HUFFY CORP
Form 10-K
March 05, 2004

FORM 10-K

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

(MARK ONE)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR 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 1-5325

HUFFY CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

| OHIO | 31-0326270 |
|---|---|
| (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION) | (I.R.S. EMPLOYER IDENTIFICATION NO.) |
| 225 BYERS ROAD, MIAMISBURG, OHIO | 45342 |
| (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) | (ZIP CODE) |

Registrant's telephone number, including area code: (937) 866-6251

Securities registered pursuant to Section 12(b) of the Act:

| TITLE OF EACH CLASS | NAME OF EACH EXCHANGE ON WHICH REGISTERED |
|---|---|
| Common Stock, $1.00 Par Value | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act: None

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 [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

The aggregate market value of the Common Stock held by non-affiliates of the registrant, as of June 27, 2003, was $105,365,477.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes [X] No [ ]

The number of shares outstanding of each of the registrant's classes of Common Stock, as of June 27, 2003, was 15,052,211.

DOCUMENTS INCORPORATED BY REFERENCE

The Huffy Corporation Proxy Statement for its Annual Meeting of Shareholders on April 22, 2004. Only such portions of the Proxy Statement as are specifically incorporated by reference under Parts II and III of this Report shall be deemed filed as part of this Report.

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PART I

ITEM 1. BUSINESS

Huffy Corporation, an Ohio corporation formed in 1928, and its subsidiaries (collectively called "Huffy" or the "Company") are engaged in the sporting goods segment in the design and sale of wheeled and related products, including bicycles, scooters, tricycles, skateboards and inline skates; golf equipment; hockey equipment, snowboards and licensing. Also within the sporting goods segment, the Company designs, manufactures and markets basketball backboards and accessories and purchases excess sports equipment and accessories and resells these products to sporting goods retailers. In addition, the Company operates a service segment that is involved in the assembly and repair of a variety of wheeled and other products and merchandising services to retail customers. The Company's executive offices are located in Miamisburg, Ohio and its principal business offices and/or manufacturing facilities are located in Miamisburg and Springboro, Ohio; Sussex, Wisconsin; and Toronto, Ontario, Canada.

The general development of the business is discussed in more detail below.

The Company is reporting its operations as two segments, sporting goods products and services to retailers. This change from a single segment was adopted in 2002 as a result of a shift in the mix of Huffy Service Solutions, Inc. business toward assembly services not directly related to the sporting goods industry, as well as the acquisition of McCalla Company and its subsidiaries and the Gen-X Sports Inc. businesses. Information regarding revenues from unaffiliated customers, operating profit and total assets for each of the Company's reporting segments is contained in the Notes to Consolidated Financial Statements included in this Annual Report on Form 10-K.

SPORTING GOODS SEGMENT

Huffy Bicycle Company, Huffy Sports Company and Gen-X Sports Inc. operate as the sporting goods segment, providing consumer products. Principal products and services include wheeled and related products, basketball backboards, balls, and related products, snowboards, golf equipment, hockey equipment, excess sports equipment, and licensing. Sales of wheeled and related products within such segment represented 40.0 percent, 44.4 percent and 55.8 percent of consolidated revenues of the Company for the years ended December 31, 2003, 2002, and 2001. Sales of portable basketball backboards, poles, goals, and balls within such segment represented 15.6 percent, 20.4 percent, and 20.4 percent of consolidated revenues of the Company for the years ended December 31, 2003, 2002, and 2001.

PRODUCTS, MARKETING AND DISTRIBUTION

The Huffy branded wheeled products, including Huffy(R) bicycles, scooters, and tricycles, hold a leading market position in the United States. Inline skates and skateboards are also included in the wheeled product group sold under such brands as Dukes, Rage and Oxygen(R), which is licensed from a third party, and Ultra Wheels(R). In 2001, Huffy Bicycle Company terminated, effective May 2002, its shelter services agreement in Mexico pursuant to which it imported wheeled products. Huffy Bicycle Company imports Huffy wheeled products from Southeast Asia including Taiwan and China. Included in the Huffy(R) product line are adult all-purpose bicycles; adult all-terrain bicycles; a series of innovative boys' and girls' 20" bicycles; a series of popular children's 12" and 16" sidewalk bicycles; children's ride-on toys, including the Green Machine(R), scooters and tricycles. In July 1999, the Company acquired the assets of American Sports Design Company, which markets and distributes high-end bicycles primarily available over the World Wide Web, through distributors and directly from the Company's advertised order center. In 2002, Huffy agreed to license the trademarks owned by American Sports Design Company under which such bicycles are sold and to sell the equipment and inventory associated with such American Sports Design Company business to the licensee. Huffy(R) and Gen-X wheeled products are advertised and are sold predominantly through United States and

Canadian national and regional high volume retailers, a distribution network accounting for approximately 85 percent of all wheeled products sold in the United States. Approximately 80 percent of Huffy Bicycle Company's wheeled products are sold under the Huffy(R) brand name with the balance being sold under private label or other Company brands.

Huffy Sports Company, a division of the Company located in Sussex, Wisconsin, is a leading supplier of basketball backboards, poles, goals, and related products, basketball, football, and soccer balls, indoor golf putting greens and indoor games and sports tables for use at home. Huffy Sports Company products, many of which bear the logo of the National Basketball Association (NBA(R)) as well as the Huffy Sports(R) trademark, are sold predominately through national and regional high volume retailers in the United States.

Gen-X Sports Inc., a subsidiary of Huffy Corporation was acquired on September 19, 2002. Gen-X is headquartered in Toronto, Ontario, Canada, and is a leading supplier of sporting goods, including golf equipment, hockey equipment, snowboards, inline skates and skateboards, and is a broker of excess merchandise, primarily in North America, and also markets product internationally, predominately in Europe. Prior to December 2003, Gen-X Sports Inc. also was a supplier of skis and accessories

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under the Volant(R) brand name. In December 2003, Gen-X Sports Inc. sold the Volant ski business assets to Amer Group plc and its US affiliate. Gen-X imports the majority of its products from China and Taiwan. Gen-X markets products under numerous brand names within the sporting goods segment, including LTD(R), Lamar(R), Sims(R), Tommy Armour(R), Ram(R), Teardrop(R), Zebra(R), Hespeler(R), Ultra Wheels(R), Rage(R), and Dukes(R). Gen-X Sports Inc. markets these products through United States and Canadian national and regional high volume retailers, as well as specialty sporting goods outlets.

RAW MATERIALS

Basic materials such as raw steel, steel and aluminum tubing, plastic, resins, and welding materials used in the Huffy Sports Company domestic manufacturing operations are purchased primarily from domestic sources. Alternate sources are available for all critical products and components, but the sudden loss of any major supplier could cause a temporary negative effect on Huffy Sports Company's operations.

PATENTS, TRADEMARKS AND LICENSES

The patents, trademarks (including the registered trademarks "Huffy" and "Huffy Sports"), licenses (including the license to use the NBA(R) logo) and other proprietary rights of the companies used in the sporting goods segment are deemed important to the Company. Generally, the NBA license associated with the Huffy Sports products has five-year terms which are renegotiated upon termination. With the acquisition of Gen-X, the Company acquired rights in numerous trademarks and patents relating to its various sporting goods products. The Company has licensed certain of these intellectual property rights to third parties and intends to expand its licensing program with the addition of such marks. The loss by the Company of its rights under any individual patent, trademark (other than "Huffy"), license or other proprietary right would not have a material adverse effect on the Company. The Company's patents, by law, have a limited life, and patent rights expire periodically. The loss of the United States registered trademark "Huffy" could have a material adverse effect on the Company. The Company has no reason to believe that anyone has rights to either the United States "Huffy" trademark or the products for which the Company

uses such trademarks.

SEASONALITY AND INVENTORY

Due to the relatively short lapse of time between placement of orders for products and shipments, the Company normally does not consider its backlog of orders as significant. Because of rapid delivery requirements of their customers, businesses in the sporting goods segment maintain sufficient quantities of inventories of finished goods to meet their customers' requirements. Sales of wheeled products are seasonal in that sales tend to be higher in the Spring and Fall of each year. Basketball products tend to have varying degrees of seasonality, none of which are significant to the operations of the Company. Sales of winter sports equipment, including snowboards tend to be higher in the Fall and Winter seasons, while golf products tend to have higher demand during the Spring and Summer seasons. The excess merchandise products tend to have minimal seasonal fluctuations.

COMPETITION AND CUSTOMERS

In the high volume retailer wheeled products business, Huffy Bicycle Company has numerous competitors in the United States market, two of which are major competitors. Even though competition in the bicycle industry is intense, Huffy Bicycle Company believes that following its transformation from a single brand manufacturer of bicycles to a multi-brand design, marketing and distribution company, it is cost competitive in the high volume retailer wheeled products market and that its decision to import, rather than manufacture, its wheeled products allows it to profitably maintain a leading market position. Huffy Bicycle Company's ability to provide its customers with low cost, innovative new products has enabled it to maintain its market position despite the marketing efforts of domestic competitors and competitors from Taiwan, China, and other nations. Huffy Sports Company has several competitors of which one is currently a major competitor. Huffy Sports Company maintains its competitive position by offering its customers high quality, innovative products at competitive prices and by supporting its products with outstanding customer service. Gen-X Sports Inc. has numerous competitors in the markets in which it competes; six of which are major competitors in golf, three of which are major competitors in action sports, four of which are major competitors in hockey equipment, and two of which are major competitors in the snowboard equipment. Gen-X Sports maintains its competitive position by offering its customers high quality, innovative products at competitive prices and by supporting its products with outstanding customer service. Sales to two customers, Wal-Mart and Kmart, aggregated over ten percent or more of the Company's consolidated revenues from each such customer for the year ended December 31, 2003, and the loss of one of these customers could have a material adverse effect on the Company and its subsidiaries as a whole.

Although to date the export business is not significant, the businesses within the sporting goods segment participate in various foreign markets and are actively involved in expanding export volume.



SERVICES TO RETAILERS SEGMENT

Huffy Service Solutions, Inc., formerly known as Huffy Service First, Inc., operates in the service segment providing in-store assembly, diagnostics and repair, and re-call and merchandising services sold to retail customers. McCalla Company, Creative Retail Services, Inc. and Creative Retail Services (Canada) Inc., acquired in March of 2002, provide merchandising services, including cycle and periodic product resets, stocking and sales training for a number of

well-known manufacturers and/or distributors serving Home Depot. The services to retailers segment represented 20.7 percent, 23.6 percent and 23.8 percent of the consolidated revenues of the Company for the years ended December 31, 2003, 2002, and 2001.

