

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

**FORM 10-K/A  
(Amendment No. 1)**

[ X ] Annual Report Pursuant to Section 13 or 15(d) of  
the Securities Exchange Act of 1934

For the fiscal year ended

August 29, 2009

OR

Transition Report Pursuant to Section 13 or 15(d) of  
the Securities Exchange Act of 1934  
for the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File number 1-9681

JENNIFER CONVERTIBLES, INC.  
(Exact name of registrant as specified in its charter)

Delaware

\_\_\_\_\_  
(State or other jurisdiction  
of incorporation or organization)

11-2824646

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

417 Crossways Park Drive  
Woodbury, New York 11797

\_\_\_\_\_  
(Address of principal executive office)

Registrant's telephone number, including area code (516) 496-1900

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

<u>Title of class</u>	<u>Name of each exchange on which registered</u>
Common Stock, Par Value \$0.01	NYSE Amex

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

(do not check if smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes

No

The aggregate market value of the registrant's voting and non-voting common stock held by non-affiliates of the registrant (without admitting that any person whose shares are not included in such calculation is an affiliate) computed by reference to the price at which the common stock was last sold, as of the last business day of the registrant's most recently completed second fiscal quarter was \$1,517,257.

The number of shares outstanding of common stock, as of December 11, 2009 was 7,073,466.

#### DOCUMENTS INCORPORATED BY REFERENCE

The following documents (or parts thereof) are incorporated by reference into the following parts of this Form 10-K: Certain information required in Part III of this Annual Report on Form 10-K is incorporated by reference from the registrant's proxy statement relating to its Annual Meeting of Stockholders to be held on February 9, 2010.

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**EXPLANATORY NOTE**

This Amendment No. 1 on Form 10-K/A (this "Amendment") is filed by Jennifer Convertibles, Inc. to amend our Annual Report on Form 10-K for the fiscal year ended August 29, 2009, as originally filed with the Securities and Exchange Commission on December 14, 2009 (the "Form 10-K"). The purpose of this Amendment is to add signatures inadvertently omitted from the Report of Independent Registered Public Accounting Firm in the Financial Statements and the Consent of Independent Registered Public Accounting Firm in Exhibit 23.1 and to correct the following typographical error in Item 1 Business: Reference to Note 3 under the General caption for the Jennifer Operating Segments should have been "Note 4". We have amended and restated Item 1, the Financial Statements and Exhibit 23.1 in their entireties to reflect these changes. No other material changes were made to the Form 10-K.

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## Item 1. Business.

*Unless otherwise set forth herein, when we use the term ‘we’ or any derivation thereof, we mean Jennifer Convertibles Inc., a Delaware corporation, and its direct or indirect subsidiaries.*

### **Business Overview**

Jennifer Convertibles, Inc. was incorporated in 1986 and began operations with a single retail store in Paramus, New Jersey.

Currently, we are the owner and licensor of the largest group of sofabed specialty retail stores and leather specialty retail stores in the United States, with stores located throughout the Eastern seaboard, in the Midwest, on the West Coast and in the Southwest. As of August 29, 2009, our stores included 149 Jennifer Convertibles® stores and 14 Jennifer Leather stores. Of these 163 stores, we owned 142 and licensed 21, including 19 owned and operated by a related private company, “the related company”, and two owned by a third party operated by the related company. There have been recent changes in our arrangements with the related company. (See Items 1A and 7 included in this Annual Report on Form 10-K.) During fiscal 2007, we opened our first full line home furnishings store under a licensing agreement, as Ashley Furniture HomeStore®. As of August 29, 2009, we operate two Ashley Furniture HomeStores.

Our operations are classified into two operating segments organized by product line: Jennifer and Ashley. The Jennifer segment owns and licenses the sofabed specialty retail stores. The Ashley segment is a big box, full line home furniture retail store. These operating segments enable us to more effectively offer diverse home furnishings and accessories and expand our reach to a broader consumer base. For certain financial information regarding our operating segments, see Note 13 to the Consolidated Financial Statements included under Item 8 of this Annual Report and incorporated herein by reference.

### **Operating Segments**

#### **Jennifer**

##### General

Jennifer Convertibles® stores specialize in the retail sale of a complete line of sofabeds. The stores also sell companion pieces such as sofas, loveseats, chairs and ottomans. In most cases they are accessorized with tables, lamps and rugs, which we also sell. Jennifer Leather® stores specialize in the sale of leather living room furniture and offer the same complement of companion pieces and accessories. Our products are manufactured by several manufacturers and range from med-high end to relatively inexpensive models. We are the largest dealer of Sealy® sofabeds as well as the largest dealer of Simmons® sofabeds. In order to generate sales, our licensees and we rely on aggressive pricing, the attractive image of our stores, extensive advertising and prompt delivery.

We believe that the image presented by our stores is an important factor in our overall marketing strategy. Accordingly, stores are designed to display our merchandise in an attractive setting designed to show the merchandise, as it would appear in a customer’s home. All of our stores have a similar clearly defined style, are designed as showrooms for the merchandise and are carpeted, well lit and well maintained. Inventories for delivery are maintained in separate warehouses. We display a variety of sofabeds, sofas and companion pieces at each Jennifer Convertibles and Jennifer Leather retail location with tables and lamps. In contrast to certain of our competitors that primarily target particular segments of the market, we attempt to attract customers covering the broadest socio-economic range of the market and, accordingly, offer a complete line of sofabeds and sofas made by a number of manufacturers in a variety of styles at prices currently ranging from approximately \$299 to \$2,200.

Although each style of sofabed, loveseat, sofa, chair and recliner is generally displayed at Jennifer Convertibles stores in one color and fabric, samples of the other available colors and fabrics or leathers are available on selected merchandise. Up to 500 different colors and fabrics are available for an additional charge. To maximize the use of our real estate and offer customers greater selection and value, we, as is common in the mattress industry, sell various sizes of sofabeds with various sizes of mattresses but display only one size of sofabed at our stores. We display leather furniture in a number of different grades of leathers as well as offer a selection in various high fashion blended leathers and constructions. We generate additional revenue by selling tables and offering related services, such as lifetime fabric protection. The related company provides the lifetime fabric protection services for certain Jennifer segment stores located in New York and New Jersey and an independent outside company provides the lifetime fabric protection services for all other Jennifer segment stores.

