



FINANCIAL REVIEW

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## Overview

Furniture Brands International, Inc. (the "Company") is one of the largest home (residential) furniture manufacturers in the United States. The Company markets its products through four primary operating subsidiaries: Broyhill Furniture Industries, Inc.; Lane Furniture Industries, Inc.; Thomasville Furniture Industries, Inc.; and HDM Furniture Industries, Inc. The Company manufactures, sources (i.e., imports) and distributes (i) case goods, consisting of bedroom, dining room and living room furniture, (ii) stationary upholstery products, consisting of sofas, loveseats, sectionals and chairs, (iii) occasional furniture, consisting of wood, metal and glass tables, accent pieces, home entertainment centers and home office furniture, (iv) recliners, motion furniture and sleep sofas, and (v) accessories.

The Company primarily sells its products through diverse distribution channels consisting of independent furniture dealers, national and local chain stores, department stores, specialty stores and decorator showrooms. In recent years, the Company has focused its distribution growth on single-branded, dedicated furniture centers, galleries and stores, taking advantage of its strong brand names and breadth of product. Most recently, the Company has announced its long-term strategy is to focus more heavily on single-branded stores, both independently and Company-owned.

To gain access to the premium price point segment of the home furniture market in the United States, on December 28, 2001, the Company acquired substantially all of the assets and liabilities of Henredon Furniture Industries, Drexel Heritage Furnishings and Maitland-Smith (collectively HDM Furniture Industries, Inc.). The purchase price of the acquisition was \$287.6 million, consisting of \$177.0 million in cash and 4.0 million shares of the Company's Common Stock. The acquisition established the Company as the residential furniture industry's only full-line resource in all middle and upper price categories.

During the past four years, the residential furniture market in the United States has been negatively impacted by the general economic slowdown, as well as a structural shift to offshore sourcing (primarily to Asia, but also to other countries with comparatively low labor costs) of various products – particularly case goods (wood furniture). As a result, domestic manufacturing capacity utilization has been trending down, hurting the operating profitability of many companies in the industry.

In reaction to this change in sourcing activity, the Company has been implementing a plan to reduce its domestic manufacturing capacity. This plan has included the closing of 23 manufacturing facilities. In 2004, the Company recorded pretax restructuring and impairment charges of \$9.2 million, consisting of \$5.9 million charged to cost of operations and \$3.3 million charged to the selling, general and administrative expenses. In 2003, pretax restructuring and impairment charges of \$17.8 million were recorded, consisting of \$7.1 million charged to cost of operations and \$10.7 million charged to selling, general and administrative expenses. Pretax restructuring and impairment charges of \$26.4 million were recorded in 2001, consisting of \$5.9 million charged to cost of operations and \$20.5 million charged to selling, general and administrative expenses.

To take advantage of its strong brand names and overall breadth of product, the Company has initiated a stores development program in order to gain better control and to accelerate the growth rate of its retail distribution. This program will expand the number of stores dedicated to selling exclusively the Company's brands. Currently, there are 229 dedicated stores, nine of which are owned by the Company, with a long-term goal of over 400 stores, many of which may be owned by the Company.

## Results of Operations

As an aid to understanding the Company's results of operations on a comparative basis, the following table has been prepared to set forth certain statements of operations and other data for 2004, 2003, and 2002.

<i>(Dollars in millions)</i>	<i>Year Ended December 31,</i>					
	<i>2004</i>		<i>2003</i>		<i>2002</i>	
	<i>Dollars</i>	<i>% of Net Sales</i>	<i>Dollars</i>	<i>% of Net Sales</i>	<i>Dollars</i>	<i>% of Net Sales</i>
Net sales	\$2,447.4	100.0%	\$2,434.1	100.0%	\$2,458.8	100.0%
Cost of operations	1,781.0	72.8	1,777.8	73.0	1,782.8	72.5
Selling, general and administrative expenses	461.7	18.9	440.3	18.1	424.3	17.3
Depreciation and amortization	49.0	2.0	50.9	2.1	49.3	2.0
Earnings from operations	155.7	6.3	165.1	6.8	202.4	8.2
Interest expense	15.3	0.6	19.4	0.8	21.7	0.9
Other income, net	2.3	0.1	3.5	0.1	3.7	0.2
Earnings before income tax expense	142.7	5.8	149.2	6.1	184.4	7.5
Income tax expense	51.1	2.1	54.6	2.2	65.6	2.7
Net earnings	\$ 91.6	3.7%	\$ 94.6	3.9%	\$ 118.8	4.8%
Earnings per common share - diluted	\$ 1.66	—	\$ 1.68	—	\$ 2.11	—
Gross profit <sup>1</sup>	\$ 628.5	25.7%	\$ 614.8	25.3%	\$ 633.6	25.8%

<sup>1</sup>The Company believes that gross profit provides useful information regarding a company's financial performance. Gross profit has been calculated by subtracting cost of operations and the portion of depreciation associated with cost of goods sold from net sales.

<i>(Dollars in millions)</i>	<i>Year Ended December 31,</i>		
	<i>2004</i>	<i>2003</i>	<i>2002</i>
Net sales	\$2,447.4	\$2,434.1	\$2,458.8
Cost of operations	1,781.0	1,777.8	1,782.8
Depreciation (associated with cost of goods sold)	37.9	41.5	42.4
Gross profit	\$ 628.5	\$ 614.8	\$ 633.6

## Year Ended December 31, 2004 Compared to Year Ended December 31, 2003

Net sales for 2004 were \$2,447.4 million, essentially unchanged from \$2,434.1 million reported for 2003. 2004 was the fourth consecutive difficult year for the residential furniture industry primarily due to weak consumer demand for furniture. The Company was also negatively impacted by the bankruptcy of a major customer (Breuners) at mid-year which resulted in the loss of over \$40.0 million in annual sales volume.

Cost of operations for 2004 was \$1,781.0 million compared to \$1,777.8 million in 2003. Cost of operations as a percentage of net sales decreased from 73.0% for 2003 to 72.8% for 2004. The decrease in cost of operations as a percentage of net sales was due to the increase in imported product partially offset by a decrease in domestic capacity utilization and increases in raw material prices.

Selling, general and administrative expenses increased to \$461.7 million in 2004 from \$440.3 million in 2003. As a percentage of net sales, these expenses increased from 18.1% in 2003 to 18.9% in 2004. The increase was due to additional bad debt expense related to the Breuners bankruptcy, increases in pension expense (due primarily to actuarial assumption changes), advertising and professional fees, partially offset by reduced asset impairment and restructuring charges.

Interest expense for 2004 totaled \$15.3 million compared to \$19.4 million in 2003. The decrease in interest expense reflects the Company's long-term debt reduction program and lower interest rates.

Other income, net for 2004 totaled \$2.3 million compared to \$3.5 million for 2003. For 2004, other income consisted of interest on short-term investments and notes receivable of \$1.1 million and other miscellaneous income and expense items totaling \$1.2 million.

Income tax expense for 2004 totaled \$51.1 million, producing an effective tax rate of 35.8% compared with an effective tax rate of 36.6% for 2003. The decrease in the effective tax rate for 2004 was the result of increased research and development credits and reduced state income taxes.

Earnings per common share on a diluted basis were \$1.66 and \$1.68 for 2004 and 2003, respectively. Weighted average shares used in the calculation of earnings per common share on a diluted basis were 55,219,572 in 2004 and 56,255,788 in 2003. The reduction in average shares was due to the impact of stock repurchases during 2004. No stock repurchases occurred in 2003.

Gross profit for 2004 was \$628.5 million compared with \$614.8 million for 2003, an increase of 2.2%. The increase in gross profit margin from 25.3% in 2003 to 25.7% in 2004 was primarily due to an increase in imported product partially offset by a decrease in domestic capacity utilization.

## Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Net sales for 2003 were \$2,434.1 million compared to \$2,458.8 million in 2002, a decrease of \$24.7 million or 1.0%. 2003 was the third consecutive difficult year for the residential furniture industry primarily due to weak consumer demand for furniture – particularly at the upper-end price points. However, positive comparisons were achieved during the latter part of the year as consumers reacted favorably to better economic conditions and financial markets.

Cost of operations for 2003 was \$1,777.8 million compared to \$1,782.8 million in 2002. Cost of operations as a percentage of net sales increased from 72.5% for 2002 to 73.0% for 2003. The increase in cost of operations as a percentage of net sales was due to \$7.1 million of restructuring charges in 2003 as well as the residual effects of lowering domestic manufacturing capacity to meet sourcing requirements.

Selling, general and administrative expenses increased to \$440.3 million in 2003 from \$424.3 million in 2002. As a percentage of net sales, these expenses increased from 17.3% in 2002 to 18.1% in 2003. The increase was due to \$10.7 million in asset impairment and restructuring costs recorded in 2003. Other major expense increases included pensions (due primarily to actuarial assumption changes) and advertising (to promote the Company's various brands).

Interest expense for 2003 totaled \$19.4 million compared to \$21.7 million in 2002. The decrease in interest expense reflects the Company's long-term debt reduction program and lower interest rates.

Other income, net for 2003 totaled \$3.5 million compared to \$3.7 million for 2002. For 2003, other income consisted of interest on short-term investments and notes receivable of \$0.7 million and other miscellaneous income and expense items totaling \$2.8 million.

Income tax expense for 2003 totaled \$54.6 million, producing an effective tax rate of 36.6% compared with an effective tax rate of 35.6% for 2002. The increase in the effective tax rate for 2003 was the result of reduced state income tax credits derived from certain industrial revenue bonds, which the Company is repaying according to established amortization schedules.

Earnings per common share on a diluted basis were \$1.68 and \$2.11 for 2003 and 2002, respectively. Weighted average shares used in the calculation of earnings per common share on a diluted basis were 56,255,788 in 2003 and 56,386,827 in 2002. The reduction in average shares was due to the impact of stock options using the treasury method of calculation. No stock repurchases occurred in 2003 or 2002.

Gross profit for 2003 was \$614.8 million compared with \$633.6 million for 2002, a decrease of 3.0%. The decrease in gross profit margin from 25.8% in 2002 to 25.3% in 2003 was primarily due to asset impairment and restructuring costs previously discussed.

## Financial Condition and Liquidity

### LIQUIDITY

Cash and cash equivalents at December 31, 2004 totaled \$51.2 million compared to \$71.7 million at December 31, 2003. For 2004, net cash provided by operating activities totaled \$107.3 million. Net cash used by investing activities totaled \$22.5 million. Net cash used by financing activities totaled \$105.3 million.

Working capital was \$711.1 million at December 31, 2004 compared to \$703.2 million at December 31, 2003. The current ratio was 4.6-to-1 at December 31, 2004 compared to 4.8-to-1 at December 31, 2003.

At December 31, 2004, long-term debt totaled \$302.4 million compared to \$303.2 million at December 31, 2003. The Company's debt-to-capitalization ratio was 24.0% at December 31, 2004 compared to 23.9% at December 31, 2003. The company has completed its deleveraging program except for required amortization of certain industrial revenue bonds.

### FINANCING ARRANGEMENTS

To meet short-term capital and other financial requirements, the Company maintains a \$550.0 million revolving credit facility with a group of financial institutions. The revolving credit facility (which was refinanced on December 18, 2003) allows for the issuance of letters of credit and cash borrowings. Letter of credit outstandings are limited to no more than \$150.0 million, with cash borrowings limited only by the facility's maximum availability less letters of credit outstanding. On December 31, 2004, there were \$300.0 million in cash borrowings and \$19.0 million in letters of credit outstanding, leaving an excess of \$231.0 million available under the facility for future liquidity needs.

Cash borrowings under the revolving credit facility bear interest at a base rate or at an adjusted Eurodollar rate plus an applicable margin which varies, depending upon the type of loan the Company executes. The applicable margin over the base rate and Eurodollar rate is subject to adjustment based upon achieving certain credit ratings. At December 31, 2004, loans outstanding under the revolving credit facility consisted of \$300.0 million based on the adjusted Eurodollar rate which in conjunction with the interest rate swaps described below, under "Market Risk", have a weighted average interest rate of 4.04%.

The Company believes that its revolving credit facility, together with its historically strong cash generation from operations, will be adequate to meet liquidity requirements for the foreseeable future. These requirements would include normal, historical capital expenditure levels as well as the Company's recently implemented cash dividend program. The following table summarizes the cash payments related to the Company's outstanding contractual obligations:

	<i>Less than 1 year</i>	<i>1-3 years</i>	<i>4-5 years</i>	<i>More than 5 years</i>	<i>Total</i>
Long-term debt obligations	\$ 0.8	\$ 1.6	\$300.8	\$ —	\$303.2
Operating lease obligations (net of subleases)	25.2	44.7	35.5	60.8	166.2
Purchase obligations <sup>1</sup>	—	—	—	—	—
	\$26.0	\$46.3	\$336.3	\$60.8	\$469.4

<sup>1</sup>The Company is not a party to any long-term supply contracts with respect to the purchase of raw materials or finished goods.

## Other

### MARKET RISK

The Company is exposed to market risk from changes in interest rates. The Company's exposure to interest rate risk consists of its floating rate revolving credit facility. This risk is managed using interest rate swaps to fix a portion of the Company's floating rate long-term debt. Currently interest rate swaps fix the rate on the entire outstanding balance on the revolving credit facility; therefore, an increase in interest rates would have no impact on the Company's net earnings.

### FUNDED STATUS OF THE DEFINED BENEFIT PENSION PLAN

As of December 31, 2004, the accumulated benefit obligation of the Company's defined benefit pension plan exceeded the fair value of the plan's assets. As a result, the minimum pension liability increased by \$9.5 million. Total minimum pension liability at December 31, 2004 was \$54.6 million, \$34.1 million, net of tax. The after tax charge is recorded as a component of other comprehensive income (expense).

### CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results are likely to differ from those estimates, but management believes such differences are not significant.

**Revenue Recognition** — The Company recognizes revenue (sales) when finished goods are shipped, with appropriate provisions for returns and uncollectible accounts. Shipping revenues have historically been netted against related expenses. We have reclassified these revenues to net sales, increasing net sales and cost of operations by \$72.1 million, \$66.4 million and \$61.1 million in 2004, 2003 and 2002, respectively. This reclassification had no impact on earnings.

**Allowance for Doubtful Accounts** — The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of the Company's customers to make required payments. The allowance for doubtful accounts is based upon the review of specific customer account balances and an overall aging of the accounts receivable.

**Inventories** — Inventories are stated at the lower of cost (first-in, first-out) or market. Inventories are regularly reviewed for obsolescence and appropriate adjustments recorded, if necessary, to insure their value is recoverable.

**Long-lived Assets** — Long-lived assets, which consist primarily of goodwill, trademarks and property, plant and equipment, are reviewed for impairment whenever events or changes in business circumstances indicate the carrying values of the assets may not be recoverable. Impairment losses are recognized if expected future cash flows of the related assets are less than the carrying value.