Huffy Service Solutions, Inc., a wholly-owned subsidiary of the Company, headquartered in Miamisburg, Ohio, with additional offices in Alpharetta, Georgia, Mooresville, North Carolina and Toronto, Ontario, Canada, serves the needs of major retailers in 50 states, Puerto Rico, Guam, the Virgin Islands and Canada by providing in-store assembly and repair of bicycles and outdoor power equipment, and in-store display services for a variety of products, including, among other things, grills, physical fitness equipment, and furniture. Huffy Service Solutions, Inc. is the only assembly service business of this kind available to high volume retailers on a nationwide basis. Huffy Service Solutions, Inc. also offers merchandising services (product resets and periodic maintenance of displays) to manufacturers who supply high volume retailers. In March 2002, Huffy Service First purchased McCalla Company and subsidiaries, Creative Retail Services, Inc. and Creative Retail Services (Canada) Inc., which together provide merchandising, including cycle and periodic product resets, stocking and sales training for a number of well-known manufacturers and/or distributors serving the Do-It-Yourself retail channel throughout North America. McCalla Company and Creative Retail Services, Inc. are headquartered in Alpharetta, Georgia and Creative Retail Services (Canada) Inc. has an office in Toronto, Ontario, Canada.

SEASONALITY

The demand for services provided by Huffy Service Solutions, Inc. is seasonal in that assembly service demand is generally strongest in Spring and at the Winter holiday season. The McCalla companies provide merchandising services throughout the year, with minimal seasonal fluctuations.

COMPETITION AND CUSTOMERS

Huffy Service Solutions, Inc. has numerous competitors in the United States market, none of which is a major national competitor in the in-store and in-home assembly service business and three of which are major competitors in the merchandising services business. Huffy Service Solutions, Inc. believes it remains competitive due to its nationwide network of operations, competitive pricing and full service solution marketing approach and the recent ISO registration of its Quality Management System, specifically its Training Program. The McCalla companies have a number of competitors in the Home Center channel and maintain their competitive position by providing excellent customer service through a well-trained workforce positioned throughout North America.

OTHER ADDITIONAL INFORMATION REGARDING THE COMPANY'S BUSINESS

On March 16, 1999, Huffy sold substantially all of the assets of True Temper Hardware Company and all of the shares of the capital stock of True Temper Limited to an affiliate of U.S. Industries, Inc. On November 3, 2000, Huffy sold all of the issued and outstanding shares of Washington Inventory Service to WIS Holdings Corp., an affiliate of Sterling Investment Partners, L.P.

The Company's website address is www.huffy.com. The Company makes available free of charge through a link provided at such website its Forms 10-K, 10-Q and 8-K as well as any amendments thereto. Such reports are available as soon as reasonably practicable after they are filed or furnished to the Securities and Exchange Commission.

The number of persons employed full-time by the Company as of December 31, 2003, was 1,068.

ITEM 2. PROPERTIES

Location and general character of the principal plants and other materially important physical properties of the Company as of January 2, 2004.

| Location | Building Description | Business Segment | Are |
|---|---|---|---|
| Miamisburg, Ohio | Offices, display and warehouse facilities<br><br>(Corporate and Huffy Service Solutions, Inc.) | Sporting Goods and Services | |
| Springboro, Ohio | Offices and warehouse facility<br><br>(Huffy Bicycle Company) | Sporting Goods | |
| Sussex, Wisconsin | Offices and manufacturing<br><br>(Huffy Sports Company) | Sporting Goods | |
| Toronto, Ontario, Canada | Offices, display and retail outlets<br><br>(Gen-X Sports Inc.) | Sporting Goods | |
| Carson, California | Warehouse facility<br><br>(Huffy Bicycle Company and Gen-X Sports Inc.) | Sporting Goods | |
| Brampton, Ontario, Canada | Warehouse facility<br><br>(Gen-X Sports Inc.) | Sporting Goods | |

(1) Subject to two consecutive options to renew for additional terms of five years each.

(2) Subject to one option to renew for an additional term of five years.

(3) Subject to one option to renew for an additional term of five years.

(4) The Company operates two warehouses in Carson, California. The first warehouse is 292,900 square feet, and the lease expires in 2007; the second is 105,654 square feet, and the lease expires in 2007. Each lease is subject to two consecutive options to renew for additional terms of five years.

(5) Subject to one option to renew for an additional term of three years.

All of the Company's facilities are in good condition and are considered suitable for the purposes for which they are used. The Sussex, Wisconsin

manufacturing facility normally operates on two full shifts, with third shift operations scheduled as needed.

ITEM 3. LEGAL PROCEEDINGS

The Company along with numerous California water companies and other potentially responsible parties ("PRPs") for the Baldwin Park Operable Unit of the San Gabriel Valley Superfund have been named in fourteen civil lawsuits which allege claims related to the contaminated groundwater in the Azusa, California area (collectively, the "San Gabriel Cases").

The San Gabriel Cases had been stayed for a variety of reasons, including a number of demurrers and writs taken in the Appellate Division, relating primarily to the California Public Utilities Commission ("PUC") investigation described below. The resulting Appellate Division decisions were reviewed by the California Supreme Court, which ruled in February 2003. The cases have been reactivated as a result of the California Supreme Court's decision, with the trial level Coordination Judge holding a number of Status Conferences on all of the cases, at which conferences issues pertaining to the three master complaints (two of which include the Company as a defendant), demurrers to such master complaints, case management orders, selection of "bellweather" plaintiffs, initial written discovery, and hearings to resolve the PUC-related issues remanded by the California Supreme Court were discussed. As noted by the matters being discussed with the Court, the toxic tort cases are in their initial stages. Thus, it is impossible to currently predict the outcome of any of the actions.

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The Company, along with the other PRPs for the Baldwin Park Operable Unit of the San Gabriel Valley Superfund Site (the "BPOU"), was also named in four civil lawsuits filed by water purveyors. The water purveyor lawsuits alleged CERCLA, property damage, nuisance, trespass and other claims related to the contaminated groundwater in the BPOU (collectively, the "Water Entity Cases"). The Company was named as a direct defendant by the water purveyor in two of these cases, and was added as a third party defendant in the two others by Aerojet General Corporation, which, in those cases, was the only PRP sued by the water purveyors. Each of the Water Entity Cases have been settled through the entry of the Project Agreement. According to the terms of the Project Agreement, the Water Entity Cases have been dismissed without prejudice. The Third Party complaints filed by Aerojet in connection with the Water Entity Cases have also been dismissed without prejudice, subject to Aerojet filing a new suit in the event a final allocation agreement cannot be worked out.

On March 12, 1998, the PUC commenced an investigation in response to the allegations in the toxic tort actions that "drinking water delivered by the water utilities caused death and personal injury to customers." The PUC's inquiry addressed two broad issues central to these allegations: 1) "whether current water quality regulation adequately protects the public health;" and 2) "whether respondent utilities are (and for the past 25 years have been) complying with existing drinking water regulation." On November 2, 2000, the PUC issued its Final Opinion and Order Resolving Substantive Water Quality Issues. Significantly, the Order finds, in pertinent part, that: 1) "existing maximum contaminant level ("MCLs") and action level ("ALs") established by the DHS are adequate to protect the public health;" 2) "there is a significant margin of safety when MCLs are calculated so that the detection of carcinogenic contaminants above MCLs that were reported in this investigation are unlikely to pose a health risk;" 3) based upon its comprehensive review of 25 years of utility compliance records, that for all periods when MCLs and ALs for specific chemicals were in effect, the PUC regulated water companies complied with DHS

testing requirements and advisories, and the water served by the water utilities was not harmful or dangerous to health; and 4) with regard to the period before the adoption by DHS of MCLs and ALs, a further limited investigation by the PUC Water Division will be conducted.

Based upon information presently available, such future costs are not expected to have a material adverse effect on the Company's financial condition, liquidity, or its ongoing results of operations. However, such costs could be material to results of operations in a future period.

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

Not applicable.

PART II

ITEM 5. MARKET PRICE OF AND DIVIDENDS ON THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Huffy Corporation Common Stock is traded on the New York Stock Exchange. The quarterly high and low prices of Huffy Corporation Common Stock during the years ended December 31, 2003 and 2002 were as follows:

| Year Ended December 31, 2003 | | | Year Ended December 31, 2002 | | |
|---|---|---|---|---|---|
| | Common Stock Price Range | | | Common Stock Price Range | |
| Quarter | High | Low | Quarter | High | Low |
| First | $7.12 | $ 4.82 | First | $7.05 | $ 5.95 |
| Second | 7.07 | 5.13 | Second | 8.90 | 6.98 |
| Third | 7.90 | 5.76 | Third | 8.60 | 5.48 |
| Fourth | 6.83 | 5.05 | Fourth | 7.98 | 5.97 |

As of December 31, 2003, there were 16,037,799 shares of Huffy Corporation Common Stock outstanding and there were 3,172 shareholders of record. Management estimates an additional 4,500 shareholders hold their stock in nominee name. Trading volume of the Company's Common Stock during the twelve months ended December 31, 2003 totaled 8,892,100 shares. The average number of common shares outstanding during this period was approximately 15,349,763 shares. The Company is limited in its ability to pay dividends pursuant to the terms of its Second Amended and Restated Loan and Security Agreement, as amended.

The information to be set forth in the table entitled EQUITY COMPENSATION PLAN INFORMATION is contained in the Company's Proxy Statement for its 2004 Annual Meeting of Shareholders, and is hereby incorporated herein by reference.



