OBSIDIAN ENTERPRISES INC
Form 10-Q
March 17, 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 JANUARY 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

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	Outstanding at
$.0001 par value	March 11, 2005
	3,109,333 shares

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)
(unaudited)

	January 31, 2005	October 31, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 727	$ 688
Marketable securities	97	74
Accounts receivable, net of allowance for doubtful accounts of $777 for 2005 and $494 for 2004	3,901	5,190
Accounts receivable, related parties (Note 8)	83	71
Inventories, net (Note 2)	9,727	8,971
Prepaid expenses and other assets	992	600
Deferred income tax assets	672	635
Total current assets	16,199	16,229
Property, plant and equipment, net	23,230	23,730
Other assets:		
Intangible assets:		
Goodwill not subject to amortization	7,055	7,055
Noncompete agreements, less accumulated amortization of $864 for 2005 and $783 for 2004	790	871
Trade name and customer relations, less accumulated amortization of $419 for 2005 and $390 for 2004	862	891
Deferred debt costs, less accumulated amortization of $319 for 2005 and $289 for 2004	247	277
Idle equipment	353	353
Other	12	13
	$ 48,748	$ 49,419

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

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)
(unaudited)

	January 31, 2005	October 31, 2004
Liabilities and Stockholders' Deficit		
Current liabilities:		
Current portion of long-term debt	$ 17,520	$ 18,383
Accounts payable, trade	5,296	5,242
Accounts payable, related parties (Note 8)	1,483	1,268
Accrued compensation	807	830
Accrued expenses and customer deposits	894	1,010
Total current liabilities	26,000	26,733
Accounts payable, related parties	556	556
Long-term debt, net of current portion	8,340	8,547
Long-term debt, related parties (Note 8)	23,641	20,299
Deferred income tax liabilities	974	936
Commitments and contingencies:		
Minority interest	229	244
Redeemable stock:		
Common stock, 324,933 shares outstanding for 2005 and 2004	1,571	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
Preferred stock, 5,000,000 shares authorized, no shares outstanding	---	---
Additional paid-in capital	13,311	13,315
Accumulated other comprehensive loss	(17)	(40)
Accumulated deficit	(25,858)	(22,739)
Total stockholders' deficit	(12,563)	(9,463)
	$ 48,748	$ 49,419

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

OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

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

	Three Months Ended	
	January 31, 2005	**January 31, 2004**
Net sales	$ 13,645	$ 12,046
Cost of sales	12,819	10,979
Gross profit	826	1,067
Selling, general and administrative expenses	2,736	2,345
Loss from operations	(1,910)	(1,278)
Other income (expense):		
Interest expense, net	(1,187)	(969)
Other income (expense)	(19)	29
Loss before income taxes	(3,116)	(2,218)
Income tax expense	(18)	---
Loss before minority interest	(3,134)	(2,218)
Minority interest	15	(31)
Net loss	$ (3,119)	$ (2,249)
Basic and diluted loss per share attributable to common shareholders from continuing operations:	$ (1.01)	$ (3.32)
Weighted average common and common equivalent shares outstanding, basic and diluted:	3,109,333	720,157

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

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OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

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

	Comprehensive Loss	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Deficit
Balance at October 31, 2004		3,109,333	$ 1	$ 13,315	$ (40)	$ (22,739)	$ (9,463)
Gain on available-for-sale marketable securities	$ 23				23		23
Fair value adjustment on redeemable Preferred Stock				(4)			(4)
Net loss	(3,119)					(3,119)	(3,119)
Total comprehensive loss	$ (3,096)						
Balance at January 31, 2005		3,109,333	$ 1	$ 13,311	$ (17)	$ (25,858)	$ 12,563

