

Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

LINCOLN LOGS LTD  
Form 10KSB  
May 02, 2005

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-KSB  
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended January 31, 2005

Commission File  
Number 0-12172

LINCOLN LOGS LTD.  
(Name of small business issuer in its charter)

New York  
(State or other jurisdiction of  
incorporation or organization)

14-1589242  
(I.R.S. Employer  
Identification No.)

5 Riverside Drive, Chestertown, New York 12817  
(Address of principal executive offices) (Zip Code)

Issuer's telephone number: (518) 494-5500

Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class	Name of Each Exchange on Which Registered
NONE	NONE

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, \$.01 par value  
(Title of Class)

Share Purchase Rights  
(Title of Class)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 [ ]

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will 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-KSB or any amendment to this Form 10-KSB. [X]

Issuer's revenues for the fiscal year ended January 31, 2005 were \$21,549,755.

The aggregate market value of common stock held by non-affiliates of the registrant as of April 27, 2005 was approximately \$799,200. The number of shares of Common Stock of the registrant outstanding on April 27, 2005 was 9,040,059.

# Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

1

## PART I

### ITEM 1. DESCRIPTION OF BUSINESS

#### GENERAL

Lincoln Logs Ltd. (herein the "Company") is primarily engaged in the business of designing, manufacturing and marketing a broad line of log and panelized homes to be erected by custom builders and "do-it-yourself" buyers. The Company planes cants (logs milled on four sides) at its own manufacturing facilities in Chestertown, New York and Maple Ridge, British Columbia and delivers to its customers by truck trailer a weather-tight log home or panelized shell package which includes logs or pre-engineered structural wall panels, prefabricated roof trusses, oriented strand board, dimensional lumber, windows, doors, roof shingles, nails, caulking, between-log sealant, blueprints and a construction guide. While the Company historically has not provided construction services to customers (including the sale and installation of foundations, plumbing, electrical wiring and fixtures, cabinets, and other amenities), our newly acquired subsidiary, Snake River Log Homes LLC, does provide this service from time to time. The Company also provides its customers with services related to the sale of its housing packages, such as the preparation of customized blueprints and ongoing customer service through its organization of independent representatives located throughout the United States.

The Company was incorporated in New York in 1977 and has the following wholly-owned subsidiaries: Thermo-Home Inc., a New York corporation through which the Company's panelized homes were previously manufactured and marketed (the manufacture and marketing operations of the Company's panelized homes were integrated into the operation of Lincoln Logs Ltd. during the fiscal year ended January 31, 1988); Snake River Log Homes, LLC, a sole-member limited liability company organized under the laws of the State of Idaho whose principal activity is the marketing and sale of log homes constructed of rustic logs in the Swedish-cope style; AFI Acquisitions Company, LLC, a sole-member limited liability company organized under the laws of New York in October 2003 whose principal activity is the manufacture of dimensional wood products for consumption by Lincoln Logs Ltd.; True Craft, Inc., a New York corporation that was formed in November 2004 as a holding company for the Company's Canadian subsidiaries; True Craft Log Structures Co., a Nova Scotia Unlimited Liability Corporation organized under the laws of Nova Scotia, Canada and formed in November 2004 as a holding company into which the Company's Canadian subsidiaries, True Craft Logs Structures Ltd., Hart & Son Industries Ltd. and Lincoln Logs Canada Ltd., were amalgamated and whose principal activity is the manufacture, marketing and sales of log homes principally to the Canadian, European and Pacific Rim markets. Unless the context otherwise requires, the term "Company" refers to Lincoln Logs Ltd. and its subsidiaries.

#### PRODUCTS

The Company's products include over 125 standard models of log homes ranging in size from 560 to 4,000 square feet, and in price from approximately \$27,000 to \$208,000, as well as custom designed homes with prices and sizes ranging up to approximately \$750,000 and 10,000 square feet, respectively. A majority of the Company's sales are of log homes to be occupied as primary residences by the buyers.

The Company has a product line for the general housing market utilizing a pre-engineered structural wall system, which when assembled with other standard

## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

building components, facilitates the construction of non-log traditional homes, as well as log-like structures. These product lines are marketed as the Thermo-Home(R) system and the Lincoln(R)-Panel system. Sales of this product line were approximately 13% of total sales in fiscal year 2005.

The Company also has a product line for the solarium/sunspace market utilizing architectural arches which, when assembled with other standard building components, will permit the construction of room additions for log and

2

traditional homes. The product line is referred to as Lincoln Solarium (TM). Sales of this product line as a stand-alone product were approximately 1% of total sales in fiscal year 2005, which does not include those solariums that are built into and are an integral part of the design of the Company's log home products.

Fifty percent (50%) of the purchase price of the building package is usually received prior to the manufacture by the Company of any of the solid timber components or the pre-engineered structural wall panels. The complete log home shell package or panelized home package is shipped via truck trailers and delivered to a customer upon payment of the balance of the purchase price. International sales are completed with the use of letters of credit, or are conditioned upon receipt of full payment prior to shipment.

The Company markets its products in the United States through a network of approximately 61 independent sales representatives in approximately 31 states, and through four Company-owned and operated sales centers, one in northern New York, one in northern California, one in southeastern Idaho and one in northwestern Canada. All Company operated sales centers are staffed by Company employee salespersons. Each of the Company's independent sales representatives has a written agreement with the Company that specifies the representative's sales territory and provides for the payment of a commission ranging from 13% to 17.5% of the purchase price for the log home shell package. A majority of the Company's independent sales representatives have purchased and erected one of the Company's log homes for use as a sales model. The Company maintains a cooperative advertising program for independent sales representatives pursuant to which the Company shares in the cost of advertising undertaken by qualified sales representatives.

Substantially all of the Company's sales have been to customers in the United States, with the remainder to customers in Japan (less than 5% in each fiscal year).

### SOURCES AND AVAILABILITY OF RAW MATERIALS

The Company manufactures log components from rough-sawn eastern white pine cants, western red cedar cants and western spruce cants. The cants are milled to various dimensions to produce the Company's finished product. The pine cants are purchased from several mills in the region of the Company's facilities in Chestertown, New York, Maple Ridge, British Columbia, Canada, and Rigby, Idaho; cedar cants are purchased from several mills in northern California, Oregon and western Canada. Finished logs of lodge pole pine for delivery to some of the Company's customers are purchased from an unaffiliated company on a subcontract basis. Logs constitute approximately 24% of the cost of a typical log home shell package.

Other components of the Company's log home shell package are purchased from several suppliers. These components include prefabricated roof trusses, windows, doors, nails, sheathing, dimensional lumber, shingles, caulking, and between-log sealant. The Company has not recently experienced any significant

## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

supply shortages, and does not anticipate any such shortages in the near future based upon currently available information. Alternative sources of raw materials are readily available to the Company.