**Retirement Plans** — The Company uses various assumptions to calculate retirement plan expenses and obligations. These assumptions include the discount rate, expected return on plan assets and rate of compensation increases. The Company believes the assumptions used are reasonable; however, differences in actual experience or a change in assumptions would impact the calculated obligation and future expenses. For example, a 25 basis point reduction in the discount rate would increase the accumulated benefit obligation by \$10.0 million and result in an additional charge (net of tax benefits) to shareholders' equity of \$6.2 million.

## RECENTLY ISSUED STATEMENTS OF FINANCIAL ACCOUNTING STANDARDS

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment. This statement is a revision of SFAS No. 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123 (revised 2004) establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. The statement is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. Although management has not yet determined the final impact that SFAS No. 123 (revised 2004) will have on the Company's financial position and results of operations, it is not anticipated that the impact will be materially different than the effect disclosed in Note 2 in the Notes to Consolidated Financial Statements.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs an amendment of Accounting Research Bulletin (ARB) No. 43, Chapter 4. This statement clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) by requiring that they be recognized as current-period charges. In addition, this statement requires that allocation of fixed production overhead to inventory be based on the normal capacity of the production facilities. We are currently evaluating the impact, if any, that adoption of SFAS No. 151 will have on the Company's financial position and results of operations.

In December 2003, the FASB issued a revised FASB Interpretation No. (FIN) 46, Consolidation of Variable Interest Entities. FIN 46 clarifies the application of ARB No. 51, Consolidated Financial Statements, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. The statement is effective for financial statements issued after December 31, 2003. The Company has not created any variable interest entities and the adoption of FIN No. 46 will have no impact on the Company's consolidated financial statements.

## OUTLOOK

Sales expectations for the first quarter reflect the current weakness in incoming orders compared to a strong year-ago period. The Company expects first quarter sales to be down in the mid-single digits from last year's record performance and diluted net earnings per common share to be at the lower end of the range given at the end of January.

## FORWARD-LOOKING STATEMENTS

The Company herein has made forward-looking statements within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include the Company's expected sales, earnings per share, profit margins, and cash flows, the effects of certain manufacturing realignments and other business strategies, the prospects for the overall business environment, and other statements containing the words "expects," "anticipates," "estimates," "believes," and words of similar import. The Company cautions investors that any such forward-looking statements are not guarantees of future performance and that certain factors may cause actual results to differ materially from those in the forward-looking statements. Such factors include, but are not limited to: changes in economic conditions; loss of market share due to competition; failure to anticipate or respond to changes in consumer tastes and fashion trends; failure to achieve projected mix of product sales; business failures of large customers; distribution and manufacturing realignments and cost savings programs; increased reliance on offshore (import) sourcing of various products; fluctuations in the cost, availability and quality of raw materials; product liability uncertainty; impairment of goodwill and other intangible assets and ability to open and operate new retail stores successfully. Other risk factors may be listed from time to time in the Company's future public releases and SEC reports. Please refer to the Company's Annual Report on Form 10-K for a more detailed explanation of the Company's risk factors.

Consolidated Balance Sheets

<i>(Dollars in thousands)</i>	<i>December 31, 2004</i>	<i>December 31, 2003</i>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 51,248	\$ 71,668
Receivables, less allowances of \$20,919 (\$19,378 at December 31, 2003)	374,733	366,448
Inventories (Note 4)	444,828	414,684
Deferred income taxes	28,044	25,563
Prepaid expenses and other current assets	9,272	7,689
Total current assets	908,125	886,052
Property, plant and equipment:		
Land	20,711	21,742
Buildings and improvements	258,493	251,814
Machinery and equipment	403,392	400,375
	682,596	673,931
Less accumulated depreciation	397,623	363,368
Net property, plant and equipment	284,973	310,563
Goodwill (Note 5)	183,097	183,789
Other intangible assets (Note 5)	169,671	169,671
Other assets	41,893	28,184
	\$1,587,759	\$1,578,259
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 85,363	\$ 83,584
Accrued employee compensation	28,521	29,317
Other accrued expenses	83,126	69,918
Total current liabilities	197,010	182,819
Long-term debt (Note 6)	302,400	303,200
Deferred income taxes	78,305	69,796
Other long-term liabilities	52,561	55,542
Shareholders' equity:		
Preferred stock, authorized 10,000,000 shares, no par value – issued, none	—	—
Common Stock, authorized 200,000,000 shares, \$1.00 stated value – issued 56,482,541 shares at December 31, 2004 and 56,277,066 shares at December 31, 2003 (Note 7)	56,483	56,277
Paid-in capital	226,602	221,388
Retained earnings	789,856	726,932
Accumulated other comprehensive income (expense) (Note 10)	(31,076)	(31,446)
Treasury stock at cost (3,266,456 shares at December 31, 2004 and 330,409 shares at December 31, 2003)	(84,382)	(6,249)
Total shareholders' equity	957,483	966,902
	\$1,587,759	\$1,578,259

See accompanying notes to consolidated financial statements.

*Consolidated Statements of Operations*

<i>(Dollars in thousands except per share data)</i>	<i>Year Ended December 31,</i>		
	<i>2004</i>	<i>2003</i>	<i>2002</i>
Net sales	\$2,447,430	\$2,434,130	\$2,458,836
Costs and expenses:			
Cost of operations	1,781,037	1,777,814	1,782,841
Selling, general and administrative expenses	461,687	440,267	424,329
Depreciation and amortization	49,050	50,923	49,266
Earnings from operations	155,656	165,126	202,400
Interest expense	15,314	19,384	21,732
Other income, net	2,298	3,482	3,756
Earnings before income tax expense	142,640	149,224	184,424
Income tax expense (Note 8)	51,073	54,651	65,593
Net earnings	\$ 91,567	\$ 94,573	\$ 118,831
Earnings per common share – basic (Note 7)	\$ 1.68	\$ 1.70	\$ 2.14
Earnings per common share – diluted (Note 7)	\$ 1.66	\$ 1.68	\$ 2.11

See accompanying notes to consolidated financial statements.

*Consolidated Statements of Cash Flows*

<i>(Dollars in thousands)</i>	<i>Year Ended December 31,</i>		
	<i>2004</i>	<i>2003</i>	<i>2002</i>
Cash flows from operating activities:			
Net earnings	\$ 91,567	\$ 94,573	\$ 118,831
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	49,050	50,923	49,266
Other, net	2,048	10,352	(1,545)
(Increase) decrease in receivables	(8,285)	8,602	(15,557)
(Increase) decrease in inventories	(30,144)	17,420	(62,331)
(Increase) decrease in prepaid expenses and intangible and other assets	(13,616)	4,003	(22,614)
Increase (decrease) in accounts payable, accrued interest expense and other accrued expenses	12,574	(12,243)	30,204
Increase in net deferred tax liabilities	6,018	736	16,270
Increase (decrease) in other long-term liabilities	(1,875)	(1,913)	212
Net cash provided by operating activities	107,337	172,453	112,736
Cash flows from investing activities:			
Proceeds from the disposal of assets	8,103	2,495	2,924
Additions to property, plant and equipment	(30,593)	(41,451)	(50,214)
Net cash used by investing activities	(22,490)	(38,956)	(47,290)
Cash flows from financing activities:			
Payments for debt issuance costs	—	(1,709)	—
Additions to long-term debt	—	300,000	—
Payments of long-term debt	(800)	(371,600)	(79,600)
Proceeds from issuance of Common Stock	4,230	—	—
Payments of cash dividends	(28,643)	(6,975)	—
Proceeds from the issuance of treasury stock	8,747	3,381	13,521
Payments for the purchase of treasury stock	(88,801)	—	—
Net cash used by financing activities	(105,267)	(76,903)	(66,079)
Net increase (decrease) in cash and cash equivalents	(20,420)	56,594	(633)
Cash and cash equivalents at beginning of period	71,668	15,074	15,707
Cash and cash equivalents at end of period	\$ 51,248	\$ 71,668	\$ 15,074
Supplemental Disclosure:			
Cash payments for income taxes, net	\$ 32,577	\$ 53,296	\$ 36,807
Cash payments for interest expense	\$ 16,202	\$ 20,192	\$ 20,673

