries Holdings, Inc. ("O'Sullivan Holdings") included herein have been prepared in accordance with generally accepted accounting principles for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The financial statements should be read in conjunction with the audited financial statements and notes thereto included in O'Sullivan's Annual Report on Form 10-K for the fiscal year ended June 30, 2003. The interim results are not necessarily indicative of the results that may be expected for a full year.

Note 2—Refinancing of Long-Term Debt

On September 29, 2003, O'Sullivan issued \$100.0 million of privately placed, 10.63% senior secured notes maturing on October 1, 2008. The notes were issued at a price of 95%, providing \$95.0 million in cash proceeds before expenses related to the issuance, which were about \$3.8 million. The proceeds were used to repay the term loans under O'Sullivan's senior credit facility. The notes are secured by a first-priority security interest in and lien on substantially all of O'Sullivan's assets (and on O'Sullivan's capital stock) other than accounts receivable, inventory, capital stock of O'Sullivan's subsidiaries, deposit accounts, certain books and records and certain licenses, and by a second-priority security interest in and lien on substantially all of O'Sullivan's accounts receivable, inventory, deposit accounts, certain books and records and certain licenses. The notes are guaranteed by O'Sullivan Holdings, O'Sullivan Industries - Virginia, Inc. ("O'Sullivan Industries - Virginia") and O'Sullivan Furniture Factory Outlet, Inc. On December 23, 2003, O'Sullivan filed a registration statement with respect to an offer to exchange the notes for a new issue of identical notes registered under the Securities Act of 1933, as amended. The registration statement became effective on January 8, 2004. The exchange offer is expected to close around February 25, 2004. O'Sullivan may also be required under certain circumstances to provide a shelf registration statement to cover resales of the notes.

On September 29, 2003, O'Sullivan, O'Sullivan Industries - Virginia and O'Sullivan Furniture Factory Outlet, Inc. also entered into a new five-year asset-based credit agreement which permits revolving borrowings of up to \$40.0 million to the extent of availability under a collateral borrowing base. The borrowing base at December 31, 2003 was approximately \$36.9 million. The credit agreement has a \$25.0 million sub-limit for letters of credit, of which O'Sullivan is currently utilizing approximately \$14.0 million. The credit agreement is secured by a first-priority security interest in and lien on substantially all of O'Sullivan's accounts receivable, inventory, deposit accounts, certain books and records and certain licenses, and a second-priority security interest in and lien on substantially all of O'Sullivan's assets other than accounts receivable, inventory, capital stock of O'Sullivan and its subsidiaries, deposit accounts, certain books and records and certain licenses. O'Sullivan Holdings guaranteed the obligations under the credit agreement. The interest rate on loans under the credit agreement is a LIBOR rate plus 2.5% or an index rate plus 1.0%. A fee equal to 0.5% per annum is paid on the unused commitment under the credit agreement. No loans were outstanding under the revolving credit agreement as of December 31, 2003.

In connection with the repayment of the term loans and the termination of the revolving credit facility under the previous senior credit facility, O'Sullivan expensed approximately \$3.1 million of unamortized issuance costs related to the previous senior credit facility in the first quarter of fiscal 2004.

Long term debt consisted of the following:

	December 31, 2003	June 30, 2003
	(in thousands)	
Senior term loan, tranche A	\$ —	\$ 10,593
Senior term loan, tranche B	—	77,673
Industrial revenue bonds	10,000	10,000
Senior secured notes	95,186	—
Senior subordinated notes	<u>92,013</u>	<u>95,743</u>
Total debt	197,199	194,009
Less current portion	<u>—</u>	<u>(4,039)</u>
Total long-term debt	<u>\$ 197,199</u>	<u>\$ 189,970</u>

Total debt, including the discount, net of accretion, of \$4.8 million on the senior secured notes and \$4.0 million on the senior subordinated notes, matures as follows (in thousands):

	Fiscal year ending June 30,
2004	\$ —
2005	—
2006	—
2007	—
2008	—
Thereafter	<u>206,000</u>
	<u>\$ 206,000</u>

Note 3—Derivative Financial Instruments

As required under O’Sullivan’s previous senior credit facility, O’Sullivan hedged one-half of its term loans with an initial notional amount of \$67.5 million with a three-year, costless interest rate collar. The collar, which expired in March 2003, was based on three-month LIBOR and had a floor of 6.43% and a ceiling of 8.75%. For the three months and six months ended December 31, 2002, O’Sullivan recorded reduced interest expense of \$724,000 and \$1.3 million, respectively. These amounts represented the change in fair value of the interest rate collar.

Note 4—New Accounting Standards

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51* ("FIN 46"). FIN 46 establishes accounting guidance for consolidation of variable interest entities that function to support the activities of the primary beneficiary. FIN 46 applies to any business enterprise, public or private, that has a controlling interest, contractual relationship or other business relationship with a variable interest entity. In December 2003, the FASB issued Interpretation No. 46(R) ("FIN 46(R)") which supercedes FIN 46. FIN 46(R) is effective for all Special Purpose Entities ("SPE's") created prior to February 1, 2003 at the end of the first interim or annual reporting period ending after December 15, 2003. FIN 46(R) will be applicable to all non-SPE's created prior to February 1, 2003 by public entities at the end of the first interim or annual reporting period ending after March 15, 2004. O’Sullivan has determined that it has no SPE's. O’Sullivan is in the process of reviewing the applicability of FIN 46(R) to entities other than SPE's, but does not expect the adoption to have a material effect on its consolidated financial statements.

Note 5—Stock Based Compensation

We account for stock-based compensation for employees under Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*, and have elected the disclosure-only alternative under SFAS 123. No stock-based compensation cost is recorded, as all options granted have an exercise price equal to the

market value of the stock on the date of the grant. In accordance with SFAS 148, the following table presents the effect on net income (loss) had compensation cost for O'Sullivan's stock plans been determined consistent with SFAS 123:

	Three months ended December 31,		Six months ended December 31,	
	2003	2002	2003	2002
	(in thousands)			
Net income (loss) as reported	\$ (3,479)	\$ 2,725	\$ (8,893)	\$ 4,977
Less: total stock-based compensation expense determined under fair value method for all stock options, net of related income tax	(1)	(2)	(2)	(3)
Pro forma net income (loss)	<u>\$ (3,480)</u>	<u>\$ 2,723</u>	<u>\$ (8,895)</u>	<u>\$ 4,974</u>

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the vesting period. O'Sullivan did not grant any options during the six months ended December 31, 2003 and 2002.

Note 6—Shipping and Handling Costs

O'Sullivan reports amounts billed to customers as revenue, the cost for warehousing operations in cost of sales and freight out costs as part of selling, marketing and administrative expenses. Freight out costs included in selling, marketing and administrative expenses in the second quarters of fiscal 2004 and fiscal 2003 were approximately \$1.7 million and \$1.5 million, respectively. Freight out costs in the six months ended December 31, 2003 and 2002 were \$3.2 million and \$3.6 million, respectively.