The related company operates 21 Jennifer Convertibles stores, 19 of which it owns and two of which it manages. We do not own or collect any royalties from 17 related company owned stores, which are located in New York. However, the related company operates these stores in substantially the same way as we operate our stores. There have been recent changes in our arrangements with the related company. (See Items 1A and 7 included on this Annual Report in Form 10-K.) Fred Love, who passed away in October 2004, co-founded the related company. Mr. Love was one of our principal stockholders and also the brother-in-law of Harley J. Greenfield, our Chairman of the Board, Chief Executive Officer, director and principal stockholder. Jane Love, Mr. Greenfield’s sister, is currently acting as the interim President of the related company. Jonathan Warner has been appointed as the trustee of Mr. Love’s estate. See “Agreements and Transactions with Related Company” (Note 4) and “Certain Relationships and Related Transactions” in our Proxy Statement to be furnished in connection with our Annual Meeting of Stockholders to be held February 9, 2010, which is hereby incorporated by reference.

Merchandise ordered from inventory is generally available to be delivered within two weeks. Customers who place special orders for items, colors or fabrics not in inventory must generally wait four to six weeks for delivery, except for special order merchandise arriving from China, which may take up to 20 weeks. We believe that our ability to offer quick delivery of merchandise represents a competitive advantage.

### Operations

Generally, our stores are open seven days per week. They are typically staffed by a manager, one full-time salesperson and in some cases, one or more part-time salespersons, as dictated by the sales volume and customer traffic of each particular store. In some cases, where sales volume and customer traffic so warrant, stores may be staffed with one to three additional full-time salespersons. Our licensed stores are substantially similar in appearance and operation to our other stores.

Our licensees and we have district managers throughout the United States. The district managers supervise store management and monitor stores within their assigned district to ensure compliance with operating procedures. District managers report to and coordinate operations in their district with our executive management.

An inventory of approximately 85% of the items displayed in the stores, in the colors and fabrics displayed, is usually stocked at our warehouse facilities, which are described below. Our licensees and we typically require a minimum cash, check or credit card deposit of 50% of the purchase price when a sales order is given, with the balance, if any, payable in cash or by bank check, certified or official check, upon delivery of the merchandise. The independent trucker making the delivery collects the balance of the purchase price.

### Marketing

We advertise in newspapers and on television in an attempt to capitalize on our marketplaces. Our approach to advertising requires us to establish a number of stores in each area in which we enter. This concentration of stores enables area-advertising expenses to be spread over a larger revenue base and to increase the prominence of the local advertising program.

We create advertising campaigns for use by our stores, which also may be used by the related company stores. The related company bears a share of advertisement costs in New York. However, we also advertise independently of the related company outside of the New York metropolitan area. We are entitled to reimbursement from most of our licensees, which are responsible for their respective costs of advertising; however, the approach and format of such advertising is usually substantially the same for our licensees and us. We also have the right to approve the content of all licensees advertising. See "Certain Relationships and Related Transactions" in our Proxy Statement to be furnished in connection with our Annual Meeting of Stockholders to be held February 9, 2010, which is hereby incorporated by reference.

In order to further understand our markets, we carefully monitor our sales and obtain other information reflecting trends in the furniture industry and changes in customer preferences. We also review industry publications, attend trade shows and maintain close contact with our suppliers to aid in identifying trends and changes in the industry.

### Leasing Strategy and Current Locations

Obtaining attractive, high-traffic store locations is critical to the success of our stores. We also select sites and negotiate leases on behalf of the related company. The site selection process involves numerous steps, beginning with the identification of territories capable of sustaining a number of stores sufficient to enable such stores to enjoy significant economies of scale, particularly in advertising, management and distribution. Significant factors in choosing a territory include market demographics and the availability of newspapers and other advertising media to efficiently provide an advertising umbrella in the new territory.

Once a territory is selected, we choose the specific locations within such territory. Although a real estate broker typically screens sites within a territory and engages in preliminary lease negotiations, we are responsible for selection of each location. The leased locations are generally in close proximity to heavily populated areas, shopping malls, and other competing retail operations that are on or near major highways or major thoroughfares, are easily accessible by car or other forms of transportation and provide convenient parking.

The locations currently leased by our licensees and us generally range in size from approximately 2,000 square feet to 13,000 square feet. We anticipate that stores opened in the future will range from approximately 2,000 square feet to 4,000 square feet. Stores may be freestanding or part of a strip shopping center.

In fiscal 2009, we closed seven stores. We closed one store as of October 31, 2009 and anticipate closing 3 to 7 additional stores during fiscal 2010. We do not anticipate opening any additional Jennifer Convertibles® or Jennifer Leather stores during fiscal 2010. We plan to open additional stores when attractive opportunities present themselves and we will selectively close stores where economics so dictate.

#### Sources of Supply

We currently purchase merchandise for our stores, and the stores of our licensees and the related company, from a variety of domestic manufacturers generally on 30 to 75 day terms. We also purchase from an overseas manufacturer on 150-day terms. Our purchasing power combined with the purchasing power of our licensees and of the related company enables us to receive the right, in some instances, to exclusively market certain products, fabrics and styles. See "Certain Relationships and Related Transactions" in our Proxy Statement to be furnished in connection with our Annual Meeting of Stockholders to be held February 9, 2010, which is hereby incorporated by reference.

Our principal suppliers are Caye Upholstery LLC ("Caye"), a Chinese supplier, Ashley Furniture Industries and Klaussner Furniture Industries, Inc. ("Klaussner"). Klaussner manufactures sofas under the Sealy® brand name.

On July 11, 2005, we entered into a Credit Agreement, as amended (the "Credit Agreement") and a Security Agreement with Caye. Under the amended Credit Agreement, Caye agreed to make available to us a credit facility of up to \$13,500,000, effectively extending Caye's payment terms for merchandise shipped to us from 75 days to 105 days after receipt of goods. On July 10, 2009, we entered into a letter agreement with Caye pursuant to which we agreed to pay down our debt to Caye by approximately \$400,000 in exchange for Caye releasing their security interest in all of our assets and terminating all obligations under the Credit Agreement. In exchange for this release, Caye has provided us with approximately \$500,000 of trade credit in place of the credit facility of \$13,500,000. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a more detailed description of these transactions.