### COMPETITION

The Company believes that there are approximately 350 firms engaged in the sale of log home materials, of which approximately 125 firms sell log home packages or kits and are in direct competition with the Company.

The Company's principal competitors are: Tennessee Log Homes, Real Log Homes, Northeastern Log Homes, Kuhns Bros. and Jim Barna Log Systems. The Company believes that its competitive position with respect to those firms is favorable, especially in the areas of quality and range of product, price, appearance, and energy efficiency.

### EMPLOYEES

As of January 31, 2005, the Company employed 109 persons, 104 of whom are full time employees and 5 individuals that are part-time employees.

3

The Company has never had a work stoppage and regards its employee relations as satisfactory. Employees are not covered by collective bargaining agreements.

### PATENTS

The Company does not possess any patents covering the system utilized to erect a Lincoln Logs solid timber home or any of the components thereof.

### TRADEMARKS

The Company has registered the trademarks LINCOLN LOGS LTD.(R) (and design), THERMO LOG(R), CASHCO(R), THERMO-HOME(R), STACK 'N BUILD(R), CHECKMATE(R), LINCOLN-SEAL(R), and WEATHERBLOC(R) (and design) in the United States Patent and Trademark Office. The Company has registered the words "THE ORIGINAL LINCOLN LOGS" in several states. Canadian trademarks issued to the Company are "LINCOLN LOGS LTD." (and design), "EARLY AMERICAN LOG HOMES" (and design), "THERMO-HOME," "LINCOLN-SEAL", "STACK 'N BUILD," and "TRUE-CRAFT LOG STRUCTURES." The Company also owns the federally registered trademark "LINCOLN" in the United States. Although these trademarks are believed by the Company to have commercial value, it is the Company's opinion that the invalidation of any of these trademarks would not have a material adverse effect on the Company.

The Company is party to an agreement pursuant to which the Company agreed not to use the phrase "Lincoln Log Homes" either as a trademark or in any manner other than in a purely textual sense (e.g., "Lincoln Log" homes).

### RESEARCH AND DEVELOPMENT

No expenditures were made by the Company for research and development during the fiscal years ended January 31, 2005 or 2004.

### GOVERNMENT REGULATIONS

Compliance with federal, state and local regulations that have been enacted or adopted to regulate the discharge of materials into the environment, or otherwise relating to the protection of the environment, has not had in the past, and the Company believes will not have in the future, a material effect upon the capital expenditures, earnings or competitive position of the Company.

## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

State and local regulations have been adopted with respect to the materials utilized in the construction and various other aspects of residential housing. The Company believes that its products comply with all material regulations relating thereto.

### ITEM 2. DESCRIPTION OF PROPERTY

The Company owns several parcels of real estate located in New York and California, respectively, as follows:

#### (a) New York

- (1) An approximately 8.5 acre parcel of land on Riverside Drive, Chestertown, New York, on which are located the Company's executive offices, consisting of a 6,000 square foot log building, a 2,000 square foot log building, and the Company's production facilities, consisting of two milling machines located in a 10,200 square foot metal building, a 10,440 square foot metal-framed, open storage

4

structure, a 4,800 square foot, log-sided pole shed, and a 14,000 square foot Thermo-Home(R) and log building containing corporate offices, storage and fabricating facilities for the Company's Thermo-Home(R) product line. The remainder of the 8.5 acre parcel is utilized by the Company for outside storage of cants, logs and building materials used in the Company's log home and panelized home packages.

- (2) An approximately 19 acre parcel of undeveloped land on Route 8, Chestertown, New York, which is utilized by the Company for storage of cants and logs.
- (3) An approximately one acre parcel of land on Pine Street, Chestertown, New York, on which is located a 7,680 square foot building which was previously used as a manufacturing facility for the Company's Thermo-Home(R) product line and is currently used for additional storage of building materials for this product line.
- (4) An approximately 1.4 acre parcel of land in Lake George, New York on which is located the Company's new Northern Regional Sales Office in a 3,050 square foot log home erected by the Company.
- (5) Approximately 15 acres of land comprised of three contiguous parcels of land on Fish House Road, Galway, New York, on which is located the Company's saw mill operation, consisting of a 13,520 square foot metal building that houses log sawing production equipment, a 1,752 square foot wood-frame office building, a 900 square foot building that contains a drying kiln, and eight additional storage buildings and drying sheds ranging in size from 667 square feet to 3,528 square feet. The remainder of the 15 acres is utilized by the Company for outside storage of logs, cants, timbers and other dimensional lumber products.
- (6) In addition, the Company owns a parcel of approximately 1 acre of undeveloped land in Northeastern New York acquired by the Company for potential future use.

#### (b) California

## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

(1) The Company owns an approximately one acre parcel of land in Auburn, California, on which is located the Company's Western Regional Sales Office in a 4,000 square foot western cedar Ranch style log home, and a 2,500 square foot western cedar Cape style log home planed in the Weatherbloc(R) clapboard style.

(c) Vermont

(1) The Company owns a parcel of land of approximately 1.4 acres in Southwest Vermont, acquired by the Company for potential future use.

The Company considers these facilities to be in good condition and suitable for their respective purposes.

As collateral for its Revolving Credit and Loan Agreement dated October 7, 2003 the Company has granted mortgages on the parcels specified in Paragraphs (a) (1)-(6), (b) (1) and (c) (1) of this Item 2.

### ITEM 3. LEGAL PROCEEDINGS

Litigation commenced against the Company could materially impact our liquidity if there is an adverse outcome. Although we cannot predict the ultimate result, we are vigorously defending the following claims and have been advised that they are defensible.

On August 30, 2002, the Company, by and through one of its dealers (the "Dealer") contracted with certain home package buyers (the "Owners") to sell them a log home. Thereafter, the Owners engaged the services of another party to construct it. In accordance with both the dealer and customer contracts, the

5

Company assumes no responsibility related to the construction of the home and requires the Dealer to defend and indemnify the Company from any and all claims brought against it relating to the construction. On July 8, 2003, the Owners commenced an action in the Supreme Court of New York, Kings County, against Lincoln Logs Ltd. and the Dealer alleging misleading representations and warranties to procure the contracts; breach of contract and intentional infliction of emotional distress and demanded damages in excess of Five Hundred Thousand (\$500,000.00) Dollars. In its answer to the complaint, the Company denies the essential allegations and demanded a defense and indemnification from the Dealer and contractor. The Company's insurance carrier, The Hartford, has denied coverage on the basis that the claims fall outside the scope of the policy's coverage. The litigation is currently in the later stages of discovery.