Note 7—Inventory

Inventory, net, consists of the following:

	December 31, 2003	June 30, 2003
	(in thousands)	
Finished goods	\$ 31,303	\$ 37,744
Work in process	4,578	3,923
Raw materials	14,500	10,759
	<u>\$ 50,381</u>	<u>\$ 52,426</u>

Note 8—Condensed Consolidating Financial Information

In November 1999 O'Sullivan issued \$100 million of 13.375% senior subordinated notes due 2009. These notes were unsecured obligations of O'Sullivan; however, they were guaranteed on an unsecured basis by O'Sullivan Industries – Virginia and any future subsidiaries created, including O'Sullivan Furniture Factory Outlet, Inc., which commenced operations in April 2002. The guarantees are full and unconditional. In fiscal 2000, O'Sullivan exchanged the notes issued in November 1999 for notes with substantially identical terms and associated guarantees. The exchange notes have been registered under the Securities Act of 1933, as amended.

In September 2003 O'Sullivan issued \$100 million of 10.63% senior secured notes. These notes are secured by substantially all the assets of O'Sullivan and its guarantor subsidiaries O'Sullivan Industries - Virginia and O'Sullivan Furniture Factory Outlet, Inc. The senior secured notes are also guaranteed by O'Sullivan Holdings. The guarantees are full and unconditional. Security for the senior secured notes includes first priority liens and security interests in the stock of O'Sullivan.

The accompanying condensed consolidating financial information has been prepared and presented pursuant to SEC rules and regulations.

Condensed Consolidating Statements of Operations

Three months ended December 31, 2003

(in thousands)

	O'Sullivan Industries	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
Net sales	\$ 54,600	\$ 10,634	\$ —	\$ 65,234
Cost of sales	<u>41,336</u>	<u>9,309</u>	<u>—</u>	<u>50,645</u>
Gross profit	13,264	1,325	—	14,589
Operating expenses:				
Selling, marketing and administrative	10,375	1,104	—	11,479
Casualty loss	<u>250</u>	<u>—</u>	<u>—</u>	<u>250</u>
Operating income	2,639	221	—	2,860
Other income (expense):				
Interest expense	(6,723)	(240)	—	(6,963)
Interest income	8	—	—	8
Other financing income, net	616	—	—	616
Equity in loss of subsidiary	<u>(19)</u>	<u>—</u>	<u>19</u>	<u>—</u>
Loss before income tax provision	(3,479)	(19)	19	(3,479)
Income tax provision	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net loss	<u>\$ (3,479)</u>	<u>\$ (19)</u>	<u>\$ 19</u>	<u>\$ (3,479)</u>

Three months ended December 31, 2002

(in thousands)

	O'Sullivan Industries	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
Net sales	\$ 55,996	\$ 23,115	\$ —	\$ 79,111
Cost of sales	<u>40,884</u>	<u>18,500</u>	<u>—</u>	<u>59,384</u>
Gross profit	15,112	4,615	—	19,727
Operating expenses:				
Selling, marketing and administrative	9,355	2,183	—	11,538
Operating income	5,757	2,432	—	8,189
Other income (expense):				
Interest expense	(5,378)	(128)	—	(5,506)
Interest income	42	—	—	42
Equity in earnings of subsidiary	<u>2,304</u>	<u>—</u>	<u>(2,304)</u>	<u>—</u>
Income before income tax provision	2,725	2,304	(2,304)	2,725
Income tax provision	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net income	<u>\$ 2,725</u>	<u>\$ 2,304</u>	<u>\$ (2,304)</u>	<u>\$ 2,725</u>

Six months ended December 31, 2003

(in thousands)

	O'Sullivan Industries	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
Net sales	\$ 107,682	\$ 29,016	\$ —	\$ 136,698
Cost of sales	<u>82,164</u>	<u>25,637</u>	<u>—</u>	<u>107,801</u>
Gross profit	25,518	3,379	—	28,897
Operating expenses:				
Selling, marketing and administrative	18,956	2,880	—	21,836
Casualty loss	<u>250</u>	<u>—</u>	<u>—</u>	<u>250</u>
Operating income	6,312	499	—	6,811
Other income (expense):				
Interest expense	(12,601)	(456)	—	(13,057)
Interest income	31	—	—	31
Other financing expense, net	(2,678)	—	—	(2,678)
Equity in earnings of subsidiary	<u>43</u>	<u>—</u>	<u>(43)</u>	<u>—</u>
Income (loss) before income tax provision	(8,893)	43	(43)	(8,893)
Income tax provision	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net income (loss)	<u>\$ (8,893)</u>	<u>\$ 43</u>	<u>\$ (43)</u>	<u>\$ (8,893)</u>

Six months ended December 31, 2002

(in thousands)

	O'Sullivan Industries	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
Net sales	\$ 108,141	\$ 42,527	\$ —	\$ 150,668
Cost of sales	<u>77,777</u>	<u>33,191</u>	<u>—</u>	<u>110,968</u>
Gross profit	30,364	9,336	—	39,700
Operating expenses:				
Selling, marketing and administrative	19,322	4,214	—	23,536
Operating income	11,042	5,122	—	16,164
Other income (expense):				
Interest expense	(11,022)	(259)	—	(11,281)
Interest income	94	—	—	94
Equity in earnings of subsidiary	<u>4,863</u>	<u>—</u>	<u>(4,863)</u>	<u>—</u>
Income before income tax provision	4,977	4,863	(4,863)	4,977
Income tax provision	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net income	<u>\$ 4,977</u>	<u>\$ 4,863</u>	<u>\$ (4,863)</u>	<u>\$ 4,977</u>

Condensed Consolidating Balance Sheets

December 31, 2003 (in thousands)				
	O'Sullivan Industries	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS:				
Current assets	\$ 86,005	\$ 7,444	\$ —	\$ 93,449
Property, plant and equipment, net	36,445	29,410	—	65,855
Other assets	8,914	84	—	8,998
Investment in subsidiaries	33,768	—	(33,768)	—
Goodwill	38,088	—	—	38,088
Receivable from affiliates	—	40,509	(40,509)	—
Total assets	<u>\$ 203,220</u>	<u>\$ 77,447</u>	<u>\$ (74,277)</u>	<u>\$ 206,390</u>
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT):				
Current liabilities	\$ 18,436	\$ 19,502	\$ —	\$ 37,938
Long-term debt	187,199	10,000	—	197,199
Payable to affiliates	42,207	—	(40,509)	1,698
Other liabilities	3,581	—	—	3,581
Payable to parent - tax sharing agreement	53,235	14,177	—	67,412
Stockholder's equity (deficit)	(101,438)	33,768	(33,768)	(101,438)
Total liabilities and stockholder's equity (deficit)	<u>\$ 203,220</u>	<u>\$ 77,447</u>	<u>\$ (74,277)</u>	<u>\$ 206,390</u>

June 30, 2003 (in thousands)				
	O'Sullivan Industries	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS:				
Current assets	\$ 74,930	\$ 13,277	\$ —	\$ 88,207
Property, plant and equipment, net	40,356	31,511	—	71,867
Other assets	8,896	86	—	8,982
Investment in subsidiaries	33,725	—	(33,725)	—
Goodwill	38,088	—	—	38,088
Receivable from affiliates	—	33,425	(33,425)	—
Total assets	<u>\$ 195,995</u>	<u>\$ 78,299</u>	<u>\$ (67,150)</u>	<u>\$ 207,144</u>
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT):				
Current liabilities	\$ 20,951	\$ 20,848	\$ —	\$ 41,799
Long-term debt	179,970	10,000	—	189,970
Payable to affiliates	34,615	—	(33,425)	1,190
Other liabilities	2,439	—	—	2,439
Payable to parent - tax sharing agreement	51,543	13,726	—	65,269
Stockholder's equity (deficit)	(93,523)	33,725	(33,725)	(93,523)
Total liabilities and stockholder's equity (deficit)	<u>\$ 195,995</u>	<u>\$ 78,299</u>	<u>\$ (67,150)</u>	<u>\$ 207,144</u>