During January 2009, we began to transition from Caye to a Chinese supplier. The Chinese company which currently manufactures approximately 95% of what we historically ordered through Caye, provided a letter agreement in November 2008 to the effect that if Caye stops supplying us prior to November 12, 2009, it will supply us goods under an arrangement substantially the same as the prior arrangement with Caye except that under the agreement with the Chinese company the amount payable by us can not exceed \$10,000,000. On April 13, 2009, the Chinese supplier and we amended and restated the terms of the letter agreement to provide, that effective August 1, 2009, we have up to 150 days to pay for the goods without interest or penalty. The amended and restated letter agreement terminates on September 30, 2010, provided that the parties have an understanding that they will review certain terms on October 31, 2009. As of the current date, after review of the terms, the Chinese supplier continues to supply us goods under the terms of the amended and restated letter agreement. On December 10, 2009, the Chinese supplier further amended the terms of the letter agreement extending the terms from 150 days to 180 days. Any amounts due that are not paid within the additional 30 day grace period, will be charged interest at a per annum rate of 2% until payment is made. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a more detailed description of these transactions.

In December 1997, Klaussner purchased \$5,000,000 of our convertible preferred stock. During May 2006, Klaussner voluntarily converted 3,510 shares of Series A Preferred Stock into 500,000 shares of the Company's common stock. The remaining 6,490 shares of Series A Preferred Stock are convertible into 924,500 shares of the Company's common stock. In fiscal 2009, Klaussner gave us certain vendor credits for repairs. See "Certain Relationships and Related Transactions" in our Proxy Statement to be furnished in connection with our Annual Meeting of Stockholders to be held February 9, 2010, which is hereby incorporated by reference and "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a more detailed description of these transactions, Klaussner's \$5,000,000 investment and other transactions with Klaussner.

#### Warehousing and Related Services

Our warehousing and distribution facilities consist of warehouses in North Carolina, New Jersey and California. We also maintain satellite warehouses in California, Florida, Georgia, Massachusetts, Washington D.C., Michigan and Illinois. These warehouse facilities service both our stores and related company's stores.

#### Competition

We compete with other furniture specialty stores, major department stores, individual furniture stores and regional furniture chains, some of which have been established for a long time in the same geographic areas as our stores (or areas where we or our licensees may open stores). We believe that the principal areas of competition with respect to our business are store image, price, delivery time, selection and service. We believe that we compete effectively with such retailers because our stores offer a broader assortment of convertible sofas and leather upholstery than most of our competitors and, as a result of volume purchasing, we are able to offer our merchandise at attractive prices.

## Ashley

### General

During fiscal 2007, we opened our first Ashley Furniture HomeStore®. We opened our second store during fiscal 2008. The aim of the Ashley Furniture HomeStore® is to make beautiful home furnishings affordable. Our showrooms feature one of the most complete home furnishing lines available, including furniture and accessories for the living/family room, bedroom, dining room (both casual and formal), home theater and home office. Our Carle Place, NY location has an Ashley Sleep Center, which offers a complete line of Sealy mattresses at exceptional prices. We also generate additional revenue by selling fabric protection services to our Ashley store customers, which are provided by an unaffiliated company.

### Operations

Our Ashley stores are open seven days per week. A manager, full-time salespersons, part-time salespersons and cashiers staff them.

By selling only furniture that is made by Ashley Furniture Industries, (“Ashley Furniture”) or Ashley Furniture approved vendors, the largest home furnishings manufacturer in the United States and the #1 selling brand in North America, we are able to deliver quality and value everyday. Due to the large quantity of furniture produced by Ashley Furniture, we do not take custom orders. However, we do have a wide variety of styles in our dynamic product line.

The merchandise displayed at the store, in the colors and fabrics displayed, is not stocked at our warehouse facility, which is described below. Merchandise is ordered from Ashley Furniture at point of sale. We typically require 100% of the purchase price when the sales order is written.

### Marketing

We advertise in newspapers and on television in an attempt to capitalize on our marketplace. In addition, we participate in a co-op advertising program with Ashley Furniture. In order to further understand our market, we carefully monitor our sales and obtain other information reflecting trends in the furniture industry and changes in customer preferences. We also review industry publications, attend trade shows and maintain close contact with our supplier to aid in identifying trends and changes in the industry.

We can be located on the worldwide web at [www.ashleyhomestores.com](http://www.ashleyhomestores.com). The website is designed to showcase a wide variety of the Ashley Furniture dynamic product line, provide customers decorating tips and a room planner.

### Leasing Strategy and Current Locations

Obtaining attractive, high-traffic store locations is critical to the success of our Ashley stores. Although a real estate broker typically screens sites and engages in preliminary lease negotiations, we are responsible for selection of each location. The leased locations are generally in close proximity to heavily populated areas, shopping malls, and other competing retail operations that are on or near major highways or major thoroughfares, are easily accessible by car or other forms of transportation and provide convenient parking.

As of December 11, 2009, we opened two additional stores and executed a lease agreement to open an additional store in Brooklyn, New York. We will continue to open additional stores when attractive opportunities present themselves.

### Sources of Supply

Under a Trademark Usage Agreement, more fully described below, Ashley Furniture is the exclusive supplier of product, except for accessories and mattresses. The Ashley Furniture team includes a full time design group that is dedicated to creating furniture styles that will complement any decorating style for any room. Ashley Furniture production teams then carefully build each piece, ensuring quality construction and workmanship, in one of six manufacturing facilities in the United States. The furniture is then carefully shipped to Ashley Furniture HomeStore® locations using its own transportation fleet.

### Licensing Arrangements

On October 27, 2006, our wholly-owned subsidiary, Hartsdale Convertibles, Inc. (“Hartsdale”), entered into the Ashley Homestores, Ltd. Trademark Usage Agreement (the “Trademark Usage Agreement”) with Ashley Homestores, Ltd. (“Ashley”), pursuant to which Hartsdale was granted a 5-year nonexclusive, limited sublicense to use the image, technique, design, concept, trademarks and business methods developed by Ashley for the retail sale of Ashley products and accessories. During the 5-year term of the agreement, Hartsdale will use its best efforts to solicit sales of Ashley products and accessories at the authorized location, and in consultation with Ashley, develop annual sales goals and marketing objectives reasonably designed to assure maximum sales and market penetration of the Ashley products and accessories in the licensed territory. We have guaranteed the obligations of Hartsdale under the Trademark Usage Agreement.

### Warehousing and Related Services

We contracted with an independent trucking company that provided warehouse and distribution services through March 28, 2009. The warehouse was located in Syosset, New York. As of April 2009, the warehouse operations were relocated to our New Jersey warehouse location, which also services the Jennifer segment. An independent trucking company provides distribution services.

### Competition

We believe that the principal areas of competition with respect to our business are store image, price, delivery time, selection and service. We further believe that we effectively compete on the basis of each of these factors, particularly in selection by providing our consumers with complete home furnishing lines, including furniture and accessories. In addition, because the Ashley Furniture Industries team controls all processes from design to delivery, we are able to reduce our costs and pass these savings on to our customers with exclusive Ashley Furniture HomeStore® pricing and merchandise.