ITEM 6. SELECTED FINANCIAL DATA
FIVE-YEAR FINANCIAL AND OPERATING REVIEW (UNAUDITED)
(DOLLAR AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)

| SUMMARY OF OPERATIONS | 2003 | 2002 | 2001 |
|---|---|---|---|
| Net sales | $437,676 | $369,784 | $331,138 |
| Gross profit | 78,258 | 65,573 | 39,950 |
| Selling, general, and administrative expenses | 79,872 | 57,374 | 47,607 |
| Operating (loss) income | (1,614) | 8,199 | (11,370) |
| Other (income) expense, net | (730) | 1,636 | 303 |
| Interest expense, net | 5,627 | 1,688 | 1,128 |
| Earnings (loss) before income taxes | (6,511) | 4,875 | (12,801) |
| Income tax expense (benefit) | 966 | 540 | (4,391) |
| Earnings (loss) from continuing operations | (7,477) | 4,335 | (8,410) |
| Discontinued operations | 22 | (5,713) | -- |
| Net earnings (loss) | (7,455) | (1,378) | (8,410) |
| Earnings (loss) per common share: | | | |
| Basic Continuing operations | (0.49) | 0.36 | (0.82) |
| Net earnings (loss) | (0.49) | (0.12) | (0.82) |
| Diluted Continuing operations | (0.49) | 0.36 | (0.82) |
| Net earnings (loss) | (0.49) | (0.12) | (0.82) |
| Common dividends declared | -- | -- | -- |
| Common dividends per share | -- | -- | -- |
| Capital expenditures for plant and equipment | 5,901 | 3,144 | 2,553 |
| Weighted average common share outstanding: | | | |
| Basic | 15,350 | 11,833 | 10,298 |
| Diluted | 15,350 | 11,979 | 10,298 |
| FINANCIAL POSITION AT YEAR END | | | |
| Total assets | 292,971 | 281,092 | 145,485 |
| Working capital | 676 | 302 | 44,376 |
| Net investment in plant and equipment | 16,799 | 15,511 | 9,267 |
| Current Portion of Long-Term Debt | 80,402 | 59,327 | -- |
| Long-term obligations | 542 | 317 | -- |
| Shareholders' equity | 72,656 | 71,747 | 65,602 |
| Equity per share outstanding | 4.53 | 4.90 | 6.32 |
| CASH FLOWS | | | |
| Net cash provided by (used in) continuing operating activities | (18,419) | (1,572) | 40,786 |
| Net cash provided by (used in) discontinued operations | 22 | (5,713) | -- |
| Net cash provided by (used in) operating activities | (18,397) | (7,285) | 40,786 |
| Net cash provided by (used in) investing activities | (7,074) | (26,298) | (2,549) |
| Net cash provided by (used in) financing activities | 21,484 | 12,461 | (16,030) |
| Net change in cash and cash equivalents | (3,987) | (21,122) | 22,207 |
| PERFORMANCE MEASUREMENTS | | | |
| Earnings from continuing operations as a % of net sales | N/A | 1.2% | N/A |
| Average working capital turnover | 5.1 | 4.9 | 5.9 |
| Return on net assets | N/A | 4.3% | N/A |
| Return on beginning shareholders' equity | N/A | N/A | N/A |
| Current ratio | 1.0 | 1.0 | 1.7 |
| Total long term debt/total capital | 25.6% | 7.2% | 0.0% |
| Number of common shareholders | 3,172 | 3,223 | 3,211 |

N/A - Not Applicable.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollar amounts in thousands, except per share data)

Overview

Huffy Corporation is comprised of two business segments, the Sporting Goods Segment, and the Services to Retailers Segment. The Sporting Goods segment designs and markets sporting goods product for sales through retail outlets. The primary products distributed by this segment are wheeled and related products, basketball backboards, balls, and related products, snow boards, golf equipment, hockey equipment, excess sports equipment and licensing. Sales of wheeled and related products are the single largest product line, representing approximately 40.0% of total annual revenues of Huffy Corporation for the year ended December 31, 2003.

The primary operating locations for the Sporting Goods Segment are Springboro, Ohio; Sussex, Wisconsin; and Toronto Ontario. The Company holds a leading market position in the United States in the distribution of wheeled products such as bicycles, scooters, and tricycles. The majority of wheeled products are sold under the Huffy(R) brand name, (approximately 80%). The Company is also a leading supplier of basketball backboards, poles, goals and related products sold under the Huffy Sports brand name. Many of these products also bear the logo of the National Basketball League.

The remainder of the Sporting Goods Segment product lines includes golf, hockey, and snow boards are designed and marketed from the Company's facility in Toronto, Ontario, and are sold under a variety of brand names such as Tommy Armour(R), Oxygen(R), Dukes(R), Rage(R), Sims(R), Hespeler(R), etc.

The Company's Sporting Goods Segment tends to operate on a seasonal pattern, with its peak operating periods being the spring and the fall.

The Services to Retail Segment, operates in the service segment providing in-store assembly, diagnostics, repair, and recall and merchandising services sold to retail customers. The services to retailers segment represented approximately 21.0% of the consolidated revenues of the Company for the year 2003. The services to retailers business is conducted by a wholly owned subsidiary of Huffy Corporation, Huffy Service Solutions, Inc. located in Miamisburg, Ohio, with additional offices in Alpharetta, Georgia; Mooresville, North Carolina; and Toronto, Ontario.

Huffy Service Solutions serves the needs of retailers in 50 states, Puerto Rico, Guam, the Virgin Islands and Canada, providing in-store assembly and repair of products such as bicycles, outdoor power equipment, gas grills, and a variety of other products including in-store display services.

The Services to Retailers business segment tends to be seasonal, with the highest volume periods being the spring and the winter season.

The Company primarily markets goods and services to retail customers. Consolidation of the retail segment over the past few years has increased the competition among suppliers for each segment of business. In addition, in both of its business segments, the Company competes against numerous suppliers for its portions of the market. In such a market, price competition is heavy, and cost competitiveness is key to success. Huffy Corporation focuses significant effort on maintaining a structure that is competitive both with respect to product cost and organization structure.

On February 17, 2004, the Company announced a plan to consolidate the management, sales, marketing, procurement, logistics, and customer service

functions of its Sporting Goods segment. Management believes that the consolidation of these functions within the sporting goods segment will position the Company to better serve its customers. This consolidation will result in a reduction of approximately twenty percent, or more than one hundred people in the existing sporting goods workforce, and will result in restructuring expense of approximately $4,000 to $6,000 in 2004. The Service to Retail segment will continue to operate as an independent business under its current management.

COMPARISON OF THE YEAR ENDED DECEMBER 31, 2003 TO THE YEAR ENDED DECEMBER 31, 2002

For the year ended December 31, 2003, Huffy Corporation ("Huffy" or "Company") had a net loss of $7,455, or $0.49 per common share compared to a net loss for the same period in 2002 of $1,378, or $0.12 per common share. Prior year results include the post-acquisition earnings from Gen-X Sports Inc., acquired on September 19, 2002.

Results from continuing operations for the year ended December 31, 2003 was a net loss of $7,477, or $0.49 per common share, compared to net income of $4,335, or $0.36 per common share in 2002.



Net Sales

Net sales in 2003 were $437,676, an increase of $67,892 or 18.4% compared to net sales of $369,784 for the same period in 2002. This sales increase was almost entirely the result of the acquisition of Gen-X Sports Inc. on September 19, 2002. The 2003 consolidated sales include a full twelve months of sales for the Gen-X product lines compared to a partial year in 2002, from the September 19th acquisition date through year end. The 2002 to 2003 increase in sales for the Gen-X Sports product lines was $68,207. In addition to the Gen-X Sports Inc. impact, the 2002 to 2003 sales comparison was influenced by the following less significant factors. In the Company's basketball product line, 2003 sales were below the prior year by $6,800 reflecting a decline in consumer demand for sporting goods throughout 2003. Sales for the bicycle product line and the Services to Retailers segment both improved during 2003, when compared to 2002 results by $3,281 and $3,766 respectively. In combination, the sales increase in the bicycle and service segment were sufficient to offset the year over year sales decline in the basketball product line.

Gross Profit

Consolidated gross profit for 2003 was $78,258, or 17.9% of net sales as compared to $65,573 or 17.7% of net sales for the same period in 2002, a $12,685 improvement. The primary reason for this improvement was the inclusion of the Gen-X Sports Inc. gross margin in the 2003 results for the entire year versus 2002 when Gen-X Sports Inc. was included for a partial year only, from the September 19th acquisition date through year end. Of the annual increase in gross margin, $15,688 was contributed by Gen-X, including approximately $3,200 as the result of year over year margin improvement. The second reason for the improvement in year over year gross margin occurred in the Services to Retailers segment, where 2003 gross margin increased over the same period in 2002, by $4,257, or 4.7% of net sales. This increase is reflective of an improvement in field efficiency, and a successful cost reduction program implemented during 2003. In the bicycle product line, gross margin was slightly lower during 2003 than in 2002, a decrease of $2,331 primarily as a result of unfavorable sales mix. This decline is the result of a change in the mix of products sold, with a larger portion of 2003's sales going to opening price point and juvenile products which have a lower gross margin. The basketball product line

experienced a decline in gross margin of $5,204 during 2003 that was primarily influenced by lowered year over year sales volume, but was also impacted by increased market demand for opening price point product.

Selling, General and Administrative Expenses

Selling, general and administrative expense of $79,872, for the year ended December 31, 2003 was higher than the $57,374 experienced during the same period in 2002. The primary reason for the year over year increase of $22,498, in SG&A expenses was the inclusion of the Gen-X Sports Inc. selling and administrative support costs in consolidated operating results of the full year during 2003, versus only a partial year in 2002 from the September 19th acquisition date through December 31, 2002, an increase of $26,369. In addition to the Gen-X Sports Inc. driven expense increases, 2003 versus 2002 selling, general and administrative expenses comparisons were unfavorably impacted by economy driven cost escalation. The major areas where such cost increases occurred were pensions, insurance, and insurance related products. The cost of these expense items increased by $3,283 between 2002 and 2003. In addition, 2002 to 2003 cost comparisons were unfavorably impacted by investment in increased sales and marketing staffing to support new products expected to favorably impact 2004 sales in the Sporting Goods segment. Offsetting these increased expenses, during 2003, the Company recorded settlements of $3,335 resulting from arbitration related to expenses incurred in prior periods, and cost reduction efforts across all Huffy companies.