On April 5, 2003, the Company, by and through one of its dealers (the "Dealer") contracted with certain home package buyers (the "Owners") to sell them a log home. Thereafter, the Owners engaged the services of another party to construct it. In accordance with both the dealer and customer contracts, the Company assumes no responsibility related to the construction and requires the Dealer to defend and indemnify the Company from any and all claims brought against it relating to the construction. On December 15, 2003, the Owners commenced an action in the Supreme Court of New York, Ulster County, against a construction contractor, the Dealer and Lincoln Logs Ltd. alleging that the defendants failed to construct the home in good and workmanlike manner and demanded damages in excess of Five Hundred Thousand (\$500,000.00) Dollars. In its answer to the complaint, the Company denies the essential allegations and demanded a defense and indemnification from the Dealer and contractor. The Company's insurance carrier, The Hartford, has denied coverage on the basis that the claims fall outside the scope of the policy's coverage. The litigation is currently in the

## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

early stages of discovery.

The Company is defending certain claims in the ordinary course of and incidental to the Company's business. In the opinion of the Company's management, the ultimate settlement of these claims will not exceed amounts provided for in the consolidated financial statements.

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

None.

## PART II

### ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

- (a) The Company's Common Stock is traded over-the-counter on the OTC Bulletin Board(R). The following sets forth the range of the closing bid prices for the Company's Common Stock for the period February 1, 2003 through January 31, 2005. Such prices represent inter-dealer quotations, do not represent actual transactions, and do not include retail mark-ups, mark-downs or commissions. Such prices were determined from information provided by a majority of the market makers for the Company's Common Stock, including the underwriter for such securities of the Company.

		High Bid	Low Bid
Quarter Ended April 30, 2003	Common Stock	.48	.27
Quarter Ended July 31, 2003	Common Stock	.80	.40
Quarter Ended October 31, 2003	Common Stock	.85	.45
Quarter Ended January 31, 2004	Common Stock	1.60	.65
Quarter Ended April 30, 2004	Common Stock	1.01	.55
Quarter Ended July 31, 2004	Common Stock	.90	.54
Quarter Ended October 31, 2004	Common Stock	1.01	.30
Quarter Ended January 31, 2005	Common Stock	1.01	.42

- (b) The approximate number of holders of the Common Stock of the Company as of April 27, 2005 was 3,100.

6

- (c) No cash dividends were declared by the Company during the fiscal years ended January 31, 2005 and 2004. While the payment of dividends rests within the discretion of the Board of Directors, it is not anticipated that cash dividends will be paid in the foreseeable future, as the Company intends to retain earnings, if any, for use in the development of its business. The payment of dividends is contingent upon the Company's future earnings, if any, the Company's financial condition and its capital requirements, general business conditions and other factors. Further, the Company's Credit Agreement with its primary lender prohibits the Company's ability to make distributions without the lender's prior written consent.

- (d) The following table presents in tabular form a summary of securities authorized for issuance under equity compensation plans at January 31, 2005:

Equity Compensation Plan Information

Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	363,500	\$ 0.24	548,500
Equity compensation plans not approved by security holders	None	None	None
Total	363,500	\$ 0.24	548,500

RECENT SALES OF UNREGISTERED SECURITIES; USE OF PROCEEDS FROM REGISTERED SECURITIES

On August 29, 2003, the Company completed the acquisition of two companies affiliated through common ownership for approximately \$1,895,400. In connection with this transaction and as part of the consideration paid for these entities the Company issued a total of 287,500 unregistered shares of the Company's common stock to two individual owners of the companies. On the date of the transaction, the shares conveyed to such individuals were valued at approximately \$76,300. The shares issued to such individuals were issued by the Company pursuant to an exemption from registration set forth in Section 4(2) of the Securities Act of 1933, as amended, as the Company believes that no public offering or sale of securities occurred in connection with the transaction. All certificates representing the restricted securities contain appropriate text detailing their restricted status and the Company has issued "stop transfer" instructions to its transfer agent with respect to such securities. No commissions were paid in connection with this issuance of securities.

On November 17, 2003, the Company completed the acquisition of a limited liability company for approximately \$1,209,800. In connection with this transaction and as part of the consideration paid for these entities the Company issued a total of 300,000 unregistered shares of the Company's Common Stock to the two individual owners of the company. On the date of the transaction, the shares conveyed to such individuals were valued at approximately \$141,600. The shares issued to such individuals were issued by the Company pursuant to an exemption from registration set forth in Section 4(2) of the Securities Act of 1933, as amended, as the Company believes that no public offering or sale of securities occurred in connection with the transaction. All certificates



## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

representing the restricted securities contain appropriate text detailing their restricted status and the Company has issued "stop transfer" instructions to its transfer agent with respect to such securities. No commissions were paid in connection with this issuance of securities.

On May 15, 2003, holders of the Company's Series B Convertible Subordinated Debentures (the "B Debentures") with a total face value of \$170,000 elected to convert their respective holdings into unregistered shares of the Company's Common Stock. The Company issued 850,000 shares to the holders of the B Debentures pursuant to the conversion. The shares issued to the holders of the B Debentures were issued by the Company pursuant to an exemption from registration set forth in Section 3(a)(9) of the Securities Act of 1933, as amended. All certificates representing the restricted securities contain appropriate text detailing their restricted status and the Company has issued "stop transfer" instructions to its transfer agent with respect to such securities. No commissions were paid in connection with this issuance of securities.

On May 15, 2003, the holder of the Company's Series C Convertible Subordinated Debenture (the "C Debenture") with a total face value of \$50,000 elected to convert their respective holdings into unregistered shares of the Company's Common Stock. The Company issued 312,500 shares to the holder of the C Debenture pursuant to the conversion. The shares issued to the holder of the C Debentures were issued by the Company pursuant to an exemption from registration set forth in Section 3(a)(9) of the Securities Act of 1933, as amended. All certificates representing the restricted securities contain appropriate text detailing their restricted status and the Company has issued "stop transfer" instructions to its transfer agent with respect to such securities. No commissions were paid in connection with this issuance of securities.

8

### ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion is intended to further the reader's understanding of the consolidated financial statements, financial condition, and results of operations of Lincoln Logs Ltd. and Subsidiaries. It should be read in conjunction with the consolidated financial statements, notes and tables which are included elsewhere in this annual report. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. The actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including but not limited to those set forth under "Factors That Could Affect Future Results," and elsewhere in this report.