### **Trademarks**

The trademarks, Jennifer Convertibles®, Jennifer Leather®, Jennifer House®, With a Jennifer Sofabed, There’s Always a Place to Stay®, Jenni-Pedic®, Elegant Living®, Jennifer’s Worryfree Guarantee®, Jennifer Living Rooms®, Bellissimo Collection®, and Jennifer Sofas®, are registered with the U.S. Patent and Trademark Office and are owned by us. The related company, as licensee, was granted a perpetual royalty-free license to use and sublicense these proprietary marks (other than the ones related to Jennifer Leather) in the State of New York, subject to certain exceptions, including six stores currently owned by us and operating in New York and 11 more which the related company agreed we may open on a royalty-free basis. Pursuant to the Settlement Agreement, we now have the right to open an unlimited number of stores in New York for a royalty of \$400,000 per year, provided however, that on November 18, 2004, the Management Agreement and License pursuant to which we are required to make such royalty payments to the related company was amended such that the related company agreed to waive its rights to receive from us such annual royalty payment during the period commencing January 1, 2005 through April 30, 2005, the date on which court approval was granted. See “Certain Relationships and Related Transactions” in our Proxy Statement to be furnished in connection with our Annual Meeting of Stockholders to be held February 9, 2010, which is hereby incorporated by reference.

### **Employees**

As of August 29, 2009, we employed 448 people, including five executive officers. We have 357 employees in our Jennifer segment, 46 employees in our Ashley segment and 45 corporate employees. We train personnel to meet our expansion needs by having our most effective managers and salespersons train others and evaluate their progress and potential for us. We believe that our employee relations are satisfactory. None of our employees are represented by a collective bargaining unit.

### **Available Information**

We make available, free of charge via our website, all Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and other information filed with, or furnished to, the Securities and Exchange Commission (the “SEC” or the “Commission”), including amendments to such reports. This information is available at [www.investors.jenniferfurniture.com](http://www.investors.jenniferfurniture.com) as soon as reasonably practicable after it is electronically filed with, or furnished to, the SEC. In addition, the SEC maintains a website that contains reports, proxy and information statements, and other information regarding companies that file electronically with the Commission. This information is available at [www.sec.gov](http://www.sec.gov).

**JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

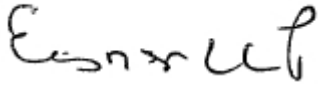
To the Board of Directors and Shareholders of  
Jennifer Convertibles, Inc.  
Woodbury, New York

We have audited the accompanying consolidated balance sheets of Jennifer Convertibles, Inc. and subsidiaries (the "Company") as of August 29, 2009 and August 30, 2008, and the related consolidated statements of operations, shareholders' equity (deficiency) and cash flows for each of the three years in the period ended August 29, 2009. Our audits also included the financial statement schedule listed in the Index at Item 15 (a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule 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. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits include consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Jennifer Convertibles, Inc. and subsidiaries as of August 29, 2009 and August 30, 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended August 29, 2009, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As described in Note 4, the Company has significant transactions with a related company.



New York, New York  
December 11, 2009

**JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES**

**Consolidated Balance Sheets**  
(In thousands, except for share data)

	<u>August 29, 2009</u>	<u>August 30, 2008</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 5,609	\$ 9,057
Restricted cash	99	1,116
Accounts receivable	1,816	779
Merchandise inventories, net	9,076	10,646
Due from Related Company, net of allowance for loss of \$947 at August 29, 2009	3,147	4,063
Prepaid expenses and other current assets	1,214	1,508
Total current assets	20,961	27,169
Marketable auction rate securities	—	1,400
Store fixtures, equipment and leasehold improvements, at cost, net	2,355	3,202
Goodwill	483	1,650
Other assets (primarily security deposits)	670	691
	\$ 24,469	\$ 34,112
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIENCY)</b>		
Current liabilities:		
Accounts payable, trade (including \$1,255 and \$892 to a stockholder)	\$ 14,317	\$ 12,932
Customer deposits	4,976	6,493
Accrued expenses and other current liabilities	6,001	3,892
Due to Related Company	400	400
Deferred rent and allowances - current portion	589	634
Total current liabilities	26,283	24,351
Deferred rent and allowances, net of current portion	2,360	2,905
Obligations under capital leases, net of current portion	96	139
Total liabilities	28,739	27,395
Commitments and contingencies (Notes 14 and 15)		
Stockholders' Equity (Deficiency):		
Preferred stock, par value \$.01 per share		
Authorized 1,000,000 shares		
Series A Convertible Preferred - issued and outstanding 6,490 shares at August 29, 2009 and August 30, 2008 (liquidation preference \$3,245)	—	—
Series B Convertible Preferred - issued and outstanding 47,989 shares at August 29, 2009 and August 30, 2008 (liquidation preference \$240)	1	1
Common stock, par value \$.01 per share		
Authorized 12,000,000 shares; issued and outstanding 7,073,466 shares at August 29, 2009 and August 30, 2008	70	70
Additional paid-in capital	29,647	29,626
Accumulated deficit	(33,988)	(22,980)
	(4,270)	6,717
	\$ 24,469	\$ 34,112

See Notes to Consolidated Financial Statements.

**JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES**

**Consolidated Statements of Operations**  
(In thousands, except for share and per share data)

	Year ended August 29, 2009 (52 weeks)	Year ended August 30, 2008 (53 weeks)	Year ended August 25, 2007 (52 weeks)
<b>Revenue:</b>			
Net sales	\$ 88,845	\$ 113,073	\$ 124,125
Revenue from service contracts	5,332	7,058	8,558
	<u>94,177</u>	<u>120,131</u>	<u>132,683</u>
Cost of sales, including store occupancy, warehousing, delivery and service costs	67,006	84,838	91,156
Selling, general and administrative expenses	33,432	37,777	37,174
Impairment of goodwill	1,167	—	—
Provision for loss related to litigation	1,300	—	—
Provision for loss on amounts due from Related Company	947	—	—
Depreciation and amortization	1,151	1,005	901
	<u>105,003</u>	<u>123,620</u>	<u>129,231</u>
(Loss) income from operations	(10,826)	(3,489)	3,452
Interest income	89	521	736
Interest expense	(19)	(16)	(14)
(Loss) income from continuing operations before income taxes	(10,756)	(2,984)	4,174
Income tax expense	9	10	124
(Loss) income from continuing operations	(10,765)	(2,994)	4,050
Loss from discontinued operations (including loss on store closings of \$116 and \$84 for 2009 and 2008, respectively)	<u>(243)</u>	<u>(335)</u>	<u>(79)</u>
<b>Net (loss) income</b>	<u><u>\$ (11,008)</u></u>	<u><u>\$ (3,329)</u></u>	<u><u>\$ 3,971</u></u>
<b>Basic (loss) income per common share:</b>			
(Loss) income from continuing operations	\$ (1.52)	\$ (0.43)	\$ 0.52
Loss from discontinued operations	(0.03)	(0.04)	(0.01)
Net (loss) income	<u><u>\$ (1.55)</u></u>	<u><u>\$ (0.47)</u></u>	<u><u>\$ 0.51</u></u>
<b>Diluted (loss) income per common share:</b>			
(Loss) income from continuing operations	\$ (1.52)	\$ (0.43)	\$ 0.46
Loss from discontinued operations	(0.03)	(0.04)	(0.01)
Net (loss) income	<u><u>\$ (1.55)</u></u>	<u><u>\$ (0.47)</u></u>	<u><u>\$ 0.45</u></u>
Weighted average common shares outstanding	7,073,466	7,073,466	6,910,523
Weighted average common shares issuable on conversion of outstanding Series A participating preferred stock	<u>—</u>	<u>—</u>	<u>924,500</u>
Total weighted average common shares basic	7,073,466	7,073,466	7,835,023
Effect of potential common share issuance:			
Stock options	—	—	847,359
Warrants	—	—	81,635
Series B convertible preferred stock	<u>—</u>	<u>—</u>	<u>54,265</u>
Weighted average common shares diluted	<u><u>7,073,466</u></u>	<u><u>7,073,466</u></u>	<u><u>8,818,282</u></u>

See Notes to Consolidated Financial Statements.

**JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES**

**Consolidated Statements of Stockholders' Equity (Deficiency)  
Years Ended August 29, 2009, August 30, 2008 and August 25, 2007  
(In thousands, except for share data)**

	Preferred stock		Preferred stock		Common stock		Additional paid-in capital	Accumulated (deficit)	Totals
	Series A		Series B						
	Shares	Par Value	Shares	Par Value	Shares	Par Value			
Balances at August 26, 2006	6,490	—	88,880	1	6,787,936	68	29,112	(23,622)	5,559
Conversion of Series B preferred stock			(40,891)	—	28,523	—			—
Dividends paid on Series B preferred stock							(48)		(48)
Other distributions in connection with conversion of Series B preferred stock							(5)		(5)
Exercise of stock options					257,007	2	525		527
Non cash compensation to consultant							21		21
Net income								3,971	3,971
Balances at August 25, 2007	6,490	\$ —	47,989	\$ 1	7,073,466	\$ 70	\$ 29,605	\$ (19,651)	\$ 10,025
Non cash compensation to consultant							21		21
Net loss								(3,329)	(3,329)
Balances at August 30, 2008	6,490	\$ —	47,989	\$ 1	7,073,466	\$ 70	\$ 29,626	\$ (22,980)	\$ 6,717
Non cash compensation to consultant							21		21
Net loss								(11,008)	(11,008)
Balances at August 29, 2009	6,490	\$ —	47,989	\$ 1	7,073,466	\$ 70	\$ 29,647	\$ (33,988)	\$ (4,270)

See Notes to Consolidated Financial Statements.

**JENNIFER CONVERTIBLES INC. AND SUBSIDIARIES**

**Consolidated Statements of Cash Flows**  
**(In thousands)**

	Year ended August 29, 2009 (52 weeks)	Year ended August 30, 2008 (53 weeks)	Year ended August 25, 2007 (52 weeks)
<b>Cash flows from operating activities:</b>			
Net (loss) income	\$ (11,008)	\$ (3,329)	\$ 3,971
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities of continuing operations:			
Depreciation and amortization	1,151	1,005	901
Impairment of goodwill	1,167	—	—
Provision for loss on amounts due from Related Company	947		
Non cash compensation to consultant	21	21	21
Loss from discontinued operations	243	335	79
(Gain) loss on disposal of property	(12)	58	10
Interest earned on annuity contract	—	—	(16)
Deferred rent	(578)	(93)	119
<b>Changes in operating assets and liabilities</b>			
Merchandise inventories, net	1,501	3,476	(846)
Prepaid expenses and other current assets	294	(272)	(76)
Accounts receivable	(1,038)	20	40
Due from Related Company, net	(31)	621	86
Other assets, net	14	3	(6)
Accounts payable, trade	1,385	(6,786)	880
Customer deposits	(1,456)	136	(451)
Accrued expenses and other current liabilities	2,135	(317)	(190)
<b>Net cash (used in) provided by operating activities of continuing operations</b>	<b><u>(5,265)</u></b>	<b><u>(5,122)</u></b>	<b><u>4,522</u></b>
<b>Cash flows from investing activities:</b>			
Capital expenditures	(306)	(828)	(1,635)
Sale of marketable auction rate securities	1,400	6,900	—
Purchase of marketable auction rate securities	—	—	(3,300)
Proceeds from redemption of annuity contract	—	—	951
Restricted cash	1,017	(40)	(213)
<b>Net cash provided by (used in) investing activities of continuing operations</b>	<b><u>2,111</u></b>	<b><u>6,032</u></b>	<b><u>(4,197)</u></b>
<b>Cash flows from financing activities:</b>			
Principal payments under capital lease obligations	(41)	(33)	(24)
Proceeds from exercise of stock options	—	—	527
Dividends on Series B preferred stock	—	—	(48)
Other distributions in connection with conversion of Series B preferred stock	—	—	(5)
<b>Net cash (used in) provided by financing activities of continuing operations</b>	<b><u>(41)</u></b>	<b><u>(33)</u></b>	<b><u>450</u></b>
<b>Net (decrease) increase in cash and cash equivalents from continuing operations</b>	<b>(3,195)</b>	<b>877</b>	<b>775</b>
<b>Net decrease in cash and cash equivalents from operating activities of discontinued operations</b>	<b>(253)</b>	<b>(188)</b>	<b>(41)</b>
<b>Net decrease in cash and cash equivalents from investing activities of discontinued operations</b>	<b>—</b>	<b>(7)</b>	<b>—</b>
<b>Cash and cash equivalents at beginning of year</b>	<b><u>9,057</u></b>	<b><u>8,375</u></b>	<b><u>7,641</u></b>
<b>Cash and cash equivalents at end of year</b>	<b><u>\$ 5,609</u></b>	<b><u>\$ 9,057</u></b>	<b><u>\$ 8,375</u></b>
<b>Supplemental disclosure of cash flow information:</b>			
Income taxes paid	<u>\$ 23</u>	<u>\$ 462</u>	<u>\$ 374</u>
Interest paid	<u>\$ 19</u>	<u>\$ 16</u>	<u>\$ 14</u>
Obligations under capital leases for equipment and leasehold improvements	<u>\$ —</u>	<u>\$ 68</u>	<u>\$ —</u>

See Notes to Consolidated Financial Statements.



## JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements August 29, 2009, August 30, 2008 and August 25, 2007 (In thousands, except for share and per share amounts)

#### (1) BUSINESS

Jennifer Convertibles, Inc. and subsidiaries (the "Company") owns and is the licensor of specialty retail stores that sell a complete line of sofa beds, as well as sofas and companion pieces, such as loveseats, chairs and recliners, and specialty retail stores that sell leather living room furniture. Such stores are in the United States and are located throughout the Eastern Seaboard, in the Midwest, on the West Coast and in the Southwest. As of August 29, 2009 and August 30, 2008, respectively, 142 and 149 Company-owned stores operated under the Jennifer Convertibles and Jennifer Leather names. On May 26, 2007, the Company opened its first Ashley Furniture Homestore and opened its second store on May 7, 2008. Subsequent to year-end two additional Ashley stores were opened. Ashley stores are located in New York and sell home furnishings, consisting of Ashley Homestores, Ltd. products and accessories.

During fiscal 2009, the Company closed seven stores of which the operating results of three have been reflected as discontinued operations in the accompanying financial statements. During fiscal 2008, the Company combined one store with another and closed ten stores of which the operating results of six have been reflected as discontinued operations in the accompanying financial statements. During fiscal 2007, the Company opened one store and closed eight stores of which the operating results of two have been reflected as discontinued operations in the accompanying financial statements. The operations of four stores closed in each of fiscal 2009 and 2008 and six stores closed during fiscal 2007 have not been reported as discontinued operations as the Company anticipates that such stores will continue to generate revenues from customers of stores located in the same territory as the closed stores.

As more fully discussed in Note 4, the Company and a related company (the "Related Company") have had numerous transactions with each other. Due to the numerous transactions with the Related Company, the results of operations of the Company are not necessarily indicative of what they would be if all transactions were with independent parties.

#### (2) LIQUIDITY

The Company has incurred a net loss and has used cash in its operating activities for the years ended August 29, 2009 and August 30, 2008. In addition, the Company has both working capital and stockholders' deficiencies as of August 29, 2009. Further, during fiscal 2009, a finance company to which the Company sold receivables on a non-recourse basis terminated its agreement with the Company, credit card processors began holding back certain payments due to the Company for credit purchases by customers (see Note 6) and the Related Company failed to make timely payments to the Company by the required due dates. As of December 11, 2009, \$1,347 of the \$4,094 due from the Related Company as of August 29, 2009, has not been paid and is past due and the Company has provided an allowance for loss with respect thereto at August 29, 2009, as management does not anticipate that \$947 of such amount, net of an offset for \$400 due to the Related Company, will be collected. In addition, subsequent thereto through November 27, 2009, the Company will provide for additional losses with respect to amounts due from the Related Company arising from transactions during such period (see Note 4). These events impact the Company's liquidity. The Company has implemented cost cutting programs, including store closings, termination of personnel, salary reductions for certain executive officers and renegotiations of lease agreements. Additionally, the credit agreement with Caye, the Company's then principal supplier was terminated in July 2009, and, in connection therewith, Caye released its security interest in the Company's assets. Further, the Company and a Chinese supplier who replaced Caye, amended and restated the terms of their letter agreement to provide the Company up to 180 days to pay for goods without interest or penalty effective August 1, 2009 through September 30, 2010. Based on the current level of store operations and available cash, and after giving effect to cost cutting programs that have been implemented and the extended credit terms received from its Chinese supplier, management anticipates that the Company will have sufficient available cash to operate for at least the next 12 months.

Further deterioration of the current economy could have a material adverse effect on the Company's liquidity and results of operations. In the event that current economic conditions deteriorate further, or continue beyond the next 12 months, with a resultant continued adverse effect on the Company's revenue, the Company may require additional debt or equity financing to continue operations. The Company has engaged an investment-banking firm to assist it with raising additional capital, but there can be no assurance that such efforts will be successful.

## JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements August 29, 2009, August 30, 2008 and August 25, 2007 (In thousands, except for share and per share amounts)

#### (3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### **Principles of consolidation:**

The consolidated financial statements include the accounts of Jennifer Convertibles, Inc. and its wholly owned subsidiaries. Intercompany balances and transactions have been eliminated in consolidation. The 2008 and 2007 results of operations and cash flows have been restated from amounts previously reported to reflect operations of stores closed in 2009 as discontinued operations.

##### **Fiscal year:**

The Company has adopted a fiscal year ending on the last Saturday in August, which would be either 52 or 53 weeks long.

##### **Use of estimates:**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 reporting period. Actual results could differ from those estimates.

##### **Segment information:**

Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosure about Segments of an Enterprise and Related Information", requires publicly held companies to report financial and other information about key revenue-producing segments of the entity for which such information is available and is utilized by the chief operating decision maker in deciding how to allocate resources and in assessing performance. SFAS No. 131 permits operating segments to be aggregated if they have similar economic characteristics, products, types of customers and methods of distribution. Accordingly, the Company's specialty furniture stores ("Jennifer") are considered to be one reportable operating segment and the Ashley stores – big box, full line home furniture retail stores are another reportable segment.

##### **Cash and cash equivalents:**

The Company considers all short-term, highly liquid instruments with a maturity of three months or less when purchased to be cash equivalents.

##### **Restricted Cash:**

Pursuant to a credit agreement with Caye Home Furnishings, LLC and its affiliates ("Caye") as more fully described in Note 8 the Company was required to maintain deposit accounts of no less than \$1 million. The deposit account in the amount of \$1 million is classified as restricted cash at August 30, 2008. During July 2009, the deposit account became unrestricted and available for operating purposes.