Discontinued Operations

During the year ended December 31, 2003, the Company recorded net income from Discontinued Operations of $22. This income includes several components. The first is the loss on the disposal of the Company's Volant(R) Ski business, $988, ($904 after tax). Also included was the 2003 operating loss incurred by the Volant(R) Ski business, $523, ($478 after tax). The third component related to Huffy Corporation's divestiture of its Washington Inventory Service subsidiary in November of 2000, and subsequent class action suits filed in California in 2001 and 2002 against the Company and the purchaser alleging violations of labor practices. As the previous owner, the Company was obligated to indemnify the purchaser for a portion of its liability, if any. The operating income of $290 ($257 after tax) of the Volant(R) ski business for the year ended December 31, 2002 has been reclassified to discontinued operations. During 2002, the Company recognized expenses of $9,185 ($5,970 after tax), to cover the settlement, legal, and other contractual liabilities associated with this action. Based upon information from the Claims Administrator released during 2003, the Company revised its estimate of claims cost, resulting in the recognition of income from Discontinued Operations for the year ended December 31, 2003 of $3,605, ($2,239 after tax). The final component of discontinued operations was related to additional product liability reserves, based upon claims made, related to products manufactured and sold by businesses which the Company previously owned. The charges recorded during 2003 were $1,346 ($835 after tax).



Net Interest Expense

Net interest expense increased from $1,688 for the year ended December 31, 2002 to $5,627 for the year ended December 31, 2003. This increase in expense reflects the acquisition of Gen-X Sports Inc. on September 19, 2002. The increase in 2003 interest expense was also driven by the increased working capital utilized by the Gen-X Sports Inc. product lines throughout 2003.

COMPARISON OF THE YEAR ENDED DECEMBER 31, 2002 TO THE YEAR ENDED DECEMBER 31,

2001

For the year ended December 31, 2002, Huffy Corporation ("Huffy" or "Company") had a net loss of $1,378, or $0.12 per common share compared to a net loss for the same period in 2001 of $8,410, or $0.82 per common share. Fiscal year 2002 results include the post-acquisition earnings from Gen-X Sports Inc. acquired on September 19, 2002. In addition, the 2002 net earnings reflect a loss from discontinued operations of $5,713 after tax, or $0.48 per common share. These charges are related to the settlement of contractually indemnified liabilities and a related lawsuit settlement regarding labor practices by one of the Company's former subsidiaries, Washington Inventory Service, limited to the period of the Company's ownership which ended on November 3, 2000. Discontinued Operations also includes a reclassification of 2002 results related to the disposal of the Volant(R) product line in 2003 to conform to the 2003 presentation. For the year ended December 31, 2002, the Company's results included sales, gross profit, and net earnings for Volant of $3,112, $774, and $257, respectively.

Results from continuing operations for the year ended December 31, 2002 were $4,335, or $0.36 per common share, compared to a net loss of $8,410, or $0.82 per common share in 2001. The net loss from continuing operations in 2001 included a pretax charge of $3,713 ($2,440 after tax), or $0.24 per common share, associated with the termination of Mexican manufacturing operations, reductions of staffing levels at Huffy Bicycle Company, and the consolidation of the financial and information technology groups. On January 22, 2002, Kmart Corporation filed for reorganization under Chapter 11 of the U.S. Bankruptcy Court. The Company recorded a charge in the fourth quarter of 2001 of $4,680 ($3,075 after tax), or $0.30 per common share, to reflect the Kmart bad debt. The 2001 net loss from continuing operations excluding the reconfiguration, refinancing and Kmart bad debt was $2,895, or $0.28 per common share.

Net Sales

Net sales in 2002 were $369,784, an increase of 11.7%, compared to net sales of $331,138 for the same period in 2001. This sales increase was primarily related to the acquisitions of Gen-X Sports Inc. and the McCalla Company during 2002. In addition, the Company's basketball products also experienced a 12.3% year over year increase in sales volume.

Gross Profit

Consolidated gross profit for 2002 was $65,573, or 17.7% of net sales as compared to $39,950, or 12.1% of net sales reported for the same period in 2001, reflecting a 64.1% improvement over the prior year gross margin. The primary reason for this improvement was the addition of Gen-X Sports Inc. and the McCalla Company to the Huffy portfolio. The second reason for the year over year increase was the improved margin in the Company's wheeled product line where favorable purchasing and warehousing variances in 2002 increased margins markedly over the depressed levels experienced during 2001 as a result of the close out of slow moving scooter inventory. The Company's basketball product line also experienced a 270 basis point improvement in year over year margins as a result of successful cost reduction programs. Pension charges added $1,072 of additional expense in 2002 as compared to 2001 expense.

Selling, General and Administrative Expenses

Selling, general and administrative expenses of $57,374, for the year ended December 31, 2002 were higher than the $47,607 experienced during the same period in 2001. The primary reason for the year over year increase in these expenses was the selling, general and administrative expenses added as a result of the acquisitions of Gen-X Sports Inc. and the McCalla Company. 2002 administrative pension expense increased by $2,214 over 2001 expense due to poor

stock market performance and declining interest rates. Although less significant, additional reasons for the increased selling, general and administrative expenses include increased brand advertising and higher incentive based compensation. 2001 selling, general and administrative expenses include a charge for the Kmart bankruptcy of $4,680.

Net Interest Expense

Net interest expense increased from $1,128 for the year ended December 31, 2001, to $1,688 in the current year. Borrowing costs to finance the acquisitions of Gen-X Sports Inc. and the McCalla Company as well as the increased working capital needs of these subsidiaries resulted in higher interest costs in 2002.

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ACQUISITIONS

On September 19, 2002, the Company acquired all of the stock of Gen-X Sports Inc. in exchange for $19,001 in cash and the issuance of 4,161,241 shares of Huffy Corporation's Class A common shares to the stockholders of Gen-X. Per the terms of the agreement, 193,466 additional common shares were issued to the Gen-X stockholders on or about the first anniversary date. Gen-X did not meet certain financial performance objectives in 2002, which would have resulted in the issuance of up to 645,161 additional common shares. In addition, the acquired companies immediately redeemed $4,970 of preferred stock at face value and refinanced their existing bank debt. Included in the assets acquired are trademarks, patents and licensing agreements recorded at their fair values at the date of acquisition of $45,800, $1,285 and $940, respectively, as well as goodwill in the amount of $12,104. During 2003, the Company sold certain assets of the Volant Ski business, including patents and trademarks valued at $310 and $2,000, respectively. Gen-X is a designer, marketer and distributor of branded sports equipment, including action sports products, winter sports products and golf products, and is a purchaser and reseller of excess sporting goods and athletic footwear inventories and special opportunity purchases.

On March 27, 2002, Huffy Service Solutions acquired the stock of McCalla Company and its subsidiaries, Creative Retail Services, Inc. and Creative Retail Services (Canada) Inc. ("McCalla"). The aggregate purchase price was $5,400, less $500 net cash acquired, and was paid in cash. A contingent purchase price payment was recorded for the McCalla acquisition of $1,645 in the fourth quarter of 2002. The $1,645 contingent purchase price payment was paid to the sellers in April 2003 and was treated as contingent purchase price in accordance with EITF 95-8 "Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination." Of the total purchase price, $4,876 was recorded as goodwill and $300 was recorded as a covenant not-to-compete. McCalla provides merchandising, including cycle and periodic product resets, stocking and sales training for a number of well-known manufacturers serving Home Depot, including, among others, Duracell and Spectrum Brands.

DISCONTINUED OPERATIONS

On December 1, 2003, the Company sold its Volant(R) Ski business to the winter sports division of the Amer Group plc (Atomic). Under the terms of the agreement, Atomic acquired all patents, trademarks and intellectual property as well as the manufacturing equipment and inventory related to such business.

Huffy Corporation divested its Washington Inventory Service subsidiary in November 2000. Subsequently, in late 2001 and mid 2002, two class action suits were filed in California seeking damages for alleged violations of labor

practices. As a previous owner, Huffy was potentially obligated to indemnify the subsidiary purchaser for some portion of any liability it or such subsidiary had in the first case and had potential liability in the latter case, both limited to the periods it owned the subsidiary. After protracted negotiations and on advice of counsel, a settlement was negotiated and preliminarily approved on January 28, 2003 by the Superior Court of California, County of Los Angeles. A charge to discontinued operations of $9,185 ($5,970 after tax) was taken during 2002 to record the Company's estimated obligation related to this matter. The settlement was given final court approval, pending compliance with the terms of the Class Settlement Agreement, and a Judgment of Dismissal was issued on April 7, 2003. The Claims Administrator issued a report as to claims made and on the amount of payments to be made which was approximately $5,200 for the Company. The Company contributed $5,121 into a court appointed escrow account for the payment of claims. The Company revised its estimate of claims which resulted in income from discontinued operations for the year ended December 31, 2003 of $3,605 ($2,239, net of tax). In addition, based upon claims made, the Company recorded additional reserves for product liability related to products manufactured and sold by businesses which it previously owned. The charges recorded during 2003 were $1,346 ($835 after tax).

LIQUIDITY AND CAPITAL RESOURCES

On March 14, 2003, the Company entered into a $15,000 subordinated Term Loan with Ableco Finance LLC (the Term Loan). The Term Loan is secured by a lien on the Company's trademarks and trade names and a subordinated position on all other assets pledged under the Company's revolving credit facility. The Term Loan matures on the earlier of the maturity of the Company's revolving credit facility or five years. Financial covenants in the Term Loan require the Company to maintain a minimum EBITDA, (Earnings Before Interest, Taxes, Depreciation and Amortization) and a fixed charge coverage ratio.

In conjunction with the new Term Loan, the Company amended its credit facility with its existing lender to incorporate the new borrowing into the agreement. Financial covenants identical to the Term Loan were added to the revolving credit facility. In addition, changes were made in the revolving credit facility's existing Net Worth covenant, which raised the minimum net worth requirement to $60,000 and increases the minimum net worth requirement to $62,500 on January 1, 2004. The revolving credit facility is secured by all assets of the Company and its affiliates and will expire on December 31, 2004, with a 12 month renewal option. In anticipation of 2003 operating losses, the Company contacted its lender to request amendment of certain of its covenants at December 31, 2003, and certain ongoing cumulative covenants in 2004. The Company received a waiver from its lenders addressing the deficiency in achieving its EBITDA and fixed charge coverage ratio covenants for the quarter ended December 31, 2003. Subsequently, the lenders entered into an additional amendment



dated February 19, 2004 which excludes $5,200 of certain charges from the cumulative twelve month calculation for December 2003.