#### Overview

The Company manufactures and markets log home construction kits, panelized home construction kits and post and beam structures. The products we sell are used to construct a weather-tight shell of a home, that is, we sell the walls, windows and doors, roof structure and roofing material, and various other interior materials. While we have not historically provided construction services to customers (including the sale and installation of foundations, plumbing, electrical wiring and fixtures, cabinets, and other such amenities) our newly acquired subsidiary Snake River Log Homes LLC does provide this

## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

service from time to time. We sell a product line of solariums, or sun rooms, which can be purchased separately or included as an integral part of the house design. This product line represents a small portion of the Company's revenue and is a product which complements the Company's design of homes. We also provide to our customers detailed construction drawings that are stamped by a professional engineer as required. We sell several styles of log homes, such as machine milled logs and logs that are turned on a lathe, and we use several species of wood such as eastern white pine, western cedar, spruce and lodge-pole pine. All logs are available in various shapes, sizes and lengths and can be ordered "pre-cut and notched," "pre-cut only," or in specified lengths to be custom cut and fitted on site. We only operate within the business segment of manufactured wood products. Our revenue is reported as a single component, which is comprised of four elements: (1) log and panelized home sales, (2) solarium sales, (3) sales of building materials, and (4) revenues from engineering and design services. Approximately 89% of the Company's total sales are derived from log home and panelized home sales in the fiscal year ended January 31, 2005.

We consider the activities that surround the manufacture and distribution of log home and panelized home construction kits to be our core business. Our business strategy is to promote and grow our core business, and to create diversification in our product lines in an effort to add strength and breadth to our business structure. As a result, we are dedicating significant resources to building infrastructure for the support of our core business and to creating more product diversification through acquisitions.

### RESULTS OF OPERATIONS

9

The following table illustrates our financial results for the fiscal year ended January 31, 2005 as compared to the fiscal year ended January 31, 2004 (in \$1,000's US).

	Fiscal Year 2005	% of Sales	Fiscal Year 2004	% of Sales	% Sales	Change
	-----	-----	-----	-----	-----	-----
Net sales	\$21,550	100%	\$15,795	100%	36%	
Cost of sales	14,301	67%	9,539	60%	50%	
Gross profit	7,249	33%	6,256	40%	16%	
Operating expense	8,040	37%	6,464	41%	24%	
Loss from operations	( 790)	(-4%)	( 208)	-1%	-280%	
Other income, net	6	--	21	--	-71%	
Loss before income taxes	( 784)	(-4%)	( 187)	-1%	-319%	
Income tax benefit	--	--	10	--	--	
Net loss	\$( 784)	(-4%)	\$( 177)	-1%	-343%	

Critical Accounting Policies and Estimates

## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

The following discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to bad debts, inventories, income taxes, and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

In addition to the significant accounting policies described in Note 3 of the Consolidated Financial Statements, the Company believes that the following discussion addresses its critical accounting policies.

**Revenue Recognition:** We recognize revenue in accordance with the Securities and Exchange Commission's Staff Accounting Bulletin No. 104 ("SAB 104"), which updated the guidance in Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements." SAB 104 requires that 4 basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an agreement exists; (2) delivery has occurred or services have been rendered; (3) the fee is fixed and determinable; and (4) collectibility is reasonably assured. Revenue from products sold is recognized upon delivery to the customer. Subsequent to the sale of our products, we have no obligation to provide any modification or customization, upgrades, enhancements, or post-delivery customer support. Design and engineering services are an integral part of the total home

10

package sold to the customer and as such, revenue for these efforts are not recognized as a separate line item in our financial statements. However, customers occasionally cancel their contracts with us. Upon cancellation we recognize revenue for services performed for design and engineering services in accordance with a predetermined fee schedule that was shared with the customer at the time of the contract signing. We deduct this amount from the deposit that accompanied the contract and return the remainder of the deposit to the customer.

**Impairment of Long-lived and Intangible Assets:** We evaluate the recoverability of the Company's long-lived assets, where indicators of impairment are present, by reviewing current and projected profitability or discounted cash flow of such assets. Intangible assets that are subject to amortization are reviewed for potential impairment whenever events or circumstances indicate that carrying amounts may not be recoverable. Intangible assets not subject to amortization are tested for impairment at least annually. We did not record any impairment losses for the fiscal year ended January 31, 2005. For the fiscal year ended January 31, 2004, we wrote down the value of a parcel of real estate that was determined to be valued higher than its fair market value by \$30,100 based on an independent real estate appraisal.

**Income Taxes:** We estimate our income taxes in each of the jurisdictions in which we operate. This process involves an estimation of our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our Consolidated Balance Sheets. We must then assess the likelihood that our deferred tax

## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in our Statement of Operations. To date, we have recorded a full allowance against our deferred tax assets.

**Reserves for Doubtful Accounts and Obsolete/Excess Inventory:** Based on our judgment, we review our accounts receivable and inventory to establish reserves that adjust the carrying value to the estimated net realizable value. On a regular basis, we evaluate our accounts receivable and inventories and establish these reserves based on a multitude of contributing factors. In the case of accounts receivable, we establish the reserve based on a combination of specific customer circumstances as well as the history of write-offs and collections. In the case of inventories, factors we consider in establishing a reserve include economic conditions, product mix, sales levels, customer acceptance of our products and changing product styles. As a result, we established a reserve for doubtful accounts receivable of \$20,199 for the fiscal year ended January 31, 2004, which was written off with its offsetting receivable in the fiscal year ended January 31, 2005, and a reserve for slow moving and obsolete inventories of \$18,000 for the fiscal years ended January 31, 2005 and 2004.

### RESULTS OF OPERATIONS

Comparison of Fiscal Year Ended January 31, 2005 ("Fiscal 2005") with Fiscal Year Ended January 31, 2004 ("Fiscal 2004")

11

**Revenues:** Net sales were \$21,549,755 for Fiscal 2005 compared with \$15,795,309 for Fiscal 2004. The increase of \$5,804,025 was primarily attributable to increased sales of our log home and panelized home construction kits. Approximately 89% of total revenues are represented by home construction kit sales and this portion improved from Fiscal 2004 to Fiscal 2005 through a 24% increase in units shipped and an increase of 7% in the average value of these units shipped. The remaining contributors to our revenues are building material sales, design and engineering services, construction, and freight revenues. Collectively these items increased 84% over Fiscal 2004 revenues, with most of the increase attributable to our newly acquired companies. Our strategy is to continue to add product offerings and to increase our market share through the introduction of new home designs, product and style selections. We anticipate that the majority of our revenues will continue to be produced through the sale of log home and panelized home construction kits.

Over the next year, we expect to continue to grow. We expect our revenues to increase by a similar rate as that of the current year based on the increase in our backlog of undelivered contracts at January 31, 2005 and the continued favorable economic climate for home construction in the United States. We also believe that the contribution of these subsidiaries during the upcoming year will add to the Company's anticipated growth.