See accompanying notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity and Comprehensive Income

(Dollars in thousands)	Year Ended December 31,		
	2004	2003	2002
<b>Common Stock:</b>			
Beginning balance	\$ 56,277	\$ 56,277	\$ 56,277
Stock plans activity (Note 7)	206	—	—
Ending balance	\$ 56,483	\$ 56,277	\$ 56,277
<b>Paid-In Capital:</b>			
Beginning balance	\$ 221,388	\$ 221,696	\$ 219,469
Stock plans activity (Note 7)	5,214	(308)	2,227
Ending balance	\$ 226,602	\$ 221,388	\$ 221,696
<b>Retained Earnings:</b>			
Beginning balance	\$ 726,932	\$ 639,334	\$ 520,503
Net earnings	91,567	94,573	118,831
Cash dividends (per share: 2004 - \$0.525, 2003 - \$0.125)	(28,643)	(6,975)	—
Ending balance	\$ 789,856	\$ 726,932	\$ 639,334
<b>Accumulated Other Comprehensive Income (Expense) (Note 10):</b>			
Beginning balance	\$ (31,446)	\$ (35,917)	\$ (5,108)
Other comprehensive income (expense)	370	4,471	(30,809)
Ending balance	\$ (31,076)	\$ (31,446)	\$ (35,917)
<b>Treasury Stock:</b>			
Beginning balance	\$ (6,249)	\$ (11,875)	\$ (31,482)
Stock plans activity (Note 7)	10,668	5,626	19,607
Purchase of treasury stock (3,431,600 shares)	(88,801)	—	—
Ending balance	\$ (84,382)	\$ (6,249)	\$ (11,875)
<b>Total Shareholders' Equity</b>	<b>\$ 957,483</b>	<b>\$ 966,902</b>	<b>\$ 869,515</b>
<b>Comprehensive Income (Expense):</b>			
Net earnings	\$ 91,567	\$ 94,573	\$ 118,831
Other comprehensive income (expense), net of tax:			
Financial instruments accounted for as hedges	6,646	6,342	(3,872)
Minimum pension liability	(5,922)	(1,658)	(26,512)
Foreign currency translation	(354)	(213)	(425)
Other comprehensive income (expense)	370	4,471	(30,809)
	\$ 91,937	\$ 99,044	\$ 88,022

See accompanying notes to consolidated financial statements.

## 1. The Company

Furniture Brands International, Inc. (referred to herein as the “Company”) is one of the largest home furniture manufacturers in the United States. During all of the years covered in these financial statements, the Company had four primary operating subsidiaries: Broyhill Furniture Industries, Inc.; Lane Furniture Industries, Inc.; Thomasville Furniture Industries, Inc. and HDM Furniture Industries, Inc.

Substantially all of the Company’s sales are made to unaffiliated furniture retailers. The Company has a diversified customer base with no one customer accounting for 10% or more of consolidated net sales and no particular concentration of credit risk in one economic sector. Foreign operations and net sales are not material.

## 2. Significant Accounting Policies

The significant accounting policies of the Company are set forth below.

### USE OF ESTIMATES

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and expenses during the reported period. Actual results are likely to differ from those estimates, but management believes such differences are not significant.

### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and all of its subsidiaries. All material intercompany transactions are eliminated in consolidation. The Company’s fiscal year ends on December 31. The operating companies included in the consolidated financial statements report their results of operations as of the Saturday closest to December 31. Accordingly, the results of operations will periodically include a 53-week fiscal year. Fiscal years 2004 and 2002 were 52-week years and fiscal year 2003 was a 53-week year.

### CASH AND CASH EQUIVALENTS

The Company considers all short-term investments with an original maturity of three months or less to be cash equivalents.

### INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out) or market. Inventories are regularly reviewed for obsolescence and appropriate adjustments recorded, if necessary, to insure their value is recoverable.

### PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are recorded at cost when acquired. Depreciation is calculated using both accelerated and straight-line methods based on the estimated useful lives of the respective assets, which generally range from 3 to 45 years for buildings and improvements and from 3 to 12 years for machinery and equipment. Long-lived assets are reviewed for impairment whenever events or changes in business circumstances indicate the carrying value of the assets may not be recoverable. Impairment losses are recognized if expected future cash flows of the related assets are less than their carrying value.

## **INTANGIBLE ASSETS**

Intangible assets consist of goodwill and trademarks. Effective with the Company's adoption of Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," on January 1, 2002, goodwill and intangible assets with indefinite lives are no longer amortized, but instead tested for impairment. Prior to adoption of SFAS No. 142, goodwill and trademarks were amortized on a straight-line basis over 20 to 40-year periods. Intangible assets are reviewed for impairment annually or whenever events or changes in business circumstances indicate the carrying value of the assets may not be recoverable. Impairment losses are recognized if future cash flows of the related assets are less than their carrying values.

## **FAIR VALUE OF FINANCIAL INSTRUMENTS**

The Company considers the carrying amounts of cash and cash equivalents, receivables, and accounts payable to approximate fair value because of the short maturity of these financial instruments.

Amounts outstanding under long-term debt agreements are considered to be carried on the financial statements at their estimated fair values because they accrue interest at rates which generally fluctuate with interest rate trends.

The Company periodically uses interest rate swap agreements (derivative financial instruments) to hedge risk associated with its floating rate long-term debt. Under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, each derivative instrument is recorded on the balance sheet as an asset or liability with any gain or loss recorded as a component of accumulated other comprehensive income (expense) until recognized in earnings. The fair value of the swap agreements is based upon quoted market prices. The net amount to be paid or received under the interest rate swap agreements is recorded as a component of interest expense. The fair value of the interest rate swap agreements is included in other assets as of December 31, 2004 and other long-term liabilities as of December 31, 2003.

## **REVENUE RECOGNITION**

The Company recognizes sales when finished goods are shipped, with appropriate provisions for returns and uncollectible accounts. Shipping revenues have historically been netted against related expenses. We have reclassified these revenues to net sales, increasing net sales and cost of operations by \$72,155, \$66,392 and \$61,127 in 2004, 2003 and 2002, respectively. This reclassification had no impact on earnings.

## **ADVERTISING COSTS**

Advertising production costs are expensed when advertisements are first aired or distributed. Total advertising costs for 2004, 2003 and 2002 were \$82,089, \$77,124 and \$72,243, respectively.

## **INCOME TAXES**

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized as income tax expense (benefit) in the period that includes the enactment date.

## Notes to Consolidated Financial Statements

(Dollars in thousands except per share data)

### STOCK-BASED COMPENSATION

The Company accounts for stock-based compensation using the intrinsic value method as prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. Had compensation cost for the Company's stock-based compensation plan been determined consistent with SFAS No. 123, Accounting for Stock-Based Compensation, the Company's net earnings and net earnings per share would have been as follows:

	Year Ended December 31,		
	2004	2003	2002
Net Earnings			
As reported	\$ 91,567	\$ 94,573	\$ 118,831
Deduct: Stock based employee compensation expense determined under fair value based method, net of income tax benefits	4,729	5,276	5,292
Pro forma	\$ 86,838	\$ 89,297	\$ 113,539
Earnings per share – basic:			
As reported	\$ 1.68	\$ 1.70	\$ 2.14
Pro forma	\$ 1.59	\$ 1.60	\$ 2.05
Earnings per share – diluted:			
As reported	\$ 1.66	\$ 1.68	\$ 2.11
Pro forma	\$ 1.58	\$ 1.60	\$ 2.02

The weighted average fair value of options granted is estimated as of the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2004	2003	2002
Risk free interest rate	3.2%	3.0%	4.3%
Expected dividend yield	1.7%	0.0%	0.0%
Expected life (years)	6.0	6.0	6.0
Expected volatility	50.8%	50.0%	49.0%

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), Share-Based Payment. This statement is a revision of SFAS No. 123, and supersedes APB Opinion No. 25. SFAS No. 123 (revised 2004) establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. The statement is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. Although management has not yet determined the final impact that SFAS No. 123 (revised 2004) will have on the Company's financial position and results of operations, it is not anticipated that the annual impact will be materially different than the pro forma disclosure above.