From time to time, the Company has requested and received additional short-term borrowing authority under its revolving credit facility with Congress Financial to cover seasonal working capital needs. In July 2003, the Company amended its revolving credit facility to increase the maximum loan amount to $105,000 and to increase the revolving loan limit to $90,000. As of December 31, 2003, the Company had $14,957 of borrowing capacity on its revolving credit facility.

Pre-bankruptcy receivables from Kmart were sold during the second quarter of 2002. The cash recovery from this transaction was consistent with previously

established reserves.

At December 31, 2003, inventory was valued at $49,606, up from $41,847 at December 31, 2002. The increase of $7,759 is primarily due to inventory for the Gen-X product lines where inventory increased by $10,528 year over year. The increased inventory levels were driven primarily by lower than anticipated sales volumes in 2003.

Accounts payable at December 31, 2003 are $74,722 as compared to $65,519 at the end of 2002. This increase reflects higher incremental purchases to support higher sales volume as well as longer payment terms negotiated with our vendors.

At December 31, 2003, cash was $3,987 lower than the same period in 2002. This decrease was the result of an increase in working capital needs between the two years, and an increase in capital spending. These increases were partially offset by an increase in short term and long term debt.

Prepaid expenses and other current assets increased by $3,796 from the prior year primarily due to the prepayment for certain inventories as required for certain Far East vendors for Gen-X.

At year end December 31, 2003, non-current deferred income tax assets were $16,539, down from $22,484 for the same period in 2002. This decline is due to the changes in accrued liabilities, reflecting the payout of significant liabilities, such as workers compensation, product liability, deferred compensation, pension, post retirement benefits other than pensions, and legal accruals.

Other assets at December 31, 2003 were $9,977 as compared to $6,650 for the same period in 2002. This increase is the result of favorable investment performance of the Huffy Master Benefit Trust, and the Huffy Supplemental/Excess Benefit Plan Trust, as well as an increase in financing fees. These increases were offset by usage of the environmental escrow balance.

At December 31, 2003 accrued salaries, wages and other compensation were at a balance of $3,313 versus $6,854 in the prior year, a decrease of $3,541. The primary reason for this decrease in year over year levels was the decrease in 2003 incentive pay accruals. Secondarily, liabilities established at December 31, 2002 for wage related liabilities associated with Washington Inventory Service, which was sold in 2000, were paid during 2003, contributing to the decline in year to year balances.

Other accrued liabilities at December 31, 2003 were $8,460, $5,526 lower than the balance at December 31, 2002. The primary reason for the year to year decrease was the WIS settlement of $7,700 paid during 2003. This decrease was partially offset by small increases in various accruals for such expenses as product liability, royalties, warranty and legal expenses.

At December 31, 2003, other current liabilities were $606, compared to $8,090 at December 31, 2002. This decline in year over year balance was driven entirely by reductions in required tax accruals due to the Company's 2003 operating loss.

At December 31, 2003, the Company valued its pension plans in accordance with SFAS Nos. 87 and 88. Due to low interest rates and poor stock market performance, the value of the plan assets is less than the accumulated benefit obligation, causing the Company to record an after tax charge to accumulated other comprehensive loss of $752.

As of December 31, 2003, the Company has the following contractual obligations and outstanding borrowings that are expected to impact future liquidity and cash flows:

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| Contractual Obligations | Total | Less than 1 year | 1-3 years |
|---|---|---|---|
| Long-term debt | $ 79,844 | $ 79,844 | $ - |
| Capital leases | 1,100 | 558 | 535 |
| Operating leases | 23,323 | 5,836 | 11,002 |
| Purchase obligations | 4,018 | 929 | 1,267 |
| Total contractual obligations | $ 108,285 | $ 87,167 | $ 12,804 |

The Company expects cash and cash equivalents, cash flow from operations and its revolving credit facility to be sufficient to finance seasonal working capital needs and capital expenditures throughout the coming year. The Company frequently reviews its credit and capital structure and makes adjustments as necessary. The Company anticipates implementation of a plan in 2004 to reduce working capital, particularly the working capital associated with the product lines acquired in the Gen-X acquisition. When fully implemented, the program should contribute improved cash flows from operations.

CRITICAL ACCOUNTING POLICIES

ALLOWANCE FOR DOUBTFUL ACCOUNTS

The Company evaluates the collectibility of its accounts receivable based upon an analysis of historical trends, aging of accounts receivable, write-off experience and expectations of future performance. Delinquent accounts are written off to selling, general and administrative expense when circumstances make further collection unlikely. In the event of a customer bankruptcy or reorganization, specific reserves are established to write down accounts receivable to the level of anticipated recovery. The Company may consult with third-party purchasers of bankruptcy receivables when establishing specific reserves. Non-specific reserves for doubtful accounts are based upon a historical bad debt write-off of approximately 0.2% of net sales. At December 31, 2003, a 0.1 percentage point change in the historical bad debts write-off percentage would impact the selling, general and administrative expenses by $438.

In January 2002, Kmart Corporation filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. Pre-bankruptcy receivables from Kmart were sold during the second quarter 2002 and cash recovered was consistent with previously established reserves. Kmart has subsequently emerged from bankruptcy, and the Company continues to supply product for its retail locations. Post Kmart's bankruptcy the Company has modified its credit terms on sales to minimize the credit risk.

INVENTORY VALUATIONS

Inventories are valued at cost (not in excess of market) determined by the first-in, first-out (FIFO) method. Management regularly reviews inventory for salability and reduces inventory to market level in the event that market price is lower than cost. On an annual basis, the Company takes a physical inventory

verifying the units on hand and comparing its perpetual records to physical counts. Periodic cycle counting procedures are used to verify inventory accuracy between physical inventories.

IMPAIRMENT OF LONG LIVED ASSETS

Long-lived assets, including fixed assets and intangibles other than goodwill, are reviewed by the Company for impairment whenever events or changes in circumstances indicate that the carrying amount of any such asset may not be recoverable. If the undiscounted cash flows (excluding interest) from the use and eventual disposition of the asset is less than the carrying value, the Company recognizes an impairment loss, measured as the amount by which the carrying value exceeds the fair value of the asset. The estimate of undiscounted cash flow is based upon, among other things, certain assumptions about expected future operating performance. The Company's estimates of undiscounted cash flow may differ from actual cash flow due to, among other things, technological changes, economic conditions, changes to its business model or changes in its operating performance. In those cases, the Company determines that the useful life of other long-lived assets should be shortened, the Company would depreciate the net book value in excess of the salvage value (after testing for impairment as described above), over the revised remaining useful life of such asset thereby increasing amortization expense.



IMPAIRMENT OF GOODWILL AND OTHER INTANGIBLE ASSETS WITH INDEFINITE LIVES

Goodwill represents the excess of assets over the assets of the business acquired. The Company adopted the provisions of SFAS No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets", as of January 1, 2002. Pursuant to SFAS No. 142, goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead are tested for impairment at least annually in accordance with the provisions of SFAS No.142.

Goodwill and other intangible assets with indefinite useful lives are tested for impairment annually during the fourth quarter, and are tested more frequently if events and circumstances indicate that an asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. This determination is made at the reporting unit level and consists of two steps. First, the Company determines the fair value of a reporting unit level and compares it to its carrying amount. Second, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill and other intangible assets with indefinite useful lives over the implied fair value of that goodwill and other intangible assets with indefinite useful lives. The implied fair value is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with SFAS No. 141, Business Combinations. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill and other intangible assets with indefinite useful lives.

PENSION AND OTHER POST RETIREMENT PLANS

The Company sponsors defined benefit pension plans covering certain salaried and hourly employees. Benefits to salaried employees are based upon the highest three consecutive years of earnings out of their last ten years of service; benefits to hourly workers are based upon their years of credited service. Contributions to the plans reflect benefits attributed to employees' service to-date and also to services expected to be provided in the future.

In addition to the Company's defined benefit pension plans, the Company sponsors several welfare benefit health care and life insurance plans that provide post retirement medical, dental, and life insurance benefits to full-time employees who meet minimum age and service requirements. The plans are contributory, with retiree contributions adjusted annually, and contain other cost-sharing features such as deductibles and coinsurance.

The liabilities for pension and other post retirement plans are determined by actuaries. Key actuarial assumptions include the discount rate, expected return on plan assets and rate of compensation increase, among others. A change to one or more of these actuarial assumptions could materially change the amounts of these liabilities.

SELF-INSURANCE RESERVES

The Company is self-insured for workers compensation, medical insurance and product liability claims up to certain maximum liability amounts. Medical insurance reserves are determined based upon historical expense experience and loss reporting trends. Workers compensation reserves are determined based upon historical trends of losses, settlements, litigation costs and other factors. The Company estimates the value of each product liability claim when reported, and then adjusts those claims by a development factor created using historical claims. The amounts accrued for self-insurance are based upon management's best estimate and the amounts the Company will ultimately disburse could differ from such accrued amounts. The majority of workers compensation and product liability expense are charged to cost of sales. The majority of medical expenses are charged to selling, general and administrative expenses.

ENVIRONMENTAL

Environmental expenditures that relate to current operations are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated.

The Company, along with others, has been designated as a potentially responsible party (PRP) by the U.S. Environmental Protection Agency (the "EPA") with respect to claims involving the discharge of hazardous substances into the environment in the Baldwin Park operable unit of the San Gabriel Valley Superfund site. The Company, along with other PRPs, the Main San Gabriel Basin Watermaster (Watermaster), the San Gabriel Water Quality Authority (WQA), and numerous local water districts (Water Districts), have worked with the EPA on a mutually satisfactory remedial plan, with the end result being a joint water supply/clean up Project Agreement which settles four different lawsuits filed by the WQA and the Water Districts. The Project Agreement was signed on March 28, 2002 and was approved by the court and became effective May 9, 2002. In developing its estimate of environmental remediation costs, the Company considers, among other things, currently available technological solutions, alternative cleanup methods, and risk-based assessments of the contamination and, as



applicable, an estimation of its proportionate share of remediation costs. The Company may also make use of external consultants and consider, when available, estimates by other PRPs and governmental agencies and information regarding the financial viability of other PRPs. Based upon information currently available, the Company believes it is unlikely that it will incur substantial previously unanticipated costs as a result of failure by other PRPs to satisfy their responsibilities for remediation costs.