**Gross Profit/Cost of Sales.** Our gross margin increased by \$993,652, to \$7,249,306 in Fiscal 2005. Although gross profit increased by 16% in Fiscal 2005 as compared with Fiscal 2004, gross profit as a percentage of sales decreased by 7%, from 40% in Fiscal 2004 to 33% in Fiscal 2005. The decrease in gross profit percentage was primarily the result of higher material costs, which increased as a percent of sales by 7% in Fiscal 2005 as compared with Fiscal 2004. Manufacturing overhead increased by 2%, while design and engineering costs decreased by 2%. Delivery and direct labor costs remained

## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

relatively constant as a percentage of sales.

Beginning in the Fiscal 2004 building season and continuing throughout Fiscal 2005, commodity lumber costs increased substantially. We use fixed price contracts, where we do not have the ability to adjust the selling price of the contracts to rising costs. The selling prices to which we are contractually bound are valid for a period of nine months from the date of the contract signing, and typically we do not raise the selling price of the contract if the shipment takes place within another three months of the expiration of the initial nine month period, regardless of increases in the costs of materials used in those contracts. Manufacturing overhead increased due to increased costs associated with facility and personnel. The design and engineering cost decrease as a percent of sales was due to the increased contribution to total sales of the subsidiaries the Company acquired in Fiscal 2004. Their use of design and engineering is dramatically less than that of the parent company. In Fiscal 2006, we believe that our gross profit percentage will begin to increase. We expect cost increases to occur in the area of building materials, but those increases should be offset by increases to our sales prices. An additional element to improving our gross profit percentage is the increased utilization of our newly-acquired subsidiaries in British Columbia, Canada for the manufacture and distribution of home building kits to customers located in the western portion of the United States.

Operating expenses: Total operating expenses for the year ended January 31, 2005 were \$8,039,610 as compared with \$6,463,628 during the fiscal year ended January 31, 2004, and increase of \$1,575,982, or 24%. As a percentage of net sales, operating expenses were 37% and 41%, respectively, for the fiscal years ended January 31, 2005 and 2004.

12

Sales commissions consist of amounts paid both to our employee sales persons and our independent dealers throughout the United States. For Fiscal 2005 commissions amounted to \$2,181,751, or 10% of net sales, compared with \$1,796,701 in Fiscal 2004, or 11% of net sales. While total commissions expense increased 21% compared to our increase in total net sales of 36%, it does not necessarily follow that commissions will increase at a proportionate rate. Employee sales representatives are compensated at commission rates that are lower than the independent dealers utilized by the Company. Depending on the mix of sales, total commissions can change at a disproportionate rate in relation to the change in net sales. Also, the Company's newly-acquired subsidiaries in British Columbia and Idaho do not have independent dealers and sell most of their home building kits to third parties who in turn sell the product to the end user. This practice results in an elimination of the commission, however, the practice also generates a lower gross profit due to sales on a wholesale basis.

Selling, general and administrative expenses of \$5,857,859 in Fiscal 2005 have increased \$1,190,932, or 26%, when compared to the same expenses in Fiscal 2004 of \$4,666,927. However, as a percentage of total net sales, selling, general and administrative expenses decreased by 2%, to 27% in Fiscal 2005. The primary items that contributed to the increase in expense were an increase in amortization expense, an increase in personnel and related fringe benefits, and increased spending on attendance at national trade show expositions and marketing and promotion costs. Additionally, our newly-acquired subsidiaries added to this category, contributing costs for a full year compared with less than half a year in Fiscal 2004 between the time of acquisition of such subsidiaries and the completion of the fiscal year.

In the coming year, we will continue to attend all national trade shows and to increase our marketing through various media outlets in order to expand our

## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

presence in the marketplace. We will endeavor to recruit new dealers in areas where our presence is less than optimal and we will continue to introduce new products and styles of home building kits. To meet the increased demands placed on our internal administration as a result of our expansion we will continue to increase our employment as necessary. As such we expect our selling, general and administrative costs will increase as we invest in our future.

**Interest expense:** In Fiscal 2005, interest expense was comprised of interest paid on our multi-faceted credit facility and various other credit borrowings of lesser amounts, including on notes payable. In Fiscal 2004, interest expense was comprised of interest paid on the Company's Convertible Subordinated Debentures (which debentures matured on May 15, 2003 and all were converted into common stock of the Company), on our multi-faceted credit facility established in October 2003 and on various other credit borrowings of lesser amounts. We expect the Company's interest expense to increase during the coming fiscal year as we use this credit facility to expand our business and to support our inventory and operational needs.

**Income taxes:** For Fiscal 2005, the Company has not accrued any income tax expense, nor has any benefit been recognized. In Fiscal 2005, the Company will not owe federal income taxes principally due to losses incurred and to differences in depreciation rates used for book and tax purposes.

**Net loss:** Though sales increased for the year, the Company incurred a net loss of \$784,298 for Fiscal 2005. The principal factors that caused the loss were the unrecoverable cost increases relating to fixed price contracts, The

13

losses incurred at the Company's subsidiary in British Columbia stemming from a slow sales year and from reorganizational efforts which were ongoing during Fiscal 2005. We believe, though, that this subsidiary, along with the other subsidiaries acquired during Fiscal 2004 will enhance our core business and improve our ability to grow. In addition, the Company continues to spend on marketing and promotion in order to expand our presence and market share. The increase in sales in Fiscal 2005, as well as the increase in our backlog of undelivered contracts of 28% over the amount at the end of the previous fiscal year, leads us to believe this is a sound strategy. We are expecting increased sales during the upcoming year, and we anticipate the Company will return to profitability in the fiscal year ended January 31, 2006.

### LIQUIDITY AND CAPITAL RESOURCES

Fiscal year 2004 brought significant changes to the Company's financial structure as a result of the acquisition of three businesses and the acquisition of the assets of a fourth business. In August 2003 we acquired two companies affiliated through common ownership, True Craft Log Structures, Ltd. and Hart & Son Industries, Ltd. located in Maple Ridge, British Columbia, Canada; in October 2003 we acquired all of the assets of Adirondack Forest Industries, Inc., a saw mill located in Galway, New York; and in November 2003 we acquired Snake River Log Homes LLC, located in Rigby, Idaho. The intent of these acquisitions is to expand our product offerings, to have manufacturing and distribution capability on the west coast of North America, to increase the Company's market share both domestically and internationally, to acquire the capability to manufacture the wood products that we sell, and to employ the talent of certain individuals who are associated with the acquired companies.