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

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OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Three Months Ended	
	January 31, 2005	January 31, 2004
Cash flow from operating activities:		
Loss from continuing operations	$ (3,119)	$ (2,249)
Adjustments to reconcile loss from continuing operations to net cash used in operating activities:		
Depreciation and amortization	844	776
Other	352	189
Changes in operating assets and liabilities:		
Accounts receivable, net	1,289	797
Inventories, net	(756)	(980)
Other	(267)	538
Net cash used in operating activities	(1,657)	(929)
Cash flows from investing activities:		
Capital expenditures	(512)	(318)
Proceeds from sale of equipment	270	---
Net cash used in investing activities	(242)	(318)
Cash flows from financing activities:		
Advances from related parties, net	203	175
Net repayments on lines of credit	(537)	(345)
Net borrowings on long-term debt, including related parties	2,272	825
Net cash provided by financing activities	1,938	655
Increase (decrease) in cash and cash equivalents	39	(592)
Cash and cash equivalents, beginning of period	688	1,148
Cash and cash equivalents, end of period	$ 727	$ 556
Interest paid	$ 601	$ 545
Taxes paid	$ 34	$ 15

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

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OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Three Months Ended	
	January 31, 2005	**January 31, 2004**
Supplemental disclosure of noncash operating, investing and financing activities:		
Fair value change on mandatory redeemable preferred stock	$ (4)	$ (139)
Assignment and assumption of mandatory redeemable preferred stock to Fair Holdings	$ ---	$ 337

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

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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), 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:

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

Butyl-Rubber Reclaiming

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

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 and Related Transportation Equipment 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.

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

The accompanying financial data as of January 31, 2005 and for the three months ended January 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 January 31, 2005 and results of operations, cash flows and stockholders deficit for the three months ended January 31, 2005 have been made. The results of operations for the three months ended January 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. Certain subsidiaries of the Company are in violation of certain financial covenants in their respective credit agreements as of January 31, 2005 (as discussed in Note 3 below). All amounts outstanding as of January 31, 2005 under these credit agreements have been classified as current on our balance sheet. We are currently negotiating to amend or refinance the credit agreements where covenant violations exist and debt has matured and we do not expect these violations to impair our ability to fund current and future obligations of the Company. 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 January 31, 2005, Fair Holdings was in violation of certain covenants in its credit agreement with its lender, although the lender has waived these violations as of January 31, 2005. As of January 31, 2005, total debt outstanding to DC Investments and Fair Holdings was $23,641.

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

Management, as a part of its plan towards resolving these issues 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.

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

» Obsidian Enterprises secured an additional financial commitment from Fair Holdings to provide additional borrowings under a $15,000 line of credit agreement, which expires on January 1, 2007. Approximately $1,621 is currently available under the agreement.

» United s existing line of credit and term loan with First Indiana has matured and the Company is currently in negotiations with a new lender to replace these loans. Management expects to complete the refinancing of this debt in the first half of fiscal 2005. Under the terms of the new commitment, the maximum borrowing availability will increase by $1,400. Upon completions of this refinancing, United s working capital will improve by approximately $4,100, as that amount of the debt will be reclassified from current to long-term, less the current portion.

» In November 2004, Obsidian Leasing s credit facility with Old National Bank matured and Obsidian Leasing now has current debt obligations due of $3,260. 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 first half of fiscal 2005. Additionally, in November 2004, management sold two older coaches, reducing Obsidian Leasing s debt by $209. Management is also in negotiations to sell three additional coaches, which will further reduce debt by an estimated $354.

- » U.S. Rubber has a balloon payment on its debt which will be due October 24, 2005. Management is in the initial stages of negotiating and refinancing this debt prior to October 2005.

- » Classic received an amendment to its credit facility to temporarily increase its line of credit availability by $250 through April 2005.

- » Management is actively working to restructure or refinance portions of its high interest rate debt on more favorable terms. Approximately $22,900 of our 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.

- » 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 increase surcharges.

- » 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.

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

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. We did not meet requirements and covenants in certain debt agreements as further discussed in Note 3.

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.

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.

INSURANCE RECOVERY:

On December 1, 2004, U.S. Rubber was damaged by an electrical fire. The Company is in the process of processing its claims with its insurance carrier for damaged equipment and facilities and business interruption losses. As of January 31, 2005 the insurance claims are in process and no settlement has been made. The Company does not expect a material gain or loss on involuntary conversion or business interruption as a result of this fire.

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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 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 January 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 January 31, 2005.