The Company has recorded environmental accruals that, based upon the information available, are adequate to satisfy remediation requirements known at this time. The total accrual for estimated environmental remediation costs related to the Superfund site and other potential environmental liabilities was $3,378 ($5,232 before discounting) at December 31, 2003. Of that amount, the Company has a deposit of $2,377 that is held in escrow under the terms of the settlement agreement. Amounts in escrow will be used to fund future costs and will serve as a long-term performance assurance pending the completion of remediation. Management expects that the expenditures relating to costs currently accrued will be made over a period of fourteen years.

The environmental escrow accounts are classified as current prepaid assets on the accompanying condensed consolidated balance sheets if the funds are expected to be expended within the next 12 months and as long-term other assets for those funds, which are expected to be expended beyond 12 months. The current escrow balance at December 31, 2003 was $879 and the long-term escrow balance at December 31, 2003 was $1,498. The environmental accrual is similarly classified on the accompanying condensed consolidated balance sheet with $879 shown in accrued liabilities and $2,499 shown in other long-term liabilities as of December 31, 2003.

INCOME TAX VALUATION ALLOWANCES AND TAX RESERVES

Income taxes are accounted for under the asset and liability method. Deferred tax asset and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

At December 31, 2003, we have a valuation allowance of $8,392 primarily to reduce our net operating loss and tax credit carryforwards of $14,512 to an amount that will more likely than not be realized. These net operating loss and tax credit carryforwards exist in many state and foreign jurisdictions and have varying carryforward periods and restrictions on usage. The estimation of future taxable income in these state and foreign jurisdictions and our resulting ability to utilize net operating loss and tax credit carryforwards can significantly change based on future events, including our determinations as to the feasibility of certain tax planning strategies. Thus, recorded valuation allowances may be subject to material future changes.

As a matter of course, we may be audited by federal, state and foreign tax authorities. We provide reserves for potential exposures when we consider it probable that a taxing authority may take a sustainable position on a matter contrary to our position. We evaluate these reserves, including interest thereon, on a quarterly basis to insure that they have been appropriately adjusted for events that may impact our ultimate payment for such exposures.

See Note 11 for a further discussion of our income taxes.

ACCOUNTING PRONOUNCEMENTS ISSUED NOT IMPLEMENTED

In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities", which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces FASB Interpretation No. 46, "Consolidation of Variable Interest Entities", which was issued in January 2003.

The Company will be required to apply FIN 46R to variable interest in VIEs created after December 31, 2003. For variable interests in VIEs created before January 1, 2004, the Interpretation will be applied beginning on January 1, 2005. For any VIEs that must be consolidated under FIN 46R that were created before January 1, 2004, the assets, liabilities and noncontrolling interests of the VIE initially would be measured at their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognized interest being recognized as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date FIN 46R first applies may be used to measure the assets, liabilities and noncontrolling interest of the VIE.

The Company is evaluating the impact of applying FIN 46R to existing VIEs in which it has variable interests and has not yet completed this analysis. At this time, it is anticipated that the effect on the Company's Consolidated Balance Sheet would be immaterial if implemented.



FORWARD-LOOKING STATEMENTS

This annual report contains forward looking statements that involve risks and uncertainties. Words such as "anticipate", "believe", "plan", "expect", "future", "intend", and similar expressions are used to identify forward looking statements. These statements appear throughout the 10-K, and are statements regarding our intent, belief, or current expectations primarily with respect to the Company's operations and related industry developments. The reader should not place undue reliance on these forward looking statements, which apply only as of the date of this annual report. The Company's actual results could differ materially from those anticipated in these forward looking statements.

INFLATION

Inflation rates in the United States have not had a significant impact on the Company's operating results for the three years ended December 31, 2003. The impact on the Company is minimized as a result of rapid turnover of inventories and partially offset by cost reduction programs and increased operating efficiency.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to short-term interest rate risks and foreign currency exchange rate risks. The Company does not use derivative instruments for trading purposes.

Interest Rate Risk

Interest rate risk arises primarily from variable rate borrowings in the United States and Canada. The Company has entered into an interest rate swap, which is recognized on the balance sheet at fair value. The Company has determined that the swap is effective; therefore, changes in the fair value of the swap are recorded on a quarterly basis as an adjustment to accumulated other comprehensive loss. The swap was retired in January 2004 with the renegotiation of the Sussex, Wisconsin facility lease.

At December 31, 2003, a hypothetical 100 basis point increase in short-term interest rates would result in a reduction of $237 in earnings before income taxes

Foreign Currency Exchange Risk

All subsidiaries of the Company, except Creative Retail Services (Canada) Inc., use the U.S. dollar as their functional currency. A small portion of the Company's sales, receivables, purchases and expenses are denominated in Euros, Australian dollars and Canadian dollars. The Company also maintains bank accounts in Euros, Australian dollars and the Canadian dollars to facilitate international operations. At this time, the Company's exposure to currency exchange risk is not considered material.



ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Huffy Corporation:

We have audited the accompanying consolidated balance sheets of Huffy Corporation and subsidiaries (the "Company") as of December 31, 2003 and 2002, and the related consolidated statements of operations, cash flows and shareholders' equity for each of the years in the three-year period ended December 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Huffy Corporation and subsidiaries as of December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company adopted the provisions of the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," as of January 1, 2002.

/s/ KPMG LLP
KPMG LLP
Cincinnati, OH
February 12, 2004



HUFFY CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollar Amounts in Thousands, Except Share Data)

| | 2003 | 2002 |
|---|---|---|
| Product sales | $ 347,019 | $ 282,676 |
| Service revenue | 90,657 | 87,108 |
| Net sales | 437,676 | 369,784 |
| Cost of products sold | 281,877 | 226,369 |
| Cost of services sold | 77,541 | 77,842 |
| Cost of sales | 359,418 | 304,211 |
| Gross profit | 78,258 | 65,573 |
| Selling, general and administrative expenses | 79,872 | 57,374 |
| Plant closure and manufacturing reconfiguration | -- | -- |
| Operating income (loss) | (1,614) | 8,199 |
| Other expense (income): | | |
| Interest expense | 5,990 | 1,973 |
| Interest income | (363) | (285) |
| Other (income) expense, net | (730) | 1,636 |
| Earnings (loss) before income taxes | (6,511) | 4,875 |
| Income tax expense (benefit) | 966 | 540 |
| Earnings (loss) from continuing operations | (7,477) | 4,335 |
| Discontinued operations: | | |
| Income (loss) from discontinued operations, net of income tax provision (benefit) of $810 and $(3,182), in 2003 and 2002, respectively | 926 | (5,713) |
| Loss on disposal of discontinued operations, net of income tax benefit of $84 | (904) | -- |
| Net loss | $ (7,455) | $ (1,378) |
| Earnings (loss) per common share: | | |
| Basic: | | |
| Weighted average number of common shares | 15,349,763 | 11,833,213 |
| Earnings (loss) from continuing operations | $ (0.49) | $ 0.36 |
| Earnings (loss) from discontinued operations | 0.00 | (0.48) |
| Net earnings (loss) per common share | $ (0.49) | $ (0.12) |
| Diluted: | | |
| Weighted average number of common shares | 15,349,763 | 11,978,747 |
| Earnings (loss) from continuing operations | $ (0.49) | $ 0.36 |
| Earnings (loss) from discontinued operations | 0.00 | (0.48) |
| Net earnings (loss) per common share | $ (0.49) | $ (0.12) |

See accompanying notes to the consolidated financial statements.

HUFFY CORPORATION
CONSOLIDATED BALANCE SHEETS
(Dollar Amounts In Thousands, Except Share Data)

| | DECEMBER 31, 2003 | DECEMBER 31, 2002 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 1,432 | $ 5,419 |
| Accounts and other receivables, net | 101,283 | 92,850 |
| Inventories | 49,606 | 41,847 |
| Deferred income tax assets | 9,338 | 12,227 |
| Prepaid expenses and other current assets | 12,551 | 8,755 |
| Total current assets | 174,210 | 161,098 |
| Property, plant and equipment, at cost: | | |
| Land and land improvements | 1,621 | 1,621 |
| Buildings and building improvements | 4,611 | 4,611 |
| Machinery and equipment | 19,403 | 18,970 |
| Office furniture, fixtures and equipment | 16,210 | 17,498 |
| Leasehold improvements | 2,322 | 2,069 |
| Construction in progress | 1,303 | 933 |
| | 45,470 | 45,702 |
| Less: Accumulated depreciation and amortization | 28,671 | 30,191 |
| Net property, plant and equipment | 16,799 | 15,511 |
| Excess of cost over net assets acquired, net | 29,627 | 26,663 |
| Intangible assets, net | 45,313 | 48,112 |
| Deferred income tax assets | 16,539 | 22,484 |
| Pension assets | 506 | 574 |
| Other assets | 9,977 | 6,650 |
| | $ 292,971 | $ 281,092 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Notes payable | $ 62,374 | $ 54,069 |
| Current installments of long-term obligations | 18,028 | 5,258 |
| Accounts payable | 74,722 | 65,519 |
| Accrued expenses: | | |
| Salaries, wages and other compensation | 3,313 | 6,854 |
| Insurance | 5,152 | 6,141 |
| Environmental | 879 | 879 |
| Other | 8,460 | 13,986 |
| Total accrued expenses | 17,804 | 27,860 |
| Other current liabilities | 606 | 8,090 |
| Total current liabilities | 173,534 | 160,796 |
| Long-term obligations, less current installments | 542 | 317 |
| Pension liabilities | 31,692 | 31,934 |
| Postretirement benefits other than pension | 9,158 | 9,340 |
| Other long-term liabilities | 5,389 | 6,958 |
| Total liabilities | 220,315 | 209,345 |

| | | |
|---|---|---|
| Shareholders' equity: | | |
| Common stock; 60,000,000 shares authorized, 22,553,280 and 21,153,290 shares issued, and 16,037,799 and 14,637,809 shares outstanding at December 31, 2003 and 2002, respectively | 22,523 | 21,153 |
| Additional paid-in capital | 102,917 | 95,267 |
| Retained earnings | 66,314 | 73,769 |
| Unearned stock compensation | (23) | (18) |
| Accumulated other comprehensive loss | (29,109) | (28,551) |
| Treasury shares, at cost | (89,966) | (89,873) |
| Total shareholders' equity | 72,656 | 71,747 |
| | $ 292,971 | $ 281,092 |

See accompanying notes to the consolidated financial statements.