The table below highlights key balances and ratios as the result of this acquisition plan (in \$1,000's of US dollars):

Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

	As of January 31,	
	2005	2004
	-----	-----
Financial Condition:		
Total Assets	\$ 11,490	\$ 11,838
Total Liabilities	\$ 9,801	\$ 9,414
Total Equity	\$ 1,689	\$ 2,424
Debt/equity ratio	2.56	1.85
Assets/debt ratio	2.65	2.64
Working Capital:		
Current Assets	\$ 4,279	\$ 4,262
Current Liabilities	\$ 6,860	\$ 6,067
Current Ratio	.62	.70
Cash Position:		
Cash & cash equivalents	\$ 858	\$ 750
Cash generated (used) from operations	\$ 521	\$ ( 250)

Financial Condition

During the year ended January 31, 2005, the Company had a decrease in assets from \$11,838,070 in Fiscal 2004 to \$11,489,983 in Fiscal 2005. The largest

14

decreases were in the areas of inventory, property, plant and equipment and intangible assets. We also had an increase in total liabilities from \$9,413,982 in Fiscal 2004 to \$9,801,161 in Fiscal 2005, with the largest increase coming from customer deposits.

During Fiscal 2004 we entered into a multi-faceted credit facility with First Pioneer Farm Credit, ACA ("First Pioneer"). The total credit available to the Company is \$3,675,000 of which the Company has utilized \$2,899,000 as of January 31, 2005, as compared with \$2,588,000 as of January 31, 2004. The proceeds from borrowings against the credit facility in Fiscal 2004 were used principally to finance the Company's recent acquisitions. Additional borrowings in Fiscal 2005 were used principally to purchase fixed assets and for working capital.

The credit facility with First Pioneer has four separate components which includes a revolving line of credit intended for the purchase of inventory and other operating needs. The credit facility has various maturity dates ranging from yearly renewal for the line of credit to terms of four to ten year for long-term portions. The interest rate for the majority of the borrowings under the First Pioneer credit facility is at the prime rate as published in the Wall Street Journal, but the interest rate for one million dollars of the credit facility is fixed for a two-year period at a below-prime rate. This portion of the loan is subsidized by the State of New York and is provided as an incentive for the creation of employment in the State of New York.

The Company, in Fiscal 2004, used common stock and seller financing in the form of non-interest bearing long-term notes to finance a portion of the acquisitions. The seller financing was payable over terms of five to seven years with the majority of the notes subject to monthly repayments while a smaller amount is due on an annual basis.

## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

In May 2003, all holders of the Company's Series B and Series C Convertible Subordinated Debentures, a total of \$220,000, converted their holdings into the common stock of the Company at the maturity date of the debentures. The Company issued 1,162,500 shares of common stock pursuant to the conversion of those debentures.

### Working Capital; Sources and Uses of Cash

At January 31, 2005, we had a working capital deficiency of \$2,580,238 as current liabilities exceeded current assets. At January 31, 2004, we had a working capital deficiency of \$1,804,864. At January 31, 2005 our working capital deficiency increased from the previous year by \$775,374. Our balance of cash and cash equivalents increased during Fiscal 2005 primarily due to cash provided by a decrease in inventories and an increase in customer deposits and accrued expenses, as well as an increase in bank borrowings. Cash was used to purchase fixed assets, to decrease trade accounts payable and increase prepaid expenses, and to pay down various notes and bank debt.

We believe that our cash and cash equivalents, together with expected revenues from operations, will be sufficient to meet the Company's anticipated working capital requirements for the fiscal year ended January 31, 2006. We anticipate that as we enter into the building season shipping cycle that we will generate the needed working capital from the undelivered backlog of contracts at January 31, 2005. Also, we have not drawn all of the available funds provided under the First Pioneer credit facility, which is available to us to supplement the funds generated by our operations.

Our backlog of undelivered contracts at January 31, 2005 was approximately \$32,304,000. This is an increase of \$7,084,000 or 28% from the prior year's ending backlog at January 31, 2004. A contract is considered to be part of our

15

backlog when the contract is signed by the customer, is accompanied by a deposit and is countersigned by an officer of the Company. It has been the Company's experience, over the past four years for which such statistics have been kept, that the products for an average of approximately 43% of the undelivered contracts in the backlog at the end of the fiscal year are shipped in the subsequent fiscal year. To the extent this historical standard is used to forecast the Company's performance in the fiscal year ending January 31, 2006, approximately \$13,890,700 of product is anticipated to be delivered with respect to the contracts contained in the beginning backlog at January 31, 2005. The balance of the Company's deliveries during any given fiscal year originate from contracts that are both written and delivered during the same fiscal year. Of the amount of shipments for Fiscal 2005 approximately \$11,105,000 originated from the beginning backlog of \$25,220,000 at January 31, 2004, and approximately \$8,242,000 originated from contracts written during Fiscal 2005, which represented approximately 25% of contracts written during the fiscal year. Fiscal 2006 potential revenues are contingent on various factors including general economic conditions, weather, interest rates and the overall climate for new housing construction.

The table below illustrates the changes in our backlog for the past two fiscal years (in \$1,000's of US dollars):

Fiscal Year Ended	
2005	2004
-----	-----



Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

Beginning backlog		\$ 25,220	\$ 20,088
Add: New contracts	31,575		23,266
Amendments		1,224	710
		-----	-----
Sub-total		58,019	44,064
Less: Shipments	( 19,347)	( 13,842)	
Cancellations	( 6,368)	( 5,002)	
		-----	-----
Ending backlog		\$ 32,304	\$ 25,220
		=====	=====

Each year we experience contract cancellation. The reasons for cancellations are varied and no one particular reason is dominant over the total population of reasons given by our customers. It has been our experience, over the past four years for which such statistics have been kept, for an average of approximately 23% of undelivered contracts contained in the backlog at the end of the fiscal year will cancel in the subsequent fiscal year. Similarly, the Company's records over the past four years for which such statistics have been kept, indicate that an average of 4% of the contracts written during the fiscal year will also be cancelled during that same fiscal year. In the event of cancellation of a contract, the Company does realize a certain amount of revenue for work performed relating to drafting and engineering services. These charges for work performed are calculated in accordance with a Disclosure Letter Addendum that each customer signs, which delineates specific costs for drafting and engineering services. After deduction of the charges for services performed, the balance of the customer's deposit is returned to the customer. During fiscal years 2005 and 2004 we realized revenues of \$144,810 and \$161,237, respectively, from to the aforementioned services.

Contractual Cash Obligations

We have a number of long-term obligations requiring future payments pursuant to debt and lease agreements. The table below is a presentation of all such commitments and agreements.