### RECLASSIFICATION

Certain prior year amounts have been reclassified to conform to the current year presentation.

### 3. Restructuring and Asset Impairment Charges

In 2001 the Company began implementing a plan to reduce its domestic manufacturing capacity. As of December 31, 2004, this plan has included the closing of 23 manufacturing facilities. Restructuring activity included the closing of three manufacturing facilities in 2004 and the closing of three manufacturing facilities and the realignment of two additional facilities in 2003. Also included in both years were asset impairment charges related to the write-down of previously closed facilities in order to accelerate their disposal. Asset impairment charges were recorded to reduce the carrying value of all idle facilities and related machinery and equipment to their net realizable value. The determination of the impairment charges were based primarily upon (i) consultations with real estate brokers retained to assist the Company in disposal efforts and (ii) proceeds from recent sales of Company facilities and the market prices being obtained for similar long-lived assets.

Restructuring and asset impairment charges were as follows:

	<i>Year Ended December 31,</i>		
	<i>2004</i>	<i>2003</i>	<i>2002</i>
Restructuring charges:			
Costs to shutdown, cleanup and vacate facilities	\$ 1,848	\$ 4,787	—
One-time termination benefits	669	2,331	—
Inventory writedowns	4,678	434	—
	7,195	7,552	—
Impairment charges	2,054	10,301	—
	\$ 9,249	\$ 17,853	—
Cost of operations	\$ 5,953	\$ 7,151	—
Selling, general and administrative charges	3,296	10,702	—
	\$ 9,249	\$ 17,853	—

Real estate with a carrying value of \$3,301 and \$7,223 was included in other assets as of December 31, 2004 and 2003, respectively. There were no restructuring charges included in other accrued expenses at December 31, 2004 and 2003.

### 4. Inventories

Inventories are summarized as follows:

	<i>December 31,</i> <i>2004</i>	<i>December 31,</i> <i>2003</i>
Finished products	\$ 268,170	\$ 252,582
Work-in-process	49,362	52,513
Raw materials	127,296	109,589
	\$ 444,828	\$ 414,684

## 5. Goodwill and Other Intangible Assets

Goodwill and other intangible assets include the following:

	<i>December 31, 2004</i>	<i>December 31, 2003</i>
Goodwill	\$265,835	\$266,527
Less: accumulated amortization	82,738	82,738
<b>Goodwill</b>	<b>\$183,097</b>	<b>\$183,789</b>
Trademarks and trade names	\$206,179	\$206,179
Less: accumulated amortization	36,508	36,508
<b>Other intangible assets</b>	<b>\$169,671</b>	<b>\$169,671</b>

On January 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 142 requires that goodwill and other intangible assets with indefinite lives no longer be amortized, but instead be tested annually for impairment or whenever events or changes in business circumstances indicate the carrying value of the assets may not be recoverable. No impairment was recorded in 2004 or 2003. The Company's other intangible assets consist of trademarks and trade names all having indefinite lives.

## 6. Long-Term Debt

Long-term debt consists of the following:

	<i>December 31, 2004</i>	<i>December 31, 2003</i>
Revolving credit facility (unsecured)	\$300,000	\$300,000
Other	2,400	3,200
	<b>\$302,400</b>	<b>\$303,200</b>

The following discussion summarizes certain provisions of the long-term debt.

#### **REVOLVING CREDIT FACILITY**

On December 18, 2003, the Company refinanced its revolving credit facility with a group of financial institutions. The new facility is an unsecured revolving credit facility with a commitment of \$550,000 and a maturity date of June 7, 2008. The facility allows for issuance of letters of credit and cash borrowings. Letters of credit outstanding are limited to no more than \$150,000, with cash borrowings limited only by the facility's maximum availability less letters of credit outstanding.

Currently, for letter of credit issuances, a fee of 1.00% per annum (subject to increase/decrease based upon the Company achieving certain credit ratings from Standard & Poor's and Moody's) is assessed for the account of the lenders ratably. A further fee of 0.125% is assessed on standby letters of credit representing a facing fee. A customary administrative charge for processing letters of credit is also payable to the relevant issuing bank. Letter of credit fees are payable quarterly in arrears.

Cash borrowings under the revolving credit facility bear interest at a base rate or at an adjusted Eurodollar rate plus an applicable margin which varies, depending upon the type of loan the Company executes. The applicable margin over the base rate and adjusted Eurodollar rate is subject to adjustment based upon achieving certain credit ratings. At December 31, 2004, loans outstanding under the revolving credit facility consisted of \$300,000 based on the adjusted Eurodollar rate, which in conjunction with the interest rate swaps have a weighted average interest rate of 4.04%.

At December 31, 2004, there were \$300,000 of cash borrowings and \$19,018 in letters of credit outstanding under the revolving credit facility, leaving an excess of \$230,982 available for future liquidity needs.

The revolving credit facility has no mandatory principal payments; however, the commitment matures on June 7, 2008. The facility requires the Company to meet certain financial covenants including a minimum consolidated net worth (\$875,000 as of December 31, 2004 and \$900,000 thereafter) and maximum leverage ratio (ratio of consolidated debt to consolidated EBITDA (as defined in the credit agreement) of 2.75 to 1). In addition, the facility requires repayment upon the occurrence of a change of control of the Company. As of December 31, 2004, the Company was in compliance with all financial covenants.

#### **OTHER**

Other long-term debt consists of industrial revenue bonds with an interest rate of 7.0%.

#### **INTEREST RATE SWAP AGREEMENTS**

In May 2004, in order to reduce the impact of changes in interest rates on its floating rate long-term debt, the Company entered into three interest rate swap agreements each having a notional amount of \$100,000 and a termination date in May 2007. The Company pays the counterparties a fixed rate of 2.55% per annum and receives payment based upon the floating three-month LIBOR rate.

## 7. Common Stock

The Company's restated certificate of incorporation includes authorization to issue up to 200 million shares of Common Stock with a \$1.00 per share stated value. As of December 31, 2004, 56,482,541 shares of Common Stock were issued.

The Company has been authorized by its Board of Directors to repurchase its Common Stock from time to time in open market or privately negotiated transactions. Common Stock repurchases are recorded as treasury stock and may be used for general corporate purposes. As of December 31, 2004, the Company has Board of Directors' authorization for the repurchase of an additional \$50,000 of its Common Stock.

Shares of Common Stock were reserved for the following purposes at December 31, 2004:

	<i>Number of Shares</i>
Common Stock options:	
Granted	3,918,481
Available for grant	1,808,975
	5,727,456

The Company has outstanding option grants pursuant to the 1992 Stock Option Plan and the 1999 Long-Term Incentive Plan. These plans are administered by the Executive Compensation and Stock Option Committee of the Board of Directors and permit certain key employees to be granted nonqualified options, performance-based options, restricted stock, or combinations thereof. Options must be issued at market value on the date of grant and expire in a maximum of ten years.