Condensed Consolidating Statements of Cash Flows

Six months ended December 31, 2003 (in thousands)				
	O'Sullivan Industries	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
Net cash flows provided (used) by operating activities:	\$ (2,863)	\$ 7,362	\$ —	\$ 4,499
Investing activities:				
Capital expenditures	(462)	(78)	—	(540)
Repayment of loans to affiliates	7,083	—	(7,083)	—
Net	6,621	(78)	(7,083)	(540)
Financing activities:				
Advances (repayment) of loans from affiliates	508	(7,083)	7,083	508
Proceeds from borrowings	95,000	—	—	95,000
Repayment of borrowings	(92,265)	—	—	(92,265)
Debt issuance costs	(3,806)	—	—	(3,806)
Net	(563)	(7,083)	7,083	(563)
Cash and cash equivalents:				
Net increase in cash and cash equivalents	3,195	201	—	3,396
Cash and cash equivalents, beginning of period	7,878	99	—	7,977
Cash and cash equivalents, end of period	\$ 11,073	\$ 300	\$ —	\$ 11,373

Six months ended December 31, 2002 (in thousands)				
	O'Sullivan Industries	Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
Net cash flows provided (used) by operating activities:	\$ (7,867)	\$ 8,897	\$ —	\$ 1,030
Investing activities:				
Capital expenditures	(1,719)	(985)	—	(2,704)
Repayment of loans to affiliates	7,955	—	(7,955)	—
Net	6,236	(985)	(7,955)	(2,704)
Financing activities:				
Advances (repayment) of loans from affiliates	684	(7,955)	7,955	684
Repayment of borrowings	(5,819)	—	—	(5,819)
Net	(5,135)	(7,955)	7,955	(5,135)
Cash and cash equivalents:				
Net decrease in cash and cash equivalents	(6,766)	(43)	—	(6,809)
Cash and cash equivalents, beginning of period	15,648	129	—	15,777
Cash and cash equivalents, end of period	\$ 8,882	\$ 86	\$ —	\$ 8,968

Note 9—Income Taxes

O'Sullivan recorded no tax expense for the three or six months ended December 31, 2003 and 2002 because of the valuation allowance recorded in the quarter ended March 31, 2002.

Note 10—Related Party Transactions

O'Sullivan Industries entered into a management services agreement with Bruckmann, Rosser, Sherrill & Co., LLC ("*BRS*") for strategic and financial advisory services on November 30, 1999. The fee for these services is the greater of (a) 1% of O'Sullivan Industries' consolidated cash flow (as defined in the indenture related to the O'Sullivan Industries senior subordinated notes) or (b) \$300,000 per year. Under the management services agreement, BRS can also receive reimbursement for expenses.

The credit agreement, the indenture for the senior secured notes and the management services agreement all contain certain restrictions on the payment of the management fee. The management services agreement provides that no cash payment for the management fee can be made unless the fixed charge coverage ratio (as defined in the indenture for the senior subordinated notes) for O'Sullivan Industries' most recently ended four full fiscal quarters would have been greater than 2.0 to 1.0. Similarly, the indenture for the senior secured notes provides that payments under the management services agreement are conditional and contingent upon the fixed charge coverage ratio (as defined in the indenture for the senior secured notes) for the four most recently ended full fiscal quarters immediately preceding any payment date being at least 2.0 to 1. The credit agreement prevents O'Sullivan Industries from paying fees and expenses under the management services agreement if a default or event of default exists or if one would occur as a result of the payment. All fees and expenses under the management services agreement are subordinated to the senior subordinated notes.

The management fees and reimbursable expenses of \$145,000 and \$233,000 recognized in the first half of fiscal years 2004 and 2003, respectively, are included in selling, marketing and administrative expense in the accompanying consolidated statements of operations. O'Sullivan Industries paid BRS \$713,000 in the first quarter of fiscal 2003 for the balance owed through June 30, 2002 and \$305,000 as a prepayment of the fiscal 2003 management fee. An additional prepayment of \$285,000 for fiscal 2003 management fees was made in January 2003. The prepaid balance at December 31, 2003 and June 30, 2003 was \$2,000 and \$147,000, respectively, and is included in prepaid expenses and other current assets on the consolidated balance sheet.

Note 11—Commitments and Contingencies

Payable to Parent - Tax Sharing Agreement. Future payments to O'Sullivan Holdings with respect to the tax sharing agreement between O'Sullivan Holdings and RadioShack are contingent on taxable income. The maximum payments are fiscal 2004—\$11.6 million; fiscal 2005—\$10.5 million; fiscal 2006—\$11.3 million; and thereafter—\$38.7 million. O'Sullivan estimates that its payments to O'Sullivan Holdings with respect to the tax sharing agreement between O'Sullivan Holdings and RadioShack during fiscal 2004 will aggregate \$2.3 million.

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

Overview

We are a leading ready-to-assemble furniture manufacturer in North America with over 45 years of experience. We design, manufacture and distribute a broad range of RTA furniture products—computer workcenters, desks, entertainment centers, audio stands, bookcases and cabinets.

Recent Trends

Our net sales for the second quarter of fiscal 2004 were down about 17.5% from sales for the same quarter in fiscal 2003. For the first half of fiscal 2004, our sales declined about 9.3%. Our sales declined for several reasons:

- increasing competition from imported furniture, particularly from China;

- the slowdown of economic growth and consumer spending in the United States from 2001 into 2003;
- liquidations and bankruptcies by a number of customers, including Montgomery Ward, Ames and Kmart;
- increased competition from domestic competition due to excess capacity in the RTA furniture industry;
- inventory reductions by our customers; and
- a focus by several of our retail partners toward higher price point offerings, which include products using materials other than our particleboard and laminate capabilities.

These factors will continue to affect our business throughout the remainder of fiscal 2004.

Due to the low sales levels, we decreased production levels at our manufacturing facilities, which adversely affected our fixed cost absorption. We also increased promotional activities with several of our major retail partners. As a result, our operating income fell to \$2.9 million for the quarter ended December 31, 2003, compared with \$8.2 million for the quarter ended December 31, 2002. For the first half of fiscal 2004, our operating income was \$6.8 million compared to \$16.2 million in the first half of fiscal 2003. Net loss for the quarter ended December 31, 2003 was \$3.5 million compared to a net income of \$2.7 million in the comparable period of fiscal 2003. Net loss for the six months ended December 31, 2003 was \$8.9 million, compared to a net income of \$5.0 million for the six months ended December 31, 2002. The net loss for the fiscal 2004 quarter reflects lower sales and the reduction in operating income. The net loss for the first half of fiscal 2004 reflects lower sales and operating income, as well as the write-off of unamortized debt issuance costs related to our previous senior credit facility. The net loss also reflects increased interest expense due to our July 1, 2003 adoption of SFAS 150, pursuant to which we now account for dividends on our mandatorily redeemable senior preferred stock as interest expense.

Several manufacturers, including O'Sullivan, have excess manufacturing capacity due to the current decline in sales in the RTA furniture segment and increasing imports. This excess capacity is causing increased competition that is expected to continue, and perhaps to intensify, through the remainder of fiscal 2004. This adversely affected our margins and results of operations in fiscal 2003, and is continuing to affect sales, margins and results of operations in fiscal 2004.