##### **Marketable Securities:**

The Company determines the appropriate classification of its investments in marketable securities at the time of purchase and reevaluates such designation at each balance sheet date. The Company's marketable securities have been classified and accounted for as available-for-sale. Available-for-sale securities are recorded at fair value with unrealized gains and losses reported, net of related income taxes, in accumulated other comprehensive income (loss) as a separate component of stockholders' equity (deficiency) until realized. As of August 29, 2009, the Company did not hold any marketable securities. Unrealized gains and losses were nominal as of August 30, 2008.

JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
August 29, 2009, August 30, 2008 and August 25, 2007  
(In thousands, except for share and per share amounts)

**Merchandise inventories:**

Merchandise inventories are stated at the lower of cost (determined on the first-in, first-out method) or market and are physically located as follows:

	August 29, 2009	August 30, 2008
Showrooms	\$ 5,068	\$ 5,681
Warehouses	4,008	4,965
	<u>\$ 9,076</u>	<u>\$ 10,646</u>

**Store fixtures, equipment and leasehold improvements:**

Store fixtures and equipment are carried at cost less accumulated depreciation, which is computed using the straight-line method over the estimated useful lives or, when applicable, the life of the lease, whichever is shorter. Betterments and major remodeling costs are capitalized. Leasehold improvements are capitalized and amortized over the shorter of their estimated useful lives or the terms of the respective leases.

**Annuity contract:**

The Company was the owner and beneficiary of an annuity contract purchased as an investment in November 2003 for \$1,065. The annuity contract was carried at contract value which is equivalent to the amount invested in the contract plus accumulated earnings, less redemptions and an insurance charge on the life of the annuitant who is an officer of the Company. Withdrawals under the contract could have been made at any time and were payable to the Company. During fiscal 2007 the annuity contract was liquidated.

**Goodwill:**

Goodwill consists of the excess of cost of the Company's investments in certain subsidiaries over the fair value of net assets acquired. The Company reviews goodwill for impairment annually during the fourth quarter of each year, and also between annual tests upon the occurrence of trigger events. The reviews are performed at the reporting unit level. Generally fair value represents discounted projected future cash flows. Impairment is indicated when the carrying value of a reporting unit including goodwill exceeds its fair value. If impairment exists, the fair value of a reporting unit is subsequently measured against the fair value of its underlying assets and liabilities, excluding goodwill, to estimate an implied fair value of the reporting unit's goodwill. Impairment loss is recognized for any excess of the carrying value of the reporting unit's goodwill over the implied fair value.

During the fiscal years ended in 2008 and 2007, the Company performed the required annual impairment tests for goodwill and determined that there was no impairment. During the fourth quarter of fiscal 2009 the annual impairment test resulted in a charge of \$1,167 for the impairment of goodwill related to stores in the Chicago and Florida areas. The impairment resulted from a substantial decline in operating performance from these stores and their failure to meet projected 2009 results. Additionally, the Company has forecast a further decline in the future operating performance of these stores.

**Income taxes:**

Deferred tax assets and liabilities are determined based on the estimated future tax effects of net operating loss carryforwards and temporary differences between the financial statement and tax bases of assets and liabilities, as measured by the current enacted tax rates. Deferred tax expense (benefit) is the result of changes in the deferred tax assets and liabilities.

**JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**  
**August 29, 2009, August 30, 2008 and August 25, 2007**  
**(In thousands, except for share and per share amounts)**

**Deferred lease and other intangible costs:**

Deferred lease costs, consisting primarily of lease commissions and payments made to assume existing leases, are deferred and amortized over the term of the lease.

**Deferred rent and allowances:**

Rent expense charged to operations differs from rent paid pursuant to certain of the Company's leases, because of the effect of free rent periods and work allowances granted by the landlord. Rent expense is calculated by allocating total rental payments, including those attributable to scheduled rent increases reduced by work allowances granted, on a straight-line basis, over the respective lease term. Accordingly, the Company has recorded deferred rent and allowances of \$2,949 and \$3,539 at August 29, 2009 and August 30, 2008, respectively.

**Revenue recognition:**

Sales and delivery fees paid by customers are recognized as revenue upon delivery of the merchandise to the customer. Sales are made on a non-financed basis. Through February 2009, sales were also made on a financed basis (see Note 6). For the Jennifer stores, a minimum deposit of 50% is typically required upon placing a non-financed sales order with the balance payable upon delivery. For non-financed sales, the Ashley stores typically require payment of 100% of the purchase price when the sales order is written.

A subsidiary of the Related Company assumes all performance obligations and risks of any loss under the lifetime protection plans for certain Jennifer stores in New York and New Jersey. An independent outside company assumes all performance obligations and risks of any loss under the protection plans for all other Jennifer stores and the Ashley stores. Accordingly, the Company recognizes revenue from the sale of service contracts related to the plans at the time of sale to the customer. As of November 29, 2009, the Company transitioned all of its stores to the independent outside company and no longer sells fabric protection to be serviced by the Related Company.

The Company is entitled to royalty income from two stores owned by the Related Company and one store owned by an unconsolidated licensee that is managed by the Related Company. Royalty income from the three stores amounted to \$102, \$143 and \$177 for the years ended August 29, 2009, August 30, 2008 and August 25, 2007, respectively. Such amounts are included in net sales in the consolidated statements of operations.

Warehousing and management fee income from the Related Company is recognized when earned.

**Advertising:**

The Company advertises in newspapers and on television. Advertising costs are expensed as incurred and are included in selling, general and administrative expenses. Advertising expense from continuing operations for the years ended August 29, 2009, August 30, 2008 and August 25, 2007 aggregated \$11,150, \$13,354, and \$12,576, respectively, net of amounts charged to the Related Company and unconsolidated licensees (see Note 4).

**Selling, general and administrative expenses:**

Included in selling, general and administrative expenses in the consolidated statement of operations are the following: compensation expense, advertising expense, professional fees, board of director fees, utilities, insurance premiums, claims and deductibles, travel and entertainment, showroom and store supplies, repairs and maintenance, finance fees, and transactions with the Related Company as more fully described in Note 4.

**Shipping and handling costs:**

Shipping and handling costs are included in cost of sales. Delivery fees paid by customers are included in revenue.

JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
August 29, 2009, August 30, 2008 and August 25, 2007  
(In thousands, except for share and per share amounts)

**Pre-opening costs:**

Costs incurred in connection with the opening of stores are expensed as incurred.

**Warranties:**

Estimated warranty costs are expensed in the same period that sales are recognized.

**Concentration of risks:**

The receivable from the Related Company as of August 29, 2009 and August 30, 2008, represents current charges aggregating \$4,094 and \$4,063, respectively, principally for merchandise transfers, warehousing services and advertising costs, which are payable within 85 days of the end of the month in which the transactions originate. At any given time, the Related Company owes the Company approximately \$4 million for the services and goods that were provided. See Note 4.