HUFFY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollar Amounts in Thousands)

| | 2003 | |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net (loss) earnings from continuing operations | $ (7,477) | $ |
| Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 4,634 | |
| (Gain) loss on sale of property, plant and equipment | 3 | |
| Write-down of certain property, plant and equipment | -- | |
| Deferred income taxes | 8,834 | |
| Changes in assets and liabilities, excluding the effects of acquisitions: | | |
| Accounts and other receivables, net | (8,433) | |
| Inventories | (7,759) | |
| Prepaid expenses | (3,796) | |
| Other assets | (1,110) | |
| Accounts payable | 9,203 | |
| Accrued expenses | (10,056) | |
| Other current liabilities | (7,484) | |
| Other long-term liabilities | 5,022 | |
| Net cash (used in) provided by continuing operating activities | (18,419) | |
| Discontinued operating activities: | | |
| Loss on disposal from discontinued operations | (904) | |
| Gain (loss) from discontinued operations | 926 | |
| Net cash provided by (used in) discontinued operating activities | 22 | |
| Net cash (used in) provided by operating activities | (18,397) | |

| | |
|---|---|
| CASH FLOWS FROM INVESTING ACTIVITIES: | |
| Capital expenditures | (5,901) |
| Proceeds from sale of property, plant and equipment | 211 |
| Gen-X acquisition | (1,384) |
| McCalla acquisition, net of cash acquired | -- |
| Net cash used in investing activities | (7,074) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | |
| Net increase (decrease) in short-term borrowings | 8,305 |
| Repayment of debt assumed in the Gen-X acquisition | -- |
| Preferred shares redeemed | -- |
| Issuance of long-term debt | 15,270 |
| Repayment of long-term debt | (2,275) |
| Issuance of common shares | 184 |
| Net cash provided by (used in) financing activities | 21,484 |
| Net change in cash and cash equivalents | (3,987) |
| Cash and cash equivalents: | |
| Beginning of the year | 5,419 |
| End of the year | $ 1,432 |

See accompanying notes to the consolidated financial statements.



HUFFY CORPORATION
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Dollar Amounts in Thousands, Except Share Data)

| | TOTAL | COMMON STOCK | ADDITIONAL PAID-IN CAPITAL | RETAINED EARNINGS | UNEARNED STOCK COMPENSATION |
|---|---|---|---|---|---|
| Balance at December 31, 2000 | $ 73,131 | $ 16,704 | $ 66,204 | $ 83,557 | $ -- |
| Comprehensive loss, net of tax: | | | | | |
| Net loss | (8,410) | | | (8,410) | |
| Minimum pension liability adjustment, net of income tax benefit of $194 | (434) | | | | |
| Unrealized loss on derivative instruments | (311) | | | | |
| Total comprehensive loss | (9,155) | | | | |
| Issuance of 227,129 shares in connection with common stock plans | 1,626 | 227 | 1,022 | | |
| Balance at December 31, 2001 | $ 65,602 | $ 16,931 | $ 67,226 | $ 75,147 | $ -- |
| Comprehensive loss, net of tax: | | | | | |
| Net loss | (1,378) | | | (1,378) | |

| | | | | | |
|---|---|---|---|---|---|
| Minimum pension liability adjustment, net of income tax benefit of $13,624 | (25,234) | | | | |
| Foreign currency translation Adjustment | 1 | | | | |
| Unrealized gain on derivative instruments, net of income tax expense of $126 | 103 | | | | |
| Total comprehensive loss | (26,508) | | | | |
| Unearned stock compensation | (18) | | | | (18) |
| Issuance of 4,161,241 shares in connection with the acquisition of Gen-X Sports Inc. | 31,932 | 4,161 | 27,771 | | |
| Issuance of 60,580 shares in connection with common stock plans | 739 | 61 | 270 | | |
| Balance at December 31, 2002 | $ 71,747 | $ 21,153 | $ 95,267 | $ 73,769 | $ (18) |
| Comprehensive loss, net of tax: | | | | | |
| Net loss | (7,455) | | | (7,455) | |
| Minimum pension liability adjustment, net of income tax benefit of $405 | (752) | | | | |
| Foreign currency translation Adjustment | 60 | | | | |
| Unrealized gain on derivative instruments, net of income tax expense of $73 | 134 | | | | |
| Total comprehensive loss | (8,013) | | | | |
| Unearned stock compensation | (5) | | | | (5) |
| Issuance of 193,466 shares in connection with the acquisition of Gen-X Sports Inc. | 1,165 | 193 | 972 | | |
| Issuance of 1,100,000 shares in connection with stock contribution to pension plan | 7,450 | 1,100 | 6,350 | | |
| Repurchase of common shares | (93) | | | | |
| Issuance of 76,524 shares in connection with common stock plans | 405 | 77 | 328 | | |
| Balance at December 31, 2003 | $ 72,656 | $ 22,523 | $ 102,917 | $ 66,314 | $ (23) |

See accompanying notes to the consolidated financial statements.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (IN THOUSANDS, EXCEPT FOR SHARE DATA)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

CONSOLIDATION - The consolidated financial statements include the accounts of Huffy Corporation and its subsidiaries. All intercompany transactions and balances have been eliminated. The accompanying statement of operations for the

year ended December 31, 2002 includes the results of operations for Gen-X Sports Inc. for the period from September 19, 2002 to December 31, 2002 and McCalla Company for the period from March 27, 2002 to December 31, 2002. The fiscal year 2003 reflects a full year of operations for both Gen-X Sports Inc. and McCalla Company.

BASIS OF PRESENTATION - The Company's financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company expects cash and cash equivalents, cash flow from operations and its revolving credit facility to be sufficient to finance seasonal working capital needs and capital expenditures throughout 2004, and for the foreseeable future; however, there can be no assurance that these funds will be sufficient. The Company's financing facilities require it to meet certain EBITDA and fixed charge coverage covenants. In order to achieve these covenants, the Company will need to perform better than it did in 2003. The Company anticipates implementation of a plan in 2004 to reduce working capital, particularly the working capital associated with the product lines acquired in the Gen-X Sports, Inc. acquisition, and will contribute to improved cash flows from operations when fully implemented. See Subsequent Events discussion in Note 19. However, there is no assurance that the Company will be able to achieve such performance levels and maintain compliance with its financial covenants. In addition, based upon the nature of the Company's financing arrangement, there can be no assurance that it will be able to obtain any additional funding on acceptable terms. In the event of default under the Company's credit facilities and in the event that the Company's lenders do not waive the default, the Company's financial position, results of operations and liquidity could be materially adversely affected.

RECLASSIFICATION - Certain prior year balances have been reclassified to conform with the 2003 presentation.

CASH AND CASH EQUIVALENTS - Cash equivalents consist principally of short-term money market instruments with original maturities of three months or less.

REVENUE RECOGNITION - The Company recognizes revenue when products are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists and the sales price is fixed and determinable. Revenue for retail services is recognized at the time the service is performed.

The Company provides for right of return privileges to certain customers. The Company's reserves for returns in accordance with Statement of Financial Accounting Standards ("SFAS") No. 48, "Revenue Recognition When Right of Return Exists."

TRADE ACCOUNTS RECEIVABLE - Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. In the event of a customer bankruptcy or reorganization, specific reserves are established to write down accounts receivable to the level of anticipated recovery. The Company may consult with third-party purchasers of bankruptcy receivables when establishing specific reserves. The Company determines the allowance based on historical write-off experience estimated at 0.2% of net sales. The Company reviews its allowance for doubtful accounts monthly. Past due balances over 90 days and over a specified amount are reviewed individually for collectibility. All other balances are reviewed on a pooled basis. In addition to the allowance for doubtful accounts, the Company also has certain allowances for claims that have been or may be incurred on all products that have been shipped. The reserves are calculated based on claims that have been submitted but not settled. The calculation also considers anticipated claims based upon historical performance. Some major retailers have chosen to manage the warranty process in exchange for a claims

allowance based on sales volume. The portion of the reserve related to retailer claims allowances is netted against accounts receivable while the balance of the reserve is classified as an accrued liability on the balance sheet. Additions to the reserve are treated as a deduction from net sales if they related to a negotiated claim allowance and as selling, general and administrative costs if they related to a general warranty expense. The allowance for doubtful accounts was $1,274 and $1,214 as of December 31, 2003 and 2002, respectively. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance-sheet credit exposure related to its customers.

CONCENTRATIONS OF CREDIT RISK - Financial instruments that potentially expose the Company to concentrations of credit risk, as defined by SFAS No. 105, consist primarily of trade accounts receivable. In the normal course of business, Huffy extends credit to various companies in the retail industry where certain concentrations of credit risk exist. These concentrations of credit risk may be similarly affected by changes in economic or credit conditions and may, accordingly,



impact Huffy's overall credit risk. Management believes that the Company's diversification of accounts receivable is sufficient to reduce potential market credit risk, and that the allowance for doubtful accounts is adequate to absorb estimated losses as of December 31, 2003.

INVENTORIES - Inventories are valued at cost (not in excess of market) determined by the first-in, first-out (FIFO) method. Management reviews inventory for salability on a quarterly basis and believes that inventory is appropriately stated at the lower of cost or market.

PROPERTY, PLANT AND EQUIPMENT - Property, plant and equipment are stated at cost. Plant and equipment under capital leases are stated at the present value of minimum lease payments. Plant and equipment held under capital leases and leasehold improvements are amortized over the shorter of the lease term or estimated useful lives.

Annual depreciation and amortization rates are as follows:

| | |
|---|---|
| Land improvements | 5 - 10% |
| Buildings and improvements | 2-1/2 - 10% |
| Office furniture, fixtures, machinery and equipment | 10 - 33-1/3% |
| Leasehold improvements | 4-1/2 - 33-1/3% |

IMPAIRMENT OF LONG LIVED ASSETS - The Company accounts for long-lived assets in accordance with the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". SFAS No. 144 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to discounted future net cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal

group classified as held for sale are presented separately in the appropriate asset and liability sections on the balance sheet.