We have recently been informed by Best Buy that it intends to reduce orders of particleboard furniture. As a result, we expect our sales to Best Buy to decline significantly. We hope to partially offset this loss by increasing sales to other customers, but we can not assure you that this will occur.

Refinancing Transactions

On September 29, 2003, O'Sullivan Industries issued \$100 million of senior secured notes and executed a new five-year \$40 million senior secured revolving credit agreement. The proceeds of the senior secured notes were used to repay O'Sullivan Industries' existing \$88.3 million senior credit facility and related fees and expenses. The senior secured notes were sold at 95% of their face value, bear interest at 10.63% and mature on October 1, 2008. As of December 31, 2003, we had no borrowings under the new credit agreement, although \$14.0 million of letters of credit were outstanding.

Raw Materials

We purchase large quantities of raw materials, including particleboard and fiberboard. We are dependent on our outside suppliers for all of our raw materials. Therefore, we are subject to changes in the prices charged by our suppliers.

Due to the nature of our product lines, we have material sensitivity to some commodities, including particleboard, fiberboard, corrugated cardboard and hardware. We manage commodity price exposures primarily through the duration and terms of our vendor agreements. A 1.0% change in our raw material prices would affect our cost of sales by approximately \$1.4 million annually.

In the first half of fiscal 2004, we saw increases of approximately 5% to 10% in the price of particleboard, our largest-cost raw material. We expect additional price increases in the last half of fiscal 2004, and perhaps beyond, as demand for particleboard has increased and suppliers have reduced capacity. Because we utilize first-in, first-out accounting for our inventory, not all of the price increases are reflected in our cost of goods sold for the first six months of fiscal 2004. These price increases will reduce our operating margins and operating income for the remainder of fiscal 2004 and perhaps beyond. Further, the reduction in particleboard manufacturing capacity may create shortages that might delay the rollouts of some new products from our fiscal year 2004 third quarter to the fourth quarter.

We will endeavor to reduce the impact of the price increases through our value analysis program and by the eventual inclusion of the higher costs in the pricing of our products. In our value analysis program, we endeavor to remove costs from the production of a product without sacrificing utility or quality of the product. We cannot assure you that we will be successful in offsetting these or future potential raw material price increases.

RadioShack Arbitration and Accounting for Tax Sharing Agreement with RadioShack

In 1994, RadioShack, then Tandy Corporation, completed an initial public offering of O'Sullivan Holdings. In connection with the offering, O'Sullivan Holdings entered into a tax sharing and tax benefit reimbursement agreement with RadioShack. RadioShack and O'Sullivan Holdings made elections under Sections 338(g) and 338(h)(10) of the Internal Revenue Code with the effect that the tax basis of our assets was increased to the deemed purchase price of the assets, and an equal amount of such increase was included as taxable income in the consolidated federal tax return of RadioShack. The result was that the tax basis of our assets exceeded the historical book basis we used for financial reporting purposes.

The increased tax basis of our assets results in increased tax deductions and, accordingly, reduced our taxable income or increased our net operating loss. Under the tax sharing agreement, O'Sullivan Holdings is contractually obligated to pay RadioShack nearly all of the federal tax benefit expected to be realized with respect to such additional basis. The payments under the agreement represent additional consideration for the stock of O'Sullivan Industries, Inc. and further increase the tax basis of our assets from the 1994 initial public offering when payments are made to RadioShack.

To the extent the benefit of these basis step-up deductions caused us to have a federal taxable loss, O'Sullivan Holdings was only obligated to pay RadioShack to the extent that the benefits were used to reduce taxable income to zero. Any additional tax deductions resulting from the step-up create a net operating loss ("NOL") carryforward on O'Sullivan Holdings' federal income tax return. Under the terms of the tax sharing agreement, if we utilized this NOL carryforward to generate future tax savings, O'Sullivan Holdings was also obligated to remit that benefit received to RadioShack.

O'Sullivan recorded the deferred tax asset created by the step-up in basis and the additional basis from the probable future payments to RadioShack as of February 1994. At the same time, we recorded our obligation to RadioShack. The amounts of the deferred tax asset and obligation to RadioShack were each \$147.9 million at February 1994. From 1994 through 2001, we reduced the amount of the deferred tax asset and the obligation to RadioShack as we realized the benefits of the deferred tax asset and paid RadioShack amounts due under the tax sharing agreement.

In November 1999, O'Sullivan Holdings completed a leveraged recapitalization and merger transaction which significantly increased our debt. As a result of the higher debt levels, we also experienced increased interest expense, which reduced our taxable income and also reduced the tax benefits used from the deductions arising from the step-up in basis. O'Sullivan Holdings reduced its payments to RadioShack accordingly. RadioShack claimed

that the deductions arising from the increased interest payments should not impact tax benefit payments due RadioShack under the tax agreement. RadioShack pursued this matter and prevailed in an arbitration ruling in March 2002. O'Sullivan Holdings reached a settlement agreement with RadioShack in May 2002. Pursuant to the settlement agreement, we paid RadioShack \$24.6 million in May 2002 and an additional \$3.1 million in June 2002. The sum of these two payments (\$27.7 million) represented the amount due RadioShack under the settlement agreement through June 30, 2002. These amounts represent the calculation of what benefits we would have realized had we not had the additional interest expense from the 1999 recapitalization and merger. The settlement agreement requires calculations into the future and quarterly payments to RadioShack if our taxable income adjusted for the additional interest expense shows that we would have realized the benefits had we not incurred the additional interest expense. If on this basis, we could have used the deductions from the step-up in basis, O'Sullivan Holdings is required to make a payment to RadioShack even though we may not be receiving any current tax benefit from these deductions.

The remaining maximum obligation to RadioShack was \$109.1 million at March 31, 2002. O'Sullivan Holdings reduced the obligation by subsequent payments; the balance was \$81.4 million at June 30, 2002 and \$72.1 million at June 30, 2003 and September 30, 2003.

Under Statement of Financial Accounting Standards ("SFAS") 109, we must determine if it is more likely than not that we will realize the net deferred tax asset as a reduction in our tax liabilities in the future. SFAS 109 requires objective evidence to support the more likely than not conclusion. The arbitration decision dramatically affected our liquidity, which reduced the amounts we could invest in sales efforts or cost improvements, as most free cash flow would now be used for O'Sullivan Holdings' payments to RadioShack or to repay our indebtedness. In addition, it became evident to us by March 2002 that the prolonged economic slowdown that started prior to September 11, 2001 was continuing. This, coupled with the adverse effect on our liquidity of the settlement, caused us to lower our projections of future taxable income. Accordingly, we projected our expected future taxable income utilizing operating performance we achieved in fiscal 2002 assuming our performance would be no better or worse over an extended period of time. Such projections indicate that we would not have taxable income until 2009 when substantially all the tax benefit deductions had been taken. At that point, the projections indicated that our net operating losses existing at that time would be utilized before they expire. However, we currently have and expect to have taxable losses for a number of years in the future. Projections over a long time are inherently uncertain, and we cannot provide objective evidence that our operations in 2009 and beyond will produce sufficient taxable income. As a result, we provided a full valuation allowance on our net deferred tax assets in fiscal 2002 with a corresponding charge to income tax expense.

As a result of providing a full valuation allowance on our net deferred tax assets in fiscal 2002, we did not record a tax provision in the first six months of fiscal 2003 or 2004. We do not expect to record a tax provision or benefit in the foreseeable future. If at a future date we determine that some or all of the deferred tax asset will more likely than not be realized, we will reverse the appropriate portion of the valuation allowance and credit income tax expense.