The Company issued 9,000 and 4,000 shares of restricted stock in 2004 and 2003, respectively. The restricted shares vest over various periods from three to five years. The deferred compensation cost is amortized to expense over the period of time the restrictions are in place and the unamortized portion is classified as a reduction of paid-in-capital in the Company's consolidated balance sheets.

Changes in options granted and outstanding are summarized as follows:

	<i>Year Ended December 31,</i>					
	<i>2004</i>		<i>2003</i>		<i>2002</i>	
	<i>Shares</i>	<i>Average Price</i>	<i>Shares</i>	<i>Average Price</i>	<i>Shares</i>	<i>Average Price</i>
Beginning of period	4,172,909	\$ 21.16	3,610,984	\$20.36	4,298,916	\$17.55
Granted	574,100	29.96	988,300	21.54	425,900	34.67
Exercised	(692,028)	18.75	(299,475)	11.29	(996,782)	13.57
Cancelled	(136,500)	26.15	(126,900)	24.80	(117,050)	27.16
End of period	3,918,481	\$ 22.70	4,172,909	\$21.16	3,610,984	\$20.36
Exercisable at end of period	2,365,656		2,252,259		2,038,134	
Weighted average fair value of options granted		\$13.28		\$10.89		\$18.08

## Notes to Consolidated Financial Statements

(Dollars in thousands except per share data)

Summarized information regarding stock options outstanding and exercisable at December 31, 2004 follows:

Range of Exercise Prices	Outstanding			Exercisable	
	Shares	Average Contractual Life (Years)	Average Price	Shares	Average Price
Up to \$10	11,806	0.1	\$ 8.46	11,806	\$ 8.46
\$10 - \$20	1,076,600	2.7	15.02	1,076,600	15.02
\$20 - \$30	2,454,075	6.5	24.37	1,064,250	23.37
Over \$30	376,000	5.6	34.23	213,000	33.90
	3,918,481	5.4	\$22.70	2,365,656	\$20.44

Weighted average shares used in the computation of basic and diluted earnings per common share for 2004, 2003, and 2002 are as follows:

	Year Ended December 31,		
	2004	2003	2002
Weighted average shares used for basic earnings per common share	54,653,995	55,736,871	55,506,837
Effect of dilutive securities:			
Stock options	565,577	518,917	879,990
Weighted average shares used for diluted earnings per common share	55,219,572	56,255,788	56,386,827

Excluded from the computation of diluted earnings per common share were options to purchase 948,449 and 432,600 shares at an average price of \$31.72 and \$33.94 per share during 2004 and 2003, respectively. These options have been excluded from the diluted earnings per share calculation because their inclusion would be antidilutive.

## 8. Income Taxes

Income tax expense is comprised of the following:

	Year Ended December 31,		
	2004	2003	2002
Current:			
Federal	\$40,899	\$49,124	\$45,208
State and local	3,443	4,633	3,307
Foreign	713	158	808
	45,055	53,915	49,323
Deferred	6,018	736	16,270
	\$51,073	\$54,651	\$65,593

The following table reconciles the differences between the federal corporate statutory rate and the Company's effective income tax rate:

	Year Ended December 31,		
	2004	2003	2002
Federal corporate statutory rate	35.0%	35.0%	35.0%
State and local income taxes, net of federal tax benefit	1.8	2.1	1.2
Other	(1.0)	(0.5)	(0.6)
Effective income tax rate	35.8%	36.6%	35.6%

## Notes to Consolidated Financial Statements

(Dollars in thousands except per share data)

The sources of the tax effects for temporary differences that give rise to the deferred tax assets and liabilities were as follows:

	<i>December 31,</i> <i>2004</i>	<i>December 31,</i> <i>2003</i>
Deferred tax assets attributable to:		
Expense accruals	\$ 15,994	\$ 17,271
Valuation allowances	15,172	16,605
Asset impairment charges	2,872	4,435
Employee pension and other benefit plans	14,207	11,209
Other	1,622	1,457
Total deferred tax assets	49,867	50,977
Deferred tax liabilities attributable to:		
Fair value adjustments	(43,239)	(43,938)
Other intangible assets	(28,973)	(26,714)
Depreciation	(15,840)	(12,751)
Inventory costs capitalized	(2,253)	(2,170)
Other	(9,823)	(9,637)
Total deferred tax liabilities	(100,128)	(95,210)
Net deferred tax liabilities	\$(50,261)	\$(44,233)

## 9. Employee Benefits

The Company sponsors or contributes to retirement plans covering substantially all employees. The total cost of all plans for 2004, 2003, and 2002 was \$16,947, \$10,678, and \$7,075, respectively.

### COMPANY-SPONSORED DEFINED BENEFIT PLANS

Employees are covered primarily by noncontributory plans, funded by Company contributions to trust funds, which are held for the sole benefit of employees. Cash contributions to the trust funds during 2004 and 2003 were \$15,000 and \$10,000, respectively. The Company does not expect to make an additional cash contribution during 2005. Monthly retirement benefits are based upon service and pay with employees becoming vested upon completion of five years of service. Annual plan benefit payments to retirees and/or beneficiaries are expected to approximate \$24,000 for the next ten years.

The investment objective of the trust funds is to ensure, over the long-term life of the trusts, an adequate asset balance to support the benefit obligations to participants, retirees and beneficiaries. In meeting this objective, the Company seeks to achieve investment returns at or above selected benchmarks consistent with a prudent level of diversification. The Company retains registered investment advisors to manage specific asset classes. Investment advisors are selected from established and financially sound organizations with proven records in managing funds in the appropriate asset class. Investment advisors are given strict investment guidelines and performance benchmarks.

Annual cost for defined benefit plans is determined using the projected unit credit actuarial method. Prior service cost is amortized on a straight-line basis over the average remaining service period of employees expected to receive benefits.

It is the Company's practice to fund pension costs to the extent that such costs are tax deductible and in accordance with ERISA. The assets of the various plans include corporate equities, government securities, corporate debt securities and insurance contracts. The following table summarizes the funded status of the Company-sponsored defined benefit plans.

*Notes to Consolidated Financial Statements*

*(Dollars in thousands except per share data)*

	<i>December 31, 2004</i>	<i>December 31, 2003</i>
<b>Change in projected benefit obligation:</b>		
Projected benefit obligation – beginning of year	\$ 385,853	\$ 349,284
Service cost	12,411	11,521
Interest cost	24,429	23,795
Plan amendments	1,377	184
Actuarial loss	14,833	20,300
Benefits paid	(20,589)	(19,231)
Projected benefit obligation – end of year	\$ 418,314	\$ 385,853
<b>Change in plan assets:</b>		
Fair value of plan assets – beginning of year	\$ 327,643	\$ 292,149
Actual return on plan assets	25,119	43,443
Employer contributions	16,276	11,282
Benefits paid	(20,589)	(19,231)
Fair value of plan assets – end of year	\$ 348,449	\$ 327,643
Funded status	\$ (69,865)	\$ (58,210)
Fair value adjustment	(11,309)	(12,800)
Recognition of minimum liability	(54,634)	(45,145)
Unrecognized net actuarial loss	97,859	84,503
Unrecognized prior service cost	2,127	1,094
Accrued pension cost	\$ (35,822)	\$ (30,558)
Accumulated benefit obligation	\$ 386,603	\$ 356,421

The fair value adjustment relates to the Company's 1992 reorganization.