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

	Three Months Ended

	Three Months Ended	
	January 31, 2005	January 31, 2004
Loss before discontinued operations	$ (3,119)	$ (2,249)
Change in fair value of mandatory redeemable preferred stock	(17)	(139)
Net loss attributable to common shareholders	$ (3,136)	$ (2,388)
Weighted average common and common equivalent shares outstanding, basic and diluted	3,109,333	720,157
Net loss per share, basic and diluted, attributable to common shareholders from continuing operations:	$ (1.01)	$ (3.32)

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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 months ended January 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:

	January 31, 2005	October 31, 2004

(in thousands, except per share and share data)

	January 31, 2005	October 31, 2004
Raw materials	$ 6,193	$ 5,346
Work-in-process	966	611
Finished goods	2,868	3,236
Valuation reserve	(300)	(222)
Total	$ 9,727	$ 8,971

3. FINANCING ARRANGEMENTS

UNITED

United s existing line of credit and term loan with First Indiana has matured and the Company is currently working with the bank on a short-term extension until a refinancing is completed. The Company is in negotiations with a new lender to replace these loans. Management expects to complete the refinancing of this debt in the first half of fiscal 2005. During the three months ended January 31, 2005, the Company paid down the line of credit by $400 and the maximum availability was reduced to $3,600. The total amount of this debt is classified as current.

Additionally, at January 31, 2005, United did not meet financial covenants under the terms of its term note with Huntington Capital Investment Company. Specifically, United did not meet its EBITDA and fixed charge coverage ratios. Huntington Capital Investment Company waived these covenant violations as of January 31, 2005. All amounts under the term note are classified as current until the Company and

3. FINANCING ARRANGEMENTS, CONTINUED

Huntington Capital Investment Company enter into an amendment, currently being negotiated, to provide relief under these covenants.

OBSIDIAN LEASING

The Company is currently discussing a forbearance agreement with its Bank and the total related debt of $3,260 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 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.

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 first quarter of 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 $15 has been recorded as a charge in the January 31, 2005 statement of operations and has been recognized on the balance sheet. Future operating results of DC Investments Leasing, if positive, will continue to be charged to minority interest. In addition, should DW Leasing generate future income in excess of previously recognized losses, such amounts would be charged to minority interest in the consolidated statement of operations and recognized as minority interest on the consolidated balance sheet. During the quarter ended January 31, 2005, DW Leasing recorded a loss of $16. As of January 31, 2005, accumulated losses of DW Leasing recognized in consolidated statements of operations exceeded income by approximately $377.

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) fifth anniversary of issuance of such shares, b) 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

5. REDEEMABLE STOCK, CONTINUED

Company s stock will result in a corresponding increase to this repurchase requirement. At January 31, 2005, the Company had violated certain financial covenants defined in the subordinated debt agreement with Huntington. The Company received a waiver of these violations as of January 31, 2005.

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.

6. STOCKHOLDERS DEFICIT

(in thousands, except per share and share data)

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 January 31, 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 January 31, 2005					
	Trailer Manufacturing	**Coach Leasing**	**Butyl Rubber Reclaiming**	**Total Segments**	**Corporate**	**Consolidated**
Sales:						
Domestic	$ 9,376	$ 638	$ 2,217	$ 12,231	$ ---	$ 12,231
Foreign	1,146	---	268	1,414	---	1,414
Total	$ 10,522	$ 638	$ 2,485	$ 13,645	$ ---	$ 13,645
Cost of goods sold	$ 9,847	$ 381	$ 2,591	$ 12,819	$ ---	$ 12,819
Loss before taxes and minority interest	$ (1,612)	$ (627)	$ (625)	$ (2,864)	$ (252)	$ (3,116)
Identifiable assets	$ 23,918	$ 13,655	$ 10,607	$ 48,180	$ 568	$ 48,748
Depreciation and amortization expense	$ 247	$ 199	$ 361	$ 807	$ 37	$ 844

(in thousands, except per share and share data)

	Three Months Ended January 31, 2005					
Interest expense	$ 446	$ 343	$ 146	$ 935	$ 252	$ 1,187