At December 31, 2002, the Company had classified $1,500 of land and $3,980 of buildings obtained in the Gen-X acquisition as net assets held for sale. These assets and related reserves were reclassified as held and used in the fourth quarter of 2003 in order to conform to the 2003 presentation, as these assets had not sold for a period of more than a year.

PRODUCT LIABILITY - The Company maintains a reserve for product liability based upon expected settlement charges for pending claims and an estimate of unreported claims derived from experience, volume and product sales mix. The Company estimates the value of each claim when reported, and then adjusts those claims by a development factor created using historical claims. The development factor takes into consideration factors that affect the value of each claim over the passage of time, such as new facts regarding the cases that were not available at the time the reserves were originally established.

FREIGHT- The Company classifies outbound freight expense to customers as an adjustment to product sales revenue on the accompanying consolidated statements of operations. For the years ended December 31, 2003, 2002 and 2001, freight expense was $4,452, $3,418 and $2,633, respectively.

GOODWILL AND OTHER INTANGIBLE ASSETS - Goodwill represents the excess of cost over fair value of the assets of the business acquired. The Company adopted the provisions of SFAS No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets", as of January 1, 2002. Pursuant to SFAS No. 142, goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead are tested for impairment at least annually in accordance with the provisions of SFAS No.142. SFAS No.142 also requires intangible assets with estimable useful lives to be amortized on the straight-line method over their respective estimated useful lives to their estimated residual values and reviewed for impairment in accordance with SFAS No. 144.

Goodwill and other intangible assets with indefinite useful lives are tested for impairment annually during the fourth quarter, and are tested more frequently if events and circumstances indicate that an asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. This determination is made at the reporting unit level and consists of two steps. First, the Company determines the fair value of a reporting unit level and compares it to its carrying amount. Second, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill and other intangible assets with indefinite useful lives over the implied fair value of that goodwill and other intangible assets with indefinite useful lives. The implied fair value is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with SFAS No. 141, Business Combinations. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill and other intangible assets with indefinite useful lives.



DISCLOSURES ABOUT THE FAIR VALUE OF FINANCIAL INSTRUMENTS - The carrying value of cash and cash equivalents, trade receivables, trade accounts payable, notes payable, and accrued expenses approximates fair value due to the short maturity of these instruments.

DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES - In accordance with SFAS No. 133,

"Accounting for Derivative Instruments and Hedging Activities", and SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities, an Amendment to SFAS No. 133", during 2003 and 2002, the Company recorded an adjustment, net of tax, of $134 and $103, respectively, in accumulated other comprehensive loss to recognize at fair value an interest rate swap that is designated as a cash-flow hedging instrument. No other derivative instruments have been identified.

The interest rate swap is recognized on the balance sheet at fair value. The Company has determined that the swap is effective; therefore, changes in the fair value of the swap are recorded on a quarterly basis as an adjustment to accumulated other comprehensive loss. The swap was redeemed in January 2004 and had no impact on the Company's results of operations.

EARNINGS (LOSS) PER COMMON SHARE - Basic earnings (loss) per share of common stock excludes any dilutive effects of stock options and is based upon the weighted average number of shares of common stock outstanding during the year. Diluted earnings (loss) per share are computed based on the weighted average number of shares of common stock and common stock equivalents outstanding during the year. The dilutive effect of stock options is excluded from the diluted per share calculation if the Company has a loss from continuing operations, as the impact would be anti-dilutive.

USE OF ESTIMATES - Management of the Company has made a number of estimates and assumptions relating to the reported amounts of assets and liabilities, the reported amounts of revenue and expenses, and the disclosures of contingent assets and liabilities to prepare these financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the impairment of property, plant and equipment, and intangibles and goodwill, valuation of receivables, inventories and deferred income tax assets, environmental remediation liabilities, and assets and obligations related to employee benefits.

STOCK OPTION PLANS - Prior to January 1, 1996, the Company accounted for its stock option plans in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. As such, compensation expense would be recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. On January 1, 1996, the Company adopted SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, which permits entities to recognize as expense over the vesting period the fair value of all stock-based awards on the date of grant. Alternatively, SFAS No. 123 also allows entities to continue to apply the provisions of APB Opinion No. 25 and provide pro forma net income and pro forma earnings per share disclosures for employee stock option grants made in 1995 and future years as if the fair-value-based method defined in SFAS No. 123 had been applied. The Company has elected to continue to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosure required by SFAS No. 123. The Company records compensation cost for fixed awards with pro-rata vesting on a pro-rata basis over the vesting period.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 2003, 2002 and 2001, respectively; expected volatility of 51.7% in 2003, 50.3% in 2002, 43.3% in 2001; risk-free interest rates from 3.4% to 4.2% for all plans and years: and expected lives from 3.91 to 7.66 years. The weighted average fair value of the options granted in 2003, 2002 and 2001 was $3.31, $3.91 and $3.59, respectively. The weighted average expected dividend assumed is zero.

At December 31, 2003, the Company has stock-based compensation plans which are

described in Note 8. The Company applies the principles of APB Opinion No. 25 and related interpretations in accounting for its plans. Accordingly, no compensation cost has been recognized for its fixed stock option plans and its stock purchase plan except for options issued below fair market value. The compensation cost that has been charged against income for options issued below fair market value and options issued to replace canceled options, was $150, $119, and $122, (after tax $93, $106, and $80) for the years ended December 31, 2003, 2002 and 2001, respectively. Had compensation cost for the Company's stock-based compensation plans been determined consistent with SFAS No. 123 for all outstanding and vested awards in each accounting period, the Company's net (loss) and (loss) per share would have been reduced to the pro forma amounts indicated below:



| | 2003 | 2002 | 2001 |
|---|---|---|---|
| Net loss | | | |
| As Reported | $ (7,455) | $ (1,378) | $ (8,410) |
| Add: Stock based employee compensation included in reported net loss, net of tax | 93 | 106 | 80 |
| Deduct: Total stock based employee compensation expense determined under the fair-value based method for all awards, net of tax | (987) | (653) | (887) |
| Net loss Proforma: | $ (8,349) | $ (1,925) | $ (9,217) |
| Loss per share as reported: | | | |
| Basic | (0.49) | (0.12) | (0.82) |
| Diluted | (0.49) | (0.12) | (0.82) |
| Loss per share Proforma: | | | |
| Basic | (0.54) | (0.16) | (0.90) |
| Diluted | (0.54) | (0.16) | (0.90) |

INCOME TAXES- Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

At December 31, 2003, we have a valuation allowance of $8,392 primarily to reduce our net operating loss and tax credit carryforwards of $14,512 to an amount that will more likely than not be realized. These net operating loss and tax credit carryforwards exist in many state an foreign jurisdictions and have varying carryforward periods and restrictions on usage. The estimation of future taxable income in these state and foreign jurisdictions and our resulting ability to utilize net operating loss and tax credit carryforwards can significantly change based on future events, including our determinations as to the feasibility of certain tax planning strategies. Thus, recorded valuation allowances may be subject to material future changes.

As a matter of course, we may be audited by federal, state and foreign tax

authorities. We provide reserves for potential exposures when we consider it probable that a taxing authority may take a sustainable position on a matter contrary to our position. We evaluate these reserves, including interest thereon, on a quarterly basis to insure that they have been appropriately adjusted for events that may impact our ultimate payment for such exposures.

See Note 11 for a further discussion of our income taxes.

ENVIRONMENTAL REMEDIATION LIABILITIES - The Company accounts for environmental remediation liabilities in accordance with the American Institute of Certified Public Accountants issued Statement of Position 96-1, "Environmental Remediation Liabilities," ("SOP 96-1"). The Company accrues for losses associated with environmental remediation obligations when such losses are probable and reasonably estimable. Accruals for estimated losses from environmental remediation obligations generally are recognized no later than completion of the remedial feasibility study. Such accruals are adjusted as further information develops or circumstances change. Recoveries of environmental remediation costs from other parties are recorded as assets when their receipt is deemed probable.

FOREIGN CURRENCY TRANSLATION - Assets and liabilities of foreign operations are generally translated into U.S. dollars at the rates of exchange in effect at the balance sheet date. Income and expense items are generally translated at the weighted average exchange rates prevailing during each period presented. Gains and losses resulting from foreign currency transactions are included in the results of operations. Gains and losses resulting from translation of financial statements of foreign subsidiaries are recorded as a component of accumulated other comprehensive loss until either sale or upon complete or substantially complete liquidation by the Company of its investments in a foreign entity.

NOTE 2. ACQUISITIONS

On September 19, 2002, the Company acquired all of the stock of Gen-X Sports Inc. and Gen-X Sports, Inc. and their subsidiaries in exchange for $19,001 in cash and the issuance of 4,161,241 shares of Huffy Corporation's Class A common shares to the stockholders of Gen-X. The $7.687 per share value of the Class A common shares issued was determined based upon the average market price of Huffy Corporation's common shares over the two day period before and after the terms of the acquisition were agreed to and announced. The purchase price was subject to certain post-closing adjustments based upon financial performance objectives in 2002 and no breach of representations and warranties clauses in 2003; whereby 645,161 and 193,466 additional common shares were subject to issuance for 2002 and 2003 to the Gen-X stockholders.



These contingent shares were issuable on or about the first anniversary date of the acquisition. The financial performance objectives were not achieved for 2002; however, as no breach of representations and warranties occurred in 2003, 193,466 shares were issued in 2003. The acquired companies redeemed $4,970 of preferred stock at face value immediately following the acquisition, and refinanced their existing bank debt. Included in the assets acquired upon the acquisition date were trademarks, patents and licensing agreements recorded at their fair values of $45,800, $1,285 and $940, respectively, as well as goodwill in the amount of $12,104. The fair values for these assets, excluding goodwill, were determined by an independent third-party appraiser. During 2003, goodwill was increased $2,960 for the issuance of 193,466 of shares in the amount of $1,165 as well as additional legal costs and other professional fees associated with the acquisition of $1,795. The Company believes that the consolidation of the Huffy and Gen-X sporting goods product lines and selling and administrative support structures will create a stronger, more competitive sporting goods

company capable of achieving greater financial strength, earnings power, operational efficiency and growth potential than either company would on its own. The acquisition also broadened each company's brand portfolios and sporting goods product offerings and broadened and diversified the customer base. Finally, the combination also decreased seasonal fluctuations in sales and earnings. See discussion of the Co