## Notes to Consolidated Financial Statements

(Dollars in thousands except per share data)

The asset allocations for the Company's defined benefit plans are as follows:

	Percentage of Plan Assets		
	Target	December 31, 2004	December 31, 2003
Equity securities	55.0%	53.4%	55.5%
Debt securities	45.0%	46.6%	44.5%
	100.0%	100.0%	100.0%

Net periodic pension expense for 2004, 2003, and 2002 included the following components:

	Year Ended December 31,		
	2004	2003	2002
Service cost-benefits earned during the period	\$ 12,411	\$ 11,521	\$ 11,033
Interest cost on the projected benefit obligation	24,429	23,795	23,378
Expected return on plan assets	(27,004)	(28,725)	(30,544)
Net amortization and deferral	3,706	355	(1,736)
Net periodic pension expense	\$ 13,542	\$ 6,946	\$ 2,131

Actuarial assumptions used to determine costs and benefit obligations are as follows:

	2004	2003	2002
Expected long-term rate of return on plan assets	7.50%	8.00%	8.50%
Weighted average discount rate	6.25%	6.75%	7.25%
Long-term rate of compensation increase	3.50%	4.00%	4.50%

Assumption used to determine benefit obligation as of December 31:

Weighted average discount rates	6.00%	6.25%	—
Long-term rate of compensation increase	3.50%	4.00%	—

The expected long-term rate of return assumption was developed through analysis of historical market returns, current market conditions and the fund's past experience.

### OTHER RETIREMENT PLANS AND BENEFITS

In addition to defined benefit plans, the Company makes contributions to defined contribution plans and sponsors employee savings plans. The cost of these plans is included in the total cost for all plans reflected above.

## 10. Other Comprehensive Income (Expense)

Other comprehensive income (expense) consists of the following:

	Year Ended December 31,		
	2004	2003	2002
Change in market value of financial instruments accounted for as hedges	\$10,225	\$ 9,757	\$ (5,957)
Minimum pension liability	(9,490)	(2,658)	(42,487)
Foreign currency translation	(354)	(213)	(425)
	381	6,886	(48,869)
Income tax expense (benefit)	11	2,415	(18,060)
	\$ 370	\$ 4,471	\$(30,809)

The components of accumulated other comprehensive income (expense), each presented net of tax, are as follows:

	December 31, 2004	December 31, 2003
Market value of financial instruments accounted for as hedges	\$ 4,008	\$ (2,638)
Minimum pension liability	(34,092)	(28,170)
Foreign currency translation	(992)	(638)
	\$ (31,076)	\$(31,446)

## 11. Commitments and Contingent Liabilities

Certain of the Company's real properties and equipment are operated under lease agreements. Rental expense under operating leases totaled \$30,610, \$30,541, and \$26,882 for 2004, 2003 and 2002, respectively. Annual minimum payments under operating leases are \$35,569, \$35,753, \$32,795, \$30,282, and \$28,486 for 2005 through 2009, respectively. Future minimum lease payments under operating leases, reduced by minimum rentals from subleases of \$123,784, aggregate \$166,194.

The Company has provided guarantees related to store leases for certain independent dealers opening Company-branded stores (e.g., Thomasville Home Furnishings Stores). The guarantees range from one to fifteen years and generally require the Company to make lease payments in the event of default by the dealer. In the event of default, the Company has the right to assign or assume the lease. The total future lease payments guaranteed at December 31, 2004 were \$94,530. The Company believes the risk of significant loss from these lease guarantees is remote.

The Company is or may become a defendant in a number of pending or threatened legal proceedings in the ordinary course of business. In the opinion of management, the ultimate liability, if any, of the Company from all such proceedings will not have a material adverse effect upon the consolidated financial position or results of operations of the Company and its subsidiaries.

## 12. Other Income, Net

Other income, net for 2004, 2003 and 2002 consisted of interest on short-term investments and notes receivable of \$1,135, \$718, and \$1,220 and other miscellaneous income and expense items totaling \$1,163, \$2,764, and \$2,536, respectively.

### 13. Quarterly Financial Information (Unaudited)

Following is a summary of unaudited quarterly information:

	<i>Fourth Quarter</i>	<i>Third Quarter</i>	<i>Second Quarter</i>	<i>First Quarter</i>
<b>Year ended December 31, 2004:</b>				
Net sales	\$ 601,981	\$ 574,800	\$ 593,088	\$ 677,561
Gross profit	153,169	145,618	151,991	177,765
Net earnings	\$ 22,333	\$ 19,423	\$ 16,602	\$ 33,209
Earnings per common share:				
Basic	\$ 0.42	\$ 0.36	\$ 0.30	\$ 0.59
Diluted	\$ 0.42	\$ 0.36	\$ 0.30	\$ 0.58
Dividends declared per common share	\$ 0.150	\$ 0.125	\$ 0.125	\$ 0.125
Common Stock price range:				
High	\$ 25.75	\$ 25.37	\$ 33.90	\$ 35.09
Low	\$ 20.75	\$ 21.10	\$ 22.75	\$ 28.15
<b>Year ended December 31, 2003:</b>				
Net sales <sup>1</sup>	\$ 634,423	\$ 572,277	\$ 596,359	\$ 631,071
Gross profit	159,835	139,547	148,821	166,573
Net earnings	\$ 22,612	\$ 19,345	\$ 23,575	\$ 29,041
Earnings per common share:				
Basic	\$ 0.41	\$ 0.35	\$ 0.42	\$ 0.52
Diluted	\$ 0.40	\$ 0.34	\$ 0.42	\$ 0.52
Dividends declared per common share	\$ 0.125	—	—	—
Common Stock price range:				
High	\$ 29.42	\$ 29.75	\$ 28.89	\$ 24.90
Low	\$ 22.75	\$ 22.51	\$ 19.00	\$ 17.23

<sup>1</sup>Amounts reflect the reclassification of shipping revenues to net sales. Amounts reclassified to net sales for 2003 were \$17,227, \$16,747, \$14,857 and \$17,561 for the first through the fourth quarter, respectively. Shipping revenues included in 2004 were \$19,030, \$17,406, \$17,010 and \$18,709, respectively.

Earnings per common share were computed independently for each of the quarters presented. The sum of the quarters may not equal the total year amount due to the impact of computing average quarterly shares outstanding for each period.

In the fourth quarter of 2003, the Company commenced a cash dividend program with an initial rate of \$0.50 per common share on an annual basis. In the fourth quarter of 2004, the cash dividend was increased to an annual rate of \$0.60 per common share. The closing market price of the Company's Common Stock on December 31, 2004 was \$25.05 per share.

**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management of Furniture Brands International, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in the Securities Exchange Act of 1934 Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the Company's internal control over financial reporting as of December 31, 2004 as required by the Securities Exchange Act of 1934 Rule 13a-15(c). In making this assessment, we used the criteria set forth in the framework in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control-Integrated Framework* our management concluded that our internal control over financial reporting was effective as of December 31, 2004.

Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2004 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report which is set forth on page 48.

Furniture Brands International, Inc.  
St. Louis, Missouri  
March 11, 2005

**THE BOARD OF DIRECTORS AND SHAREHOLDERS  
FURNITURE BRANDS INTERNATIONAL, INC.:**

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Furniture Brands International, Inc. maintained effective internal control over financial reporting as of December 31, 2004, based on the criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Furniture Brands International, Inc. maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the criteria established in *Internal Control-Integrated Framework* issued by COSO. Also, in our opinion, Furniture Brands International, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on the criteria established in *Internal Control-Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Furniture Brands International, Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2004, and our report dated March 11, 2005 expressed an unqualified opinion on those consolidated financial statements.