	Three Months Ended January 31, 2004					
	Trailer Manufacturing	Coach Leasing	Butyl Rubber Reclaiming	Total Segments	Corporate	Consolidated
Sales:						
Domestic	$ 7,504	$ 1,040	$ 2,314	$ 10,858	$ ---	$ 10,858
Foreign	980	---	208	1,188	$ ---	1,188
Total	$ 8,484	$ 1,040	$ 2,522	$ 12,046	$ ---	$ 12,046
Cost of goods sold	$ 7,887	$ 587	$ 2,505	$ 10,979	$ ---	$ 10,979
Loss before taxes and minority interest	$ (1,228)	$ (408)	$ (422)	$ (2,058)	$ (160)	$ (2,218)
Identifiable assets	$ 19,863	$ 13,761	$ 10,535	$ 44,159	$ 1,069	$ 45,228
Depreciation and amortization expense	$ 178	$ 214	$ 353	$ 745	$ 31	$ 776
Interest expense	$ 397	$ 328	$ 117	$ 842	$ 127	$ 969

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 months ended January 31, 2005 and 2004, allocated corporate expenses by segment were as follows:

7. BUSINESS SEGMENT DATA AND GEOGRAPHIC DATA, CONTINUED

	Three Months Ended	
	January 31, 2005	January 31, 2004
Trailer manufacturing	$ 656	$ 385
Coach leasing	62	69
Butyl rubber reclaiming	154	115

	Three Months Ended			
	$	872	$	569

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:

	January 31, 2005		October 31, 2004	
Balance sheet:				
Current assets:				
Accounts receivable, Obsidian Capital Company(2)	$	8	$	8
Accounts receivable, stockholders		18		11
Accounts receivable, other affiliated entities		57		52
Total assets	$	83	$	71
Current liabilities:				
Accounts payable, Obsidian Capital Company(2)	$	35	$	35
Accounts payable, stockholders		3		3
Accounts payable, DC Investments and Fair Holdings(2)		1,396		1,181
Accounts payable, other affiliated entities		50		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)		9,562		8,784
Line of credit, Fair Holdings(2)		13,378		10,815
Total liabilities	$	25,680	$	22,123

	Three Months Ended			
	January 31, 2005		January 31, 2004	
Income statement:				
Interest expense, DC Investments and Fair Holdings(2)	$	567	$	502
Rent expense, Fair Holdings(2)	$	13	$	9
Sales to Champion Trailer, Inc.(2)	$	180	$	---
Purchases from Champion Trailer, Inc.(2)	$	185	$	---
Rent expense, Roost Leasing(1)	$	36	$	---

(1) A leasing company owned by the former owners of Classic
(2) An entity controlled by Tim Durham, the Chairman of Obsidian Enterprises

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OBSIDIAN ENTERPRISES, INC. AND SUBSIDIARIES

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

8. RELATED PARTIES, CONTINUED

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.

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 three months ended January 31, 2005.

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
Total purchase price	$	3,598

Purchase Price Allocation:

Current assets, including accounts receivable and inventory	$	1,962
Machinery and equipment		805
Goodwill		1,271
Intangibles		523
Liabilities assumed		(963)
Total	$	3,598

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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)
Total cash paid	$	1,722

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.

	Three Months Ended	
	January 31, 2004	
Net sales	$	13,715
Net loss	$	(2,309)
Loss per share, basic and diluted, attributable to common shareholders from continuing operations:	$	(3.40)

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.

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.

OVERVIEW

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

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.

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

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. Certain subsidiaries of the Company are in violation of certain financial covenants in their respective credit agreements as of January 31, 2005 (as discussed in Financial Covenant Waivers below). All amounts outstanding as of January 31, 2005 under these credit agreements have been classified as current on our balance sheet. We are currently negotiating to amend or refinance the credit agreements where covenant violations exist and we do not expect these violations to impair our ability to fund current and future obligations of the Company. 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 January 31, 2005, Fair Holdings was in violation of certain covenants in the credit agreement with its lender, although its lender has waived these violations as of January 31, 2005. As of January 31, 2005, total debt outstanding to DC Investments and Fair Holdings was $23,641.

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 months ended January 31, 2005 were negatively impacted by various events discussed below. During fiscal 2005, we intend 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.

- » In the trailer and related transportation equipment 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 24% on an annualized basis and helped improve our gross margins in this segment by approximately 3% on an annualized basis. The segment was negatively affected by the significant increases in raw material prices during fiscal 2004 and the three months ended January 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 12% beginning in April 2004. Our price increases lagged behind the raw material price increases, which reduced our overall gross margins.