16

		Payments Due by Period				
Contractual Obligations	Total	Within 1 Year	2 -3 Years	4 -5 Years	After 5 Years	
		-----	-----	-----	-----	-----
Bank Debt:						
Line of Credit	\$ 753,000	\$ 753,000	\$	-0-	\$	-0-
10 Year Term Loan	1,677,160	173,520	347,040	347,040	809,560	
5 Year Term Loan	402,053	92,632	185,264	124,157	-0-	
4 Year Term Loan	66,667	25,000	41,667	-0-	-0-	
Notes Payable:						
In connection with acquisitions:						
Related Parties	316,562	87,344	157,919	71,299	-0-	
Others	1,073,632		265,857	474,950	283,755	49,070
Vehicles		14,262	11,950	2,312	-0-	-0-
Other	-0-	-0-	-0-	-0-	-0-	
Capital Lease Obligations	18,584	15,744	2,840	-0-	-0-	

## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

Operating Leases	564,976	163,353	306,630	94,993	-0-	
Other		7,500	-0-	7,500	-0-	-0-
-----						
Total Contractual Cash Obligations	\$4,894,396	\$1,588,400	\$1,526,122	\$ 921,244	\$ 858,630	
	=====	=====	=====	=====	=====	

All of the contractual obligations shown above have contractual terms whereby the due date of the debt is accelerated upon the occurrence of certain "events of default". These events of default are standard terms and conditions in most business debt agreements, such as nonpayment of the obligation, or allowing a judgment to be levied against the collateralized property that goes un-remedied for more than 30 days. If and when an event of default occurs, and the lender declares that there is an event of default and the default is not corrected within 30 days of such notice (90 days in the case of certain seller financing notes), the obligations and any unpaid interest become due and payable immediately.

The bank debt made available by First Pioneer (the "First Pioneer Credit Facility") is conditioned upon the Company's continued compliance with affirmative, negative, continuing and financial covenants. Examples of the affirmative covenants include compliance with laws; maintaining insurance; maintaining the property; maintaining books and records, and similar items. Examples of the negative covenants include not allowing liens or security interests to be placed against any of our assets; we cannot change fiscal years; we may not enter into other borrowings without the prior consent of the bank, and similar restrictions. The continuing covenants require us to provide First Pioneer with audited financial statements on an annual basis; to provide quarterly operating statements; to file all necessary tax returns annually and provide a copy to the bank, and other similar requirements. The financial covenants require us to meet two financial ratios, debt coverage ratio and current ratio, and to maintain a minimum net worth, on an annual basis. At January 31, 2005, we were required to achieve a fixed charge coverage ratio of not less than 2.0 to 1.0; achieve a current ratio of not less than 1.0 to 1.0; and to maintain a minimum tangible net worth of \$3,606,298. During Fiscal 2005, the Company failed to meet the financial covenants. Failing to meet these

17

financial covenant constitutes an "event of default" under the terms of the First Pioneer Credit Facility. The Company applied for and received a waiver from First Pioneer with regard to these financial covenants for the fiscal year ended January 31, 2005. There were no other events of default with respect to the First Pioneer Credit Facility at January 31, 2005.

We believe that the default with regard to the financial covenants of the First Pioneer Credit Facility occurred due to the aforementioned unrecoverable cost increases and losses at our subsidiary in British Columbia. We believe that our inability to meet the goals set by First Pioneer has not damaged our relationship with them, nor do we believe that it will hinder our ability to obtain future financing for contemplated projects. The Company has discussed these issues during its annual review with First Pioneer, and feels that it will meet the financial covenants that will be in effect for Fiscal 2006.

### Factors That Could Affect Future Results

Certain statements made in this Annual Report on Form 10-KSB are forward-looking statements based on our current expectations, estimates and projections about our business and our industry. These forward-looking statements involve risks and uncertainties. Our business, financial condition and results of operations

## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

could differ materially from those anticipated in these forward-looking statements as a result of certain factors, as more fully described below and elsewhere in this Form 10-KSB. You should carefully consider the risks and uncertainties described below, which are not the only ones facing our Company. Additional risks and uncertainties also may impair our business operations.

These forward-looking statements generally relate to our belief that we will increase the sales of our products to an expanding base of customers; that we will be able to leverage our West Coast manufacturing capability to provide a cost effective solution to shipment of products to customers located in the western United States, and that demand for Swedish-cope style homes will increase, particularly on the East Coast of the United States, that will lead to growth of sales revenues of the Company over the next several years.

We face significant price competition. There are no assurances that competitive pressures will not force us to accept reduced margins to compete in the future. Large companies within the industry with significantly greater resources continue to expand in the marketplace and compete for customers with a strategy that is based on price. While selling price is a distinguishing factor between companies offering log home construction kits, the Company feels that other important factors in a purchase decision are product attributes, service, quality and design.

Our industry is subject to economic fluctuations based on mortgage interest rates. The home construction industry has enjoyed robust sales over the past several years as mortgage interest rates have been at or near historical lows. Should there be an increase in mortgage rates in the future, such an increase may have an effect on the number of prospective purchasers of newly-constructed homes, which, in turn may have an effect on the number of home construction kits that the Company may be able to sell.

We are dependent on the performance of certain third-party individuals and

18

entities. We manufacture a home construction kit to be purchased by individuals who desire to build new construction. The Company does not build the home nor do we provide certain interior amenities such as plumbing, wiring, cabinet, etc., nor do we prepare the building site and install wells or septic systems. Our ability to ship the home construction kit is dependent to a large extent upon the timely performance of third party individuals and entities, such as building permit reviewing agencies and contractors, to complete their portion of the work schedule prior to our shipment of product. Any adverse incident with respect to these third party individuals and entities, such as lack of availability of heavy machinery to excavate a job site, can interfere with our ability to make shipments to our customers, and consequently, our ability to generate additional revenue.

The industry is sensitive to seasons and weather. The home construction industry is seasonal in nature and is sensitive to weather conditions. The building cycle is more active during the months of May to October and less active during the months of November to March. This is particularly true for the Company where a majority of our shipments are made into the northeast region of the United States where winter conditions may arrive earlier than expected and stay later than expected into the spring season. In addition, the initial months of spring can include rain and muddy ground conditions, which are not conducive for new home construction. Weather conditions are unpredictable and can have an adverse affect on our ability to ship product and generate revenue. In light of the effect winter weather conditions have on our first quarter shipments, the Company has routinely experienced a loss in past first quarters of the Company's fiscal year and believes it may experience a similar loss in

## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

the first quarter of fiscal year 2006. The Company is working to address the impact of the winter season on the Company's historical first-quarter financial performance through acquisitions.

### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In July, 2002, Financial Accounting Standard Board ("FASB") issued Statement No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS No. 146"). The standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by the standard include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after January 31, 2003, at which time the Company will adopt SFAS No. 146. The Company does not believe this statement will have a material impact on its financial statements.

In December 2002, FASB issued Statement No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure" ("SFAS No. 148"). The standard amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods for voluntary transition to SFAS No. 123's fair value method of accounting for stock-based employee compensation ("the fair value method"). SFAS No. 148 also requires disclosure of the effects of an entity's accounting policy with respect to stock-based employee compensation on reported net income (loss) and earnings (loss) per share in annual and interim financial statements.