**KPMG LLP**

St. Louis, Missouri  
March 11, 2005

**THE BOARD OF DIRECTORS AND SHAREHOLDERS  
FURNITURE BRANDS INTERNATIONAL, INC.:**

We have audited the accompanying consolidated balance sheets of Furniture Brands International, Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2004. 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 the standards of the Public Company Accounting Oversight Board (United States). 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 Furniture Brands International, Inc. and subsidiaries as of December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of internal control over financial reporting of Furniture Brands International, Inc. as of December 31, 2004, based on the criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 11, 2005 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

**KPMG LLP**

St. Louis, Missouri  
March 11, 2005

Five-Year Consolidated Financial Review

(Dollars in thousands except per share data)	Year Ended December 31,				
	2004	2003	2002	2001	2000
<b>Summary of operations:</b>					
Net sales <sup>1</sup>	\$ 2,447,430	\$ 2,434,130	\$ 2,458,836	\$ 1,940,515	\$ 2,160,050
Gross profit	628,543	614,776	633,558	466,794	546,859
Interest expense	15,314	19,384	21,732	21,984	36,389
Earnings before income tax expense and extraordinary item	142,640	149,224	184,424	87,694	165,997
Income tax expense	51,073	54,651	65,593	29,664	57,574
Earnings before extraordinary item	91,567	94,573	118,831	58,030	108,423
Extraordinary item	—	—	—	—	(2,522)
Net earnings	\$ 91,567	\$ 94,573	\$ 118,831	\$ 58,030	\$ 105,901
<b>Per share of Common Stock</b>					
- diluted:					
Earnings before extraordinary item	\$ 1.66	\$ 1.68	\$ 2.11	\$ 1.13	\$ 2.15
Extraordinary item	—	—	—	—	(0.05)
Net earnings	\$ 1.66	\$ 1.68	\$ 2.11	\$ 1.13	\$ 2.10
Dividends	\$ 0.525	\$ 0.125	—	—	—
<b>Weighted average common shares</b>					
— diluted (in thousands)	55,220	56,256	56,387	51,325	50,443
<b>Other information:</b>					
Working capital	\$ 711,115	\$ 703,233	\$ 652,095	\$ 603,420	\$ 548,463
Property, plant and equipment, net	284,973	310,563	333,371	321,640	303,235
Capital expenditures	30,593	41,451	50,214	22,991	53,310
Total assets	1,587,759	1,578,259	1,567,402	1,503,489	1,304,838
Long-term debt	302,400	303,200	374,800	454,400	462,000
Shareholders' equity	\$ 957,483	\$ 966,902	\$ 869,515	\$ 759,659	\$ 583,905

<sup>1</sup>Amounts reflect the reclassification of shipping revenues to net sales. Reclassifications for the last five years were \$72,155, \$66,392, \$61,127, \$49,202 and \$43,811. These reclassifications had no impact on gross profit or net earnings.

On December 28, 2001, the Company acquired through a wholly owned subsidiary – HDM Furniture Industries, Inc. – substantially all of the assets and liabilities of Henredon Furniture Industries, Drexel Heritage Furnishings and Maitland-Smith. Because the acquisition occurred prior to the last business day of 2001, it was reflected in the Company's consolidated balance sheet as of December 31, 2001; however, the Company's consolidated results of operations for 2001 do not include any of the operations of the acquired companies.

## Board of Directors

Katherine Button Bell <sup>2,3</sup>  
*Vice President and Chief Marketing Officer of Emerson Electric Co.*

John T. Foy  
*President and Chief Operating Officer of the Company*

W.G. (Mickey) Holliman <sup>1</sup>  
*Chairman of the Board and Chief Executive Officer of the Company*

John R. Jordan, Jr. <sup>2,3</sup>  
*Retired, formerly Vice Chairman of PriceWaterhouse  
(now PricewaterhouseCoopers).*

Donald E. Lasater <sup>1,3,4\*</sup>  
*Retired Chairman of the Board and Chief Executive Officer of  
Mercantile Bancorporation, Inc.*

Lee M. Liberman <sup>2,4</sup>  
*Chairman Emeritus of Laclede Gas Company*

Richard B. Loynd <sup>1\*,4</sup>  
*President of Loynd Capital Management*

Bob L. Martin <sup>2,4</sup>  
*Business Consultant, Retired President and Chief Executive Officer  
of Wal-Mart International (the international division of Wal-Mart  
Stores, Inc.)*

Aubrey B. Patterson <sup>1</sup>  
*Chairman of the Board and Chief Executive Officer of Bancorpsouth, Inc.*

Albert E. Suter <sup>1,3\*</sup>  
*Senior Advisor, Retired Vice Chairman and Chief Operating Officer of  
Emerson Electric Co.*

### Committees of the Board

<sup>1</sup> *Executive Committee*

<sup>2</sup> *Audit Committee*

<sup>3</sup> *Executive Compensation and Stock Option Committee*

<sup>4</sup> *Governance and Nominating Committee*

(\* indicates Committee Chairman)

## Principal Corporate Officers

W.G. (Mickey) Holliman  
*Chairman of the Board and Chief Executive Officer*

John T. Foy  
*President and Chief Operating Officer*

Lynn Chipperfield  
*Senior Vice-President and Chief Administrative Officer*

Denise L. Ramos  
*Senior Vice-President, Treasurer and Chief Financial Officer*

Robert L. Kaintz  
*Corporate Secretary*

Steven W. Alstadt  
*Controller and Chief Accounting Officer*

Jerry L. Lybarger  
*General Counsel and Assistant Secretary*

## Chief Executive Officers

Dennis R. Burgette  
*Broyhill Furniture Industries, Inc.*

Randall C. Spak  
*Lane Furniture Industries, Inc.*

Thomas G. Tilley, Jr.  
*Thomasville Furniture Industries, Inc.*

Stephen K. McKee  
*Henredon Furniture Industries, Inc.*

C. Jeffrey Young  
*Drexel Heritage Furniture Industries, Inc.*

Seamus Bateson  
*Maitland-Smith Furniture Industries, Inc.*

**TRANSFER AGENT AND REGISTRAR FOR COMMON STOCK**

American Stock Transfer & Trust Company  
59 Maiden Lane  
New York, NY 10038  
Contact us at:  
1-800-937-5449 or [www.amstock.com](http://www.amstock.com)

**COMMON STOCK**

As of February 28, 2005, there were approximately 1,700 stockholders of record.

**EXCHANGE LISTING**

Common shares are listed on the New York Stock Exchange (trading symbol: FBN)

**CORPORATE OFFICES**

101 South Hanley Road  
St. Louis, Missouri 63105-3493  
(314) 863-1100

**ANNUAL MEETING**

The Annual Meeting of Shareholders will be at 10:00 a.m. on Thursday, April 28, 2005 at the Corporate Offices.

The Chief Executive Officer and Chief Financial Officer have certified in writing to the Securities and Exchange Commission (SEC) as to the integrity of the Company's financial statements included in this Annual Report and incorporated by reference into the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004 filed with the SEC, and the effectiveness of the Company's disclosure controls and procedures and internal control over financial reporting. The certifications are filed as Exhibit 31 to the said Form 10-K. On May 18, 2004, the Chief Executive Officer also certified to the New York Stock Exchange that he is not aware of any violation by the Company of the New York Stock Exchange corporate governance listing standards.

**FORM 10 – K ANNUAL REPORT**

Shareholders may obtain a copy of the current Form 10-K filed with the Securities and Exchange Commission by writing to the Secretary of Furniture Brands International at the Corporate Offices.

**INDEPENDENT AUDITORS**

KPMG LLP  
10 S. Broadway, Suite 900  
St. Louis, Missouri 63102-1761  
(314) 444-1400

**INTERNET ACCESS**

Corporate news releases, Forms 10-K, 10-Q, 8-K, and amendments thereto, the annual report and other information about the Company and its subsidiaries are available through the Company's Internet Web site: [www.furniturebrands.com](http://www.furniturebrands.com)