See "Cautionary Statement Regarding Forward Looking Information."

Results of Operations

Net Sales. Net sales for the quarter ended December 31, 2003 decreased by \$13.9 million, or 17.5%, to \$65.2 million from \$79.1 million for the quarter ended December 31, 2002. Net sales for the six months ended December 31, 2003 decreased by \$14.0 million, or 9.3%, to \$136.7 million from \$150.7 million for the six months ended December 31, 2002. Our sales declined in every major channel due to extremely competitive conditions, economic uncertainties and the other reasons cited above. Most of the decline for the quarter and six months was due to a decline in unit volume, although the average price per unit also declined slightly.

Gross Profit. Gross profit decreased to \$14.6 million, or 22.4% of sales, for the three month period ended December 31, 2003, from \$19.7 million, or 24.9% of sales, for the comparable prior year quarter. The gross margin percentage for the second quarter of fiscal 2004 declined primarily because of lower sales, lower production levels,

changes in our customer mix, increasing raw material prices and increasing promotional activities with several retail partners. For the six months ended December 31, 2003, gross profit declined to \$28.9 million, or 21.1% of sales, from \$39.7 million, or 26.3% of sales. Gross profit declined for the first half of fiscal 2004 due to lower sales levels, lower production levels, changes in our customer mix, increasing promotional activities and product sold at discounted pricing.

Selling, Marketing and Administrative Expenses. Selling, marketing and administrative expenses were about flat at \$11.5 million for the three month period ended December 31, 2003, compared to the quarter ended December 31, 2002. Because of our lower sales in the fiscal 2004 period, selling, marketing and administrative expenses increased to 17.6% of our net sales for the fiscal 2004 second quarter compared to 14.6% of net sales in the second quarter of fiscal 2003. Freight out expense increased due to charges incurred to ship displays to certain customers. Royalty expenses increased due to royalties paid in connection with our license agreement with The Coleman Company, Inc. These charges were offset by decreased replacement parts expense and lower incentive compensation and profit sharing costs.

For the six months ended December 31, 2003, selling, marketing and administrative expenses decreased \$1.7 million from \$23.5 million in fiscal 2002 to \$21.8 million in fiscal 2003. The major factors contributing to the decrease were decreased bad debt expense, decreased freight out expense and lower incentive compensation and profit sharing costs.

Depreciation and Amortization. Depreciation and amortization expenses of \$3.3 million for the second quarter of fiscal 2004 and \$6.6 million year to date remained flat compared to the second quarter and year to date for fiscal 2003.

Casualty Loss. In the November 2003, a fire destroyed certain of our manufacturing equipment. We recorded a casualty loss of \$250,000 in the quarter ended December 31, 2003. We deferred recognition of potential gains resulting from estimated insurance recoveries until the insurance proceeds have been received. We currently expect to record approximately \$550,000 of gains on insurance recoveries during the second half of fiscal 2004.

Operating Income. Operating income decreased \$5.3 million to \$2.9 million for the quarter ended December 31, 2003 from \$8.2 million in the quarter ended December 31, 2002 due to lower sales and operating levels. For the six months ended December 31, 2003, operating income decreased \$9.4 million over the six months ended December 31, 2002. Our operating income declined because of our lower sales levels, lower production levels which adversely affected our fixed cost absorption, changes in customer mix, increasing raw material prices and increased promotion activities with several of our major retail partners.

Net Interest Expense. Net interest expense increased from \$5.5 million in the second quarter of fiscal 2003 to \$7.0 million in the second quarter of fiscal 2004. Net interest expense increased \$1.8 million from \$11.2 million for the first half of fiscal 2003 to \$13.0 million for the first half of fiscal 2004. Interest expense increased due primarily to the fiscal 2003 change in value of our interest rate collar that expired in March 2003. The following table summarizes our net interest expense:

	Three months ended December 31, (in thousands)		Six months ended December 31, (in thousands)	
	2003	2002	2003	2002
Interest expense on senior secured notes, credit agreement, senior credit facility, industrial revenue bonds and senior subordinated notes	\$ 6,276	\$ 5,746	\$ 11,835	\$ 11,622
Interest income	(8)	(42)	(31)	(94)
<i>Non-cash items:</i>				
Interest rate collar	—	(724)	—	(1,308)
Amortization of debt discount	292	91	396	181
Amortization of loan fees	395	393	826	786
Net interest expense	<u>\$ 6,955</u>	<u>\$ 5,464</u>	<u>\$ 13,026</u>	<u>\$ 11,187</u>

Other Financing Income (Expense). We recorded a gain of \$616,000 in the quarter ended December 31, 2003 in connection with the repurchase of \$4.0 million of our senior subordinated notes, net of original issue discount and capitalized loan fees. For the six months ended December 31, 2003, we recorded other financing expense of \$2.7 million related to the write-off of capitalized loan fees for the old senior credit facility of about \$3.3 million in the September 2003 quarter, offset by the gain on the repurchase of the subordinated notes.

Income Tax Provision. We recorded no tax expense for the first or second quarters of fiscal 2004 or 2003 because of the valuation allowance recorded in the quarter ended March 31, 2002. See “RadioShack Arbitration and Accounting for Tax Sharing Agreement with RadioShack.”

Net Income (Loss). We incurred a net loss of \$3.5 million in the second quarter of fiscal 2004 compared to net income of \$2.7 million in fiscal 2003 due to lower sales and operating levels and increased interest expense. Net income decreased \$13.9 million from net income of \$5.0 million in the first half of fiscal 2003 to a net loss of \$8.9 million in the first half of fiscal 2004 due to lower sales and operating levels, promotional activities with our retail partners and increased interest expense.

Liquidity and Capital Resources

We are highly leveraged and have a stockholder’s deficit of approximately \$101.4 million at December 31, 2003. Our primary sources of liquidity are cash flows from operations and borrowings under our senior credit agreement, which is discussed below. Our liquidity requirements will be to pay our debt, including interest expense under the senior credit agreement and notes, to provide for working capital and capital expenditures and to pay RadioShack amounts due under the tax sharing agreement. Decreased demand for our products could decrease our cash flow from operations and the availability of borrowings under our credit agreement.

Working Capital. As of December 31, 2003, cash and cash equivalents totaled \$11.4 million. Net working capital was \$55.5 million at December 31, 2003 compared to \$46.4 million at June 30, 2003.

Operating Activities. Net cash provided by operating activities for the six months ended December 31, 2003 was \$4.5 million compared to net cash provided of \$1.0 million for the six months ended December 31, 2002. Cash flow from operations increased year-over-year for the following reasons.

- Net income in fiscal 2004 was about \$13.9 million lower than in the first half of fiscal 2003.
- Included in net loss for fiscal 2004 was a non-cash charge of \$2.7 million of debt extinguishment costs, net.
- In fiscal 2003, the liability associated with the interest rate collar declined by \$1.3 million.