19

The transition provisions of SFAS No. 148 are effective in fiscal years beginning after December 15, 2002. During the fiscal year ended January 31, 2003, we adopted the disclosures practices of SFAS No. 148.

In April 2003, FASB issued Statement of Financial Accounting Standards No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS No. 149"). During the year ended January 31, 2004, we adopted the provisions of SFAS No. 149, and it had no material effect on the results of operations or financial position.

In May 2003, FASB issued Statement of Financial Accounting Standards No. 150, "Accounting For Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("SFAS No. 150"). SFAS No. 150 changes the accounting for certain financial instruments with characteristics of both liabilities and equity that, under previous pronouncements, issuers could account for as equity. The new accounting guidance contained in SFAS No. 150 requires that those instruments be classified as liabilities in the balance sheet. During the year ended January 31, 2004, we adopted the provisions of SFAS No. 150, and it had no material effect on the results of operations or financial position.

In December 2003, the staff of the Securities and Exchange Commission issued Staff Accounting Bulletin No. 104 ("SAB 104"), which updated the guidance in Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements." SAB 104 also integrates the set of related SAB 101 Frequently Asked Questions and recognizes the role of the AICPA's Emerging Issues Task Force ("EITF"), consensus on Issue No. 00-21 "Accounting for Revenue Arrangements with Multiple Deliverables." The EITF concluded that revenue arrangements with multiple elements should be divided into separate units of accounting if the deliverables in the arrangement have value to the customer on a standalone basis, if there is objective and reliable evidence of the fair value of the undelivered elements, and as long as there are no rights of return or additional performance guarantees by the Company. The provisions of EITF

## Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

Issue No. 00-21 are applicable to agreements entered into in fiscal periods commencing after June 15, 2003. SAB 104 directs companies to identify separate units of accounting based on EITF Issue 00-21 before applying the guidance of SAB 104. We believe that neither our operating results nor our financial condition will be materially affected by the provisions of EITF 00-21, nor by the guidance of SAB 104.

In December 2003, FASB issued Financial Interpretation No. 46R ("FIN 46"), "Consolidation of Variable Interest Entities." The objective of this interpretation is to provide guidance on how to identify variable interest entities ("VIE") and determining when the assets, liabilities, non-controlling interests, and results of operations of a VIE need to be included in a company's consolidated financial statements. A company that holds variable interests in an entity will need to consolidate that entity if the company's interest in the VIE is such that the company will absorb a majority of the VIE's expected losses and/or receive a majority of the entity's expected residual returns, if they occur. FIN 46 also requires additional disclosure by primary beneficiaries and other significant variable interest holders. Certain provisions of this interpretation became effective upon issuance. As of January 31, 2004, we did not have any VIE.

20

In November 2004, the FASB issued SFAS No. 151 "Inventory Costs - An Amendment of ARB No. 43, Chapter 4" ("FAS 151"). FAS 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs and spoilage should be expensed as incurred and not included in overhead. Further, FAS 151 requires that allocation of fixed and production facilities overhead to conversion costs should be based on normal capacity of the production facilities. The provisions in FAS 151 are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not believe that the adoption of FAS 151 will have a significant effect on its financial statements.

On December 16, 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised 2004), "Share Based Payment" ("SFAS 123(R)"), which is a revision of SFAS 123. SFAS 123(R) supersedes APB Opinion No. 25 and its interpretations, and amends Statement of Financial Accounting Standards No. 95, "Statement of Cash Flows." SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. SFAS 123(R) is effective for the Company at the beginning of the first interim or annual period beginning after December 15, 2005. The Company intends to adopt SFAS 123(R) beginning with its annual report for the fiscal year ended January 31, 2006. The Company does not expect that the adoption of SFAS 123(R) will have a material effect on its financial statements.

21

ITEM 7. FINANCIAL STATEMENTS

Index to Financial Statements

Page

Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

Reports of Independent Registered Public Accounting Firms	23 & 24
Consolidated balance sheets as of January 31, 2005 and 2004	25 & 26
Consolidated statements of operations for the years ended January 31, 2005 and 2004	27
Consolidated statements of changes in stockholders' equity for the years ended January 31, 2005 and 2004	28
Consolidated statements of cash flows for the years ended January 31, 2005 and 2004	29
Notes to consolidated financial statements January 31, 2005 and 2004	30 - 47

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Lincoln Logs Ltd. and Subsidiaries

We have audited the accompanying consolidated balance sheet of Lincoln Logs Ltd. and Subsidiaries as of January 31, 2005, and the related statements of operations, changes in stockholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Lincoln Logs Ltd. and Subsidiaries as of January 31, 2004, were audited by other auditors whose report dated April 28, 2004, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with the auditing 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lincoln Logs Ltd. and

Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

Subsidiaries as of January 31, 2005, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ UHY LLP

Albany, NY  
April 21, 2005

23

Report of Independent Registered Public Accounting Firm

To the Board of Directors and  
Stockholders of Lincoln Logs Ltd.

We have audited the accompanying consolidated balance sheet of Lincoln Logs Ltd. and subsidiaries as of January 31, 2004, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for the year then ended. These 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 audit.

We conducted our audit in accordance with auditing 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 audit provides 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 Lincoln Logs Ltd. and subsidiaries as of January 31, 2004, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Uhrbach Kahn & Werlin LLP

Albany, New York  
April 28, 2004

24

Edgar Filing: LINCOLN LOGS LTD - Form 10KSB

LINCOLN LOGS LTD. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
JANUARY 31, 2005 and 2004

ASSETS

	2005	2004	
		-----	-----
CURRENT ASSETS:			
Cash and cash equivalents	\$ 857,686	\$ 750,239	
Trade accounts receivable, net of allowance for doubtful accounts of \$20,199 in 2004	363,601	337,166	
Inventories			
Raw materials		1,849,741	2,032,050
Work in process	453,898	477,389	
Prepaid expenses and other current assets	719,203	564,883	
Income taxes receivable		29,686	97,427
Mortgage and note receivable	5,623	2,592	
	-----	-----	
Total current assets	4,279,438	4,261,746	
	-----	-----	
PROPERTY, PLANT AND EQUIPMENT:			
Cost	8,710,133	8,563,343	
Less accumulated depreciation	( 4,382,790)	( 3,983,816)	
	-----	-----	
Property, plant and equipment- net	4,327,343	4,579,527	
	-----	-----	
OTHER ASSETS:			
Mortgage receivable	70,938	60,053	
Deposits and other assets	68,003	70,742	
Goodwill		1,350,020	1,319,970
Intangible assets, net of accumulated amortization of \$282,767 in 2005 and \$97,537 in 2004	1,394,241	1,546,032	
	-----	-----	
Total other assets	2,883,202	2,996,797	
	-----	-----	
TOTAL ASSETS	\$11,489,983	\$11,838,070	
	=====	=====	