- Accounts receivable increased \$4.3 million in the first half of fiscal 2004 compared with an increase of \$1.3 million in the first half of fiscal 2003.
- In fiscal 2004, inventories decreased by \$2.0 million compared with \$3.4 million in fiscal 2003.
- During the first half of fiscal 2004, no amounts were due RadioShack under the terms of the tax sharing agreement; in the first half of fiscal 2003, we paid RadioShack \$6.2 million.
- Accounts payable and accrued liabilities increased \$3.9 million during the first half of fiscal 2004 compared to a decrease of \$6.8 million during the first half of fiscal 2003. Profit sharing and incentive compensation payments during the first half of fiscal 2003 were higher than in the first half of fiscal 2004 because of the respective prior year financial results. Accrued interest was higher in fiscal 2004 due to the refinancing of our old senior credit facility.

Investing Activities. We invested \$540,000 for capital expenditures for the six months ended December 31, 2003 compared to \$2.7 million for the prior year six month period. We currently estimate that the total capital expenditure requirements for the remainder of the fiscal year will be approximately \$2.0 million to \$3.0 million, which we expect to fund from cash flow from operations or cash on hand. Our ability to make future capital expenditures is subject to certain restrictions under our credit agreement.

Financing Activities. On September 29, 2003 we refinanced our old senior credit facility with \$100.0 million of new privately placed senior secured notes and an asset-based credit agreement.

The \$100.0 million senior secured notes mature on October 1, 2008 and bear interest at 10.63%. The notes were issued by O'Sullivan Industries at a price of 95%, providing \$95.0 million in cash proceeds before expenses related to the issuance of about \$3.8 million. The notes are secured by a first-priority security interest in and lien on substantially all of our assets (and on O'Sullivan Industries' capital stock) other than accounts receivable, inventory, capital stock of O'Sullivan Industries' subsidiaries, deposit accounts, certain books and records and certain licenses, and by a second-priority security interest in and lien on substantially all of our accounts receivable, inventory, deposit accounts, certain books and records and certain licenses. The notes are guaranteed by O'Sullivan Holdings, O'Sullivan Industries - Virginia and O'Sullivan Furniture Factory Outlet, Inc. We also entered into a registration rights agreement pursuant to which we are obligated to file a registration statement with respect to an offer to exchange the notes for a new issue of identical notes registered under the Securities Act of 1933, as amended, within 90 days after this offering closes, and to use all commercially reasonable efforts to cause the registration statement to declared effective on or prior to 180 days after the notes were issued. We filed the registration statement on December 23, 2003, and it became effective on January 8, 2004. The exchange offer is expected to close around February 25, 2004. We may also be required under certain circumstances to provide a shelf registration statement to cover resales of the notes.

The five-year asset-based credit agreement permits revolving borrowings of up to \$40.0 million to the extent of availability under a collateral borrowing base. The credit agreement has a \$25.0 million sub-limit for letters of credit, of which we are currently utilizing approximately \$14.0 million. The credit agreement is secured by a first-priority security interest in and lien on substantially all of our accounts receivable, inventory, deposit accounts, certain books and records and certain licenses, and a second-priority security interest in and lien on substantially all of our assets other than accounts receivable, inventory, capital stock of our subsidiaries, deposit accounts, certain books and records and certain licenses. The interest rate on loans under the credit agreement is a LIBOR rate plus 2.5% or an index rate plus 1.0%. We also pay a quarterly fee equal to 0.5% per annum of the unused commitment under the credit agreement. O'Sullivan Industries - Virginia and O'Sullivan Furniture Factory Outlet, Inc. are also parties to the credit agreement. No loans were outstanding under the credit agreement as of December 31, 2003.

In connection with the repayment of the term loans and the termination of the revolving credit facility under the senior credit facility, we expensed approximately \$3.1 million of unamortized issuance costs related to the facility in the first quarter of fiscal 2004.

Our consolidated indebtedness at December 31, 2003 was \$197.2 million consisting of:

- a credit agreement providing for asset-based revolving credit of up to \$40.0 million. The borrowing base at December 31, 2003 was approximately \$36.9 million. No borrowings were outstanding under the credit agreement, although letters of credit aggregating approximately \$14.0 million were outstanding under the credit agreement.
- \$100.0 million in 10.63% senior secured notes due October 1, 2008. These notes were issued at a price of 95% providing \$95.0 million in cash proceeds before expenses related to the issuance.
- \$96.0 million in 13-3/8% senior subordinated notes due 2009 issued with warrants to purchase 6.0% of our common and Series B junior preferred stock on a fully diluted basis. These warrants were assigned a value of \$3.5 million. These notes were issued at a price of 98.046% providing \$98.0 million in cash proceeds before expenses related to the issuance. In October 2003, we repurchased \$4.0 million of the notes and recorded other financing income of \$616,000 net of original issue discount and capitalized loan fees.
- \$10.0 million in variable rate industrial revenue bonds.

The reconciliation of consolidated indebtedness to recorded book value at December 31, 2003 is as follows:

	<u>Consolidated Indebtedness</u>	<u>Original Issue Discount Net of Accretion</u>	<u>Warrants Net of Accretion</u>	<u>Recorded Book Value</u>
		(in thousands)		
Senior secured notes	\$ 100,000	\$ (4,814)	\$ —	\$ 95,186
Senior subordinated notes	96,000	(1,391)	(2,596)	92,013
Industrial revenue bonds	10,000	—	—	10,000
Total	<u>\$ 206,000</u>	<u>\$ (6,205)</u>	<u>\$ (2,596)</u>	<u>\$ 197,199</u>

With the refinancing of our old senior credit facility, we have no principal payments due on our debt until October 2008. We expect to fund interest payments on our debt from cash flow from operations, cash on hand or borrowings under our credit agreement. We expect our borrowing availability under our credit agreement will approximate \$40.0 million reduced by any letters of credit outstanding. Decreased demand for our products could decrease our inventory and accounts receivable levels and the availability of borrowings under our credit facility.

As required under our old senior credit facility, we hedged one-half of our term loans with an initial notional amount of \$67.5 million with a costless interest rate collar. The collar, which expired on March 31, 2003, was based on three-month LIBOR with a floor of 6.43% and a ceiling of 8.75%. The counter-party to our interest rate collar provided us with the payment amount that would have been required to terminate the collar as of the end of each quarter. We recorded the change in fair value of the collar as increased or decreased interest expense in the consolidated statements of operations and included the resulting liability in accrued liabilities on the consolidated balance sheets.

See the overview section of this Management's Discussion and Analysis of Financial Condition and Results of Operations for a discussion of the impact of the Settlement Agreement with RadioShack on our liquidity and financial condition.

Off-balance Sheet Arrangements. At December 31, 2003, we had no off-balance sheet arrangements that have or are likely to have a material current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

As of December 31, 2003, our contractual obligations due in the future matured as follows:

Contractual Obligations	Total	Payments Due by Period			
		(in thousands)			
		Less than 12 months	12-36 months	36-60 months	After 60 months
Long-term debt	\$ 206,000	\$ —	\$ —	\$ 110,000	\$ 96,000
Tax Benefit payments to RadioShack ¹	72,067	14,452	20,419	28,353	8,843
Capital lease obligations	—	—	—	—	—
Operating leases—unconditional	5,219	2,011	2,951	257	—
Other long-term obligations ²	832	397	345	90	—
Total contractual cash obligations	<u>\$ 284,118</u>	<u>\$ 16,860</u>	<u>\$ 23,715</u>	<u>\$ 138,700</u>	<u>\$ 104,843</u>

¹Timing and amounts of payments to RadioShack are contingent on actual taxable income adjusted to exclude the increased interest expense arising from the 1999 recapitalization and merger. The amounts in the table above represent the maximum amounts payable to RadioShack.

²Represents payments due under retirement agreements.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities.

On an on-going basis, we evaluate our estimates, including those related to customer programs and incentives, bad debts, inventories, intangible assets, income taxes, restructuring, asset impairments, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

- We derive our revenue from product sales. We recognize revenue from the sale of products when persuasive evidence of an arrangement exists, the product has been delivered, the price is fixed or determinable and collection of the resulting receivable is reasonably assured. For all sales, we use purchase orders from the customer, whether written or electronically transmitted, as evidence that a sales arrangement exists. Generally, delivery occurs when product is delivered to a common carrier or private carrier, with standard terms being FOB shipping point. We assess whether the price is fixed or determinable based upon the payment terms associated with the transaction. We assess collection based on a number of factors, including past transaction history with the customer and the creditworthiness of the customer. Collateral generally is not requested from customers.
- We record estimated reductions to revenue for customer programs and incentive offerings including special pricing agreements, price protection, promotions and other volume-based incentives. Market conditions could require us to take actions to increase customer incentive offerings. These offerings could result in our estimates being too small and reduce our revenues when the incentive is offered.

- We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.
- We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and its estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by us, additional inventory write-downs may be required. Obsolete and slow-moving inventory reserves were approximately \$2.9 million and \$4.3 million at December 31, 2003 and June 30, 2003, respectively.
- We record our deferred tax assets at the amount that the asset is more likely than not to be realized. As of December 31, 2003, we have provided a valuation allowance against our total net deferred tax asset. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance, our determinations can change. If we objectively determine it was more likely than not we would be able to realize our deferred tax assets in the future in excess of our recorded amount, we would reduce our valuation allowance, increasing income in the period such determination was made.
- We periodically review our long-lived assets, including property and equipment, for impairment and determine whether an event or change in facts and circumstances indicates their carrying amount may not be recoverable. We determine recoverability of the assets by comparing the carrying amount of the assets to the net future undiscounted cash flows expected to be generated by those assets. Future cash flows are estimated using revenue growth projections that take into consideration the estimated life of our various products. If the sum of the undiscounted cash flows is less than the carrying value of the assets, an impairment charge is recognized. Adverse economic conditions could cause us to record impairment charges in the future.
- We assess goodwill at least annually for impairment by applying a fair-value-based test, using the enterprise as the reporting unit. If the book value of the reporting unit is below the fair value of the reporting unit, there is no impairment loss. Adverse economic conditions could cause us to record impairment charges in the future.

Legal Proceedings

On September 24, 2002, Montgomery Ward, LLC filed suit against O'Sullivan Industries in the U.S. Bankruptcy Court, District of Delaware, alleging that payments made by Montgomery Ward within 90 days prior to its bankruptcy constituted preferential transfers under the Bankruptcy Code that should be recovered from O'Sullivan Industries by Montgomery Ward, together with interest. The alleged payments aggregate \$3.7 million. We responded to the suit denying we received any preferential payments. We are contesting this lawsuit vigorously.

In August 2002, Ames decided to close all of its stores and liquidate. Actual net sales to Ames in fiscal 2003 were minimal. In August 2003, Ames Department Stores, Inc. filed suit against O'Sullivan Industries in the U.S. Bankruptcy Court, Southern District of New York alleging that payments made by Ames within 90 days prior to its bankruptcy constituted preferential transfers under the Bankruptcy Code that should be recovered from O'Sullivan Industries by Ames, together with interest. The alleged payments aggregate \$2.1 million. We received the summons in this action on September 22, 2003. We responded to the suit denying we received any preferential payments. We are contesting this lawsuit vigorously.

In November 2001 House2Home filed for bankruptcy and eventually liquidated. In January 2004 we received notice of a November 2003 suit against O'Sullivan Industries in the U.S. Bankruptcy Court, Central District of California alleging that payments made by House2Home within 90 days prior to its bankruptcy constituted preferential transfers under the Bankruptcy Code that should be recovered from O'Sullivan Industries by

House2Home together with interest. The alleged payments aggregate \$700,000. We intend to respond to the suit denying we received any preferential payments. We intend to contest this lawsuit vigorously.

Cautionary Statement Regarding Forward Looking Information

Certain portions of this Report, and particularly the Notes to the Consolidated Financial Statements and the Management's Discussion and Analysis of Financial Condition and Results of Operations, contain forward-looking statements. These statements can be identified by the use of future tense or dates or terms such as "believe," "would," "expect," "anticipate" or "plan." These forward-looking statements involve risks and uncertainties. Actual results may differ materially from those predicted by the forward-looking statements. Factors and possible events which could cause results to differ include:

- changes from anticipated levels of sales, whether due to future national or regional economic and competitive conditions, including new domestic or foreign entrants into the industry, customer acceptance of existing and new products, terrorist attacks or otherwise, as we are experiencing now;
- loss of liquidity due to the arbitration panel's opinion in *RadioShack Corporation v. O'Sullivan Industries Holdings, Inc.*;
- significant indebtedness that may limit our financial and operational flexibility;
- raw material cost increases, particularly in particleboard and fiberboard, as are occurring now and have previously occurred in 1994 and 1995 and to a lesser extent in fiscal 2000;
- pricing pressures due to excess capacity in the ready-to-assemble furniture industry, as is occurring again now, or customer demand in excess of our ability to supply product;
- transportation cost increases, due to higher fuel costs or otherwise;
- loss of or reduced sales to significant customers as a result of bankruptcy, liquidation, merger, acquisition or any other reason, as occurred with the liquidation of Montgomery Ward in fiscal 2001, the liquidation of Ames in fiscal 2003 and with the reorganization of Kmart beginning in fiscal 2002;
- actions of current or new competitors, foreign or domestic, that increase competition with our products or prices;
- the consolidation of manufacturers in the ready-to-assemble furniture industry;
- increased advertising costs associated with promotional efforts;
- increased interest rates;
- pending or new litigation or governmental regulations such as the arbitration involving RadioShack;
- other uncertainties which are difficult to predict or beyond our control; and
- the risk that we incorrectly analyze these risks and forces, or that the strategies we develop to address them could be unsuccessful.

See also the Risk Factors section in our annual report on Form 10-K for the year ended June 30, 2003.

Because these forward-looking statements involve risks and uncertainties, actual results may differ significantly from those predicted in these forward-looking statements. You should not place a lot of weight on these statements. These statements speak only as of the date of this document or, in the case of any document incorporated by reference, the date of that document.

All subsequent written and oral forward-looking statements attributable to O'Sullivan or any person acting on our behalf are qualified by the cautionary statements in this section. We will have no obligation to revise these forward-looking statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Our market risk is affected by changes in interest rates, foreign currency exchange rates and certain commodity prices. Under our policies, we may use natural hedging techniques and derivative financial instruments to reduce the impact of adverse changes in market prices. We do not hold or issue derivative instruments for trading purposes. We believe that our foreign exchange risk is not material.

We have market risk in interest rate exposure, primarily in the United States. We manage interest rate exposure through our mix of fixed and floating rate debt. Interest rate instruments may be used to adjust interest rate exposures when appropriate based on market conditions. Our interest rate collar expired on March 31, 2003. At December 31, 2003, \$10.0 million of our debt was subject to variable interest rates. A change in interest rates of one percentage point would change our cash interest by about \$100,000 annually.

Due to the nature of our product lines, we have material sensitivity to some commodities, including particleboard, fiberboard, corrugated cardboard and hardware. We manage commodity price exposures primarily through the duration and terms of our vendor agreements. A 1.0% change in our raw material prices would affect our cost of sales by approximately \$1.4 million annually.

In the first half of fiscal 2004, we saw increases of approximately 5% to 10% in the price of particleboard, our largest-cost raw material. We expect additional price increases in the last half of fiscal 2004, and perhaps beyond, as demand for particleboard has increased and suppliers have reduced capacity. Because we utilize first-in, first-out accounting for our inventory, not all of the price increases are reflected in our cost of goods sold for the first six months of fiscal 2004. These price increases will reduce our operating margins and operating income for the remainder of fiscal 2004 and perhaps beyond. Further, the reduction in particleboard manufacturing capacity may create shortages that might delay the rollouts of some new products from our fiscal year 2004 third quarter to the fourth quarter.

We will endeavor to reduce the impact of the price increases through our value analysis program and by the eventual inclusion of the higher costs in the pricing of our products. In our value analysis program, we endeavor to remove costs from the production of a product without sacrificing utility or quality of the product. We cannot assure you that we will be successful in offsetting these or future potential price increases.

ITEM 4. CONTROLS AND PROCEDURES.

(a) O'Sullivan carried out an evaluation as of the end of the period covered by this report, under the supervision and with the participation of O'Sullivan's management, including O'Sullivan's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of O'Sullivan's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based on that evaluation, O'Sullivan's Chief Executive Officer and Chief Financial Officer concluded that O'Sullivan's disclosure controls and procedures (1) were effective in alerting them, in a timely manner, to material information relating to O'Sullivan required to be included in O'Sullivan's periodic SEC filings and (2) were adequate to ensure that information required to be disclosed by O'Sullivan in the reports filed or submitted by O'Sullivan under the Exchange Act is recorded, processed and summarized and reported within the time periods specified in the SEC's rules and forms.

(b) There have been no significant changes in O'Sullivan's internal controls over financial reporting subsequent to September 30, 2003 that have materially affected or are reasonably likely to materially affect, O'Sullivan's internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

In November 2001 House2Home filed for bankruptcy and eventually closed all of its stores. In January 2004 we received notice of a November 2003 suit against O'Sullivan Industries in the U.S. Bankruptcy Court, Central District of California alleging that payments made by House2Home within 90 days prior to its bankruptcy constituted preferential transfers under the Bankruptcy Code that should be recovered from O'Sullivan Industries by House2Home together with interest. The alleged payments aggregate \$700,000. We intend to respond to the suit denying we received any preferential payments. We intend to contest this lawsuit vigorously.

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

An annual meeting of stockholders of O'Sullivan was held on November 13, 2003 to elect four directors. We did not solicit proxies. Messrs. Charles A. Carroll, Richard D. Davidson, Daniel F. O'Sullivan and Harold O. Rosser were reelected as directors. Each director received 100 votes for reelection; no votes were withheld.

ITEM 5. OTHER INFORMATION

O'Sullivan Holdings is a guarantor of our 10.63% senior secured notes due 2008. O'Sullivan Holdings files quarterly reports on Form 10-Q and annual reports on Form 10-K with the Securities and Exchange Commission. These reports are available from the SEC's web site at <http://www.sec.gov> or through our web site at www.osullivan.com.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits:

A list of exhibits required to be filed as part of this Report is set forth in the Index to Exhibits, which immediately precedes such exhibits, and is incorporated herein by reference.

(b) Reports on Form 8-K:

During the quarter ended December 31, 2003, O'Sullivan furnished a report on form 8-K under Items 7 and 9 dated September 29, 2003 relating to the closing of \$100 Million senior secured notes offering. The report was furnished on October 2, 2003.

SIGNATURES

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

O'SULLIVAN INDUSTRIES, INC.

Date: February 17, 2004

By: /s/ Richard D. Davidson
Richard D. Davidson
President and
Chief Executive Officer

Date: February 17, 2004

By: /s/ Phillip J. Pacey
Phillip J. Pacey
Senior Vice President and
Chief Financial Officer
(Principal Financial and Accounting Officer)

INDEX TO EXHIBITS

<u>Exhibit No.</u>	<u>Description</u>	<u>Page No.</u>
3.1 & 4.1	Certificate of Incorporation of O'Sullivan (incorporated by reference from Exhibit 3.1 to Registration Statement on Form S-4 (File No. 333-31282))	
3.2 & 4.2	Bylaws of O'Sullivan (incorporated by reference from Exhibit 3.2 to Registration Statement on Form S-1 (File No. 333-32182))	
4.3	Indenture dated as of November 30, 1999, by O'Sullivan Industries, Inc., as Issuer, O'Sullivan Industries - Virginia, Inc., as Guarantor, and Norwest Bank Minnesota, National Association, as Trustee, relating to O'Sullivan Industries, Inc.'s \$100,000,000 principal amount of 13.375% senior subordinated notes (incorporated by reference to Exhibit 4.4 to Quarterly Report on Form 10-Q for the quarter ended December 31, 1999 (File No. 0-28493))	
4.4	Warrant Agreement dated as of November 30, 1999 between O'Sullivan Industries Holdings, Inc. and Norwest Bank Minnesota, National Association, as Warrant Agent, relating to warrants to purchase 39,273 shares of O'Sullivan Industries Holdings, Inc. Series B junior preferred stock, including form of warrant certificate (incorporated by reference to Exhibit 4.5 to Quarterly Report on Form 10-Q for the quarter ended December 31, 1999 (File No. 0-28493))	
4.5	Warrant Agreement dated as of November 30, 1999 between O'Sullivan Industries Holdings, Inc. and Norwest Bank Minnesota, National Association, as Warrant Agent, relating to warrants to purchase 93,273 shares of O'Sullivan Industries Holdings, Inc. common stock, including form of warrant certificate (incorporated by reference to Exhibit 4.6 to Quarterly Report on Form 10-Q for the quarter ended December 31, 1999 (File No. 0-28493))	
10.1	Deed of Trust, Assignment of Rents, Security Agreement and Fixture Filing dated as of November 13, 2003 from O'Sullivan Industries, Inc. to the trustee named therein for the benefit of The Bank of New York, as Trustee (incorporated by reference to Exhibit 10.6 to Registration Statement on Form S-4 (File No. 333-111514))	
10.2	Deed of Trust, Assignment of Rents, Security Agreement and Fixture Filing dated as of November 13, 2003 from O'Sullivan Industries - Virginia, Inc. to the trustee named therein for the benefit of The Bank of New York, as Trustee and General Electric Capital Corporation, as Agent (incorporated by reference to Exhibit 10.7 to Registration Statement on Form S-4 (File No. 333-111514))	
10.3	Deed of Trust, Assignment of Rents, Security Agreement and Fixture Filing dated as of November 13, 2003 from O'Sullivan Industries, Inc. to the trustee named therein for the benefit of General Electric Capital Corporation, as Agent (incorporated by reference to Exhibit 10.8 to Registration Statement on Form S-4 (File No. 333-111514))	
10.4	Schedule of outside director fees (incorporated by reference to Exhibit 10.26 to Registration Statement on Form S-4 (File No. 333-111514))	
31.1	Certificate of chief executive officer under Section 302 of the Sarbanes-Oxley Act of 2002	29
31.2	Certificate of chief financial officer under Section 302 of the Sarbanes-Oxley Act of 2002	30

32.1	Certificate of chief executive officer under 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	31
32.2	Certificate of chief financial officer under 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	32