The Company purchased inventory from three suppliers under normal or extended trade terms amounting to 40% (Caye), 33% (Chinese supplier) and 16% (Ashley) of inventory purchases during fiscal 2009. The Company purchased inventory from three suppliers amounting to 69% (Caye), 16% (Ashley) and 12% (Klaussner) of inventory purchases during fiscal 2008 and two suppliers amounting to 71% (Caye) and 14% (Klaussner) of inventory purchases during fiscal 2007.

The Company utilizes many local banks as depositories for cash receipts received at its showrooms. Such funds are transferred daily to a concentration account maintained at one commercial bank. As of August 29, 2009 and August 30, 2008, amounts at risk and on deposit with three banks totaled 88% and 96%, of total cash and cash equivalents, respectively.

**Stock options:**

Pursuant to the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment", (SFAS 123 (R)), the Company measures the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award, usually the vesting period. There were no stock options granted or unvested stock options outstanding to employees during fiscal 2009, 2008 and 2007 and accordingly, there was no employee compensation expense related to stock options or other stock based awards during such years.

**Per share data:**

Basic net loss per common share for fiscal 2009 and 2008 is computed by dividing the net loss increased by cumulative preferred stock dividends on the Series B preferred stock of \$17 by the weighted average number of shares of common stock outstanding during the year. Potentially dilutive shares in fiscal 2009 and 2008, which aggregated 3,176,215 and 3,476,215 common shares, respectively, related to the conversion of Series A and Series B preferred stock and the exercise of stock options and warrants, were excluded from the diluted loss per share calculation because their effects would have been anti-dilutive. Basic net income per common share for fiscal 2007 is computed by dividing net income reduced by cumulative preferred stock dividends and other distributions on the Series B preferred stock of \$32 by the weighted average number of shares of common stock outstanding during the year plus weighted average common shares issuable upon conversion of the Series A participating preferred stock. Diluted net income per common share for fiscal 2007 is computed similar to basic net income per common share except that it reflects the potential dilution that could occur if dilutive options and warrants were exercised, using the treasury stock method, and assumes that the Series B preferred stock was converted into common stock.

## JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements August 29, 2009, August 30, 2008 and August 25, 2007 (In thousands, except for share and per share amounts)

#### **Fair value of financial instruments:**

The carrying amount of the investment in marketable securities approximates fair value. The carrying amount of accounts receivable, accounts payable and customer deposits approximates fair value due to their short-term nature.

#### **Recently issued accounting standards:**

In September 2006, the Financial Accounting Standards Board, "FASB", issued SFAS No. 157, "Fair Value Measurements" that defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands the disclosures about fair value measurement. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Effective August 31, 2008, the Company adopted SFAS No. 157. The adoption had no impact on the 2009 financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, which allows the Company to choose to measure selected financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. SFAS No. 159 became effective for the Company on August 31, 2008 and had no effect on the Company's 2009 financial statements, as the Company did not elect to apply the provisions of SFAS No. 159.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations", and SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements." Effective for fiscal years beginning after December 15, 2008, these statements revise and converge internationally the accounting for business combinations and the reporting of noncontrolling interests in consolidated financial statements. The adoption of these statements will change the Company's accounting treatment for any business combinations on a prospective basis.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities - An Amendment of FASB Statement No. 133. SFAS No. 161 requires enhanced qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company does not anticipate that the statement upon adoption in fiscal 2010 will have a material impact since the Company has not historically engaged in hedging activities or acquired derivative instruments.

In May 2009, the FASB issued SFAS No. 165 "Subsequent Events" which establishes accounting guidelines for subsequent events which sets forth (1) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (2) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, (3) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date and (4) requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. SFAS 165 is effective for interim or annual financial periods ending after June 15, 2009. The Company adopted SFAS 165 effective August 29, 2009 and has evaluated subsequent events through December 11, 2009, the date the financial statements were available to be issued.

In June 2009, the FASB issued SFAS No. 166 "Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140". SFAS 166 improves the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. SFAS 166 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. The Company is evaluating the impact, if any, the adoption of SFAS 166 will have on its financial statements.

## JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements August 29, 2009, August 30, 2008 and August 25, 2007 (In thousands, except for share and per share amounts)

In June 2009, the FASB issued SFAS No. 167 “Amendments to FASB Interpretation No. 46(R)”. SFAS 167 improves financial reporting by enterprises involved with variable interest entities and addresses, among other matters, constituent concerns about the application of certain key provisions of Interpretation 46(R), including those in which the accounting and disclosures under the Interpretation do not always provide timely and useful information about an enterprise’s involvement in a variable interest entity. SFAS 167 is effective as of the beginning of each reporting entity’s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. The Company does not anticipate the adoption of SFAS 167 will have any effect on its financial statements.

In June 2009, the FASB issued SFAS No. 168 “The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162”. The FASB Accounting Standards Codification (“Codification”) will be the single source of authoritative nongovernmental U.S. generally accepted accounting principles. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. SFAS 168 is effective for interim and annual periods ending after September 15, 2009. All existing accounting standards are superseded as described in SFAS 168. All other accounting literature not included in the Codification is nonauthoritative. The Company’s accounting policies will not be affected by the conversion to the Codification; however, references to specific accounting standards in the footnotes to the Company’s financial statements may be changed to refer to the appropriate section of the Codification.

#### (4) AGREEMENTS AND TRANSACTIONS WITH RELATED COMPANY

The consolidated financial statements do not include the results of operations of 21 stores licensed by the Company, 19 of which are owned and operated by a company (the “Related Company”), which is owned by the estate of a deceased stockholder of the Company who also was the brother-in-law of the Company’s Chairman of the Board and Chief Executive Officer “(CEO)”. The sister of the Company’s CEO is currently acting as the interim president of the Related Company. Seventeen of the 19 stores are located in New York and are on a royalty-free basis. Until November 1994, the Related Company was owned by three of the officers/directors/principal stockholders of the Company. In November 1994, the Related Company redeemed the stock in the Related Company of two of the principal stockholders (Harley Greenfield and Edward Seidner) for notes in the amount of \$10,273 which are due in 2023 and are collateralized by the assets of the Related Company and a pledge of the remaining stockholder’s stock in the Related Company to secure his personal guarantee of the notes. As of August 29, 2009, the remaining principal amount of the notes is \$8,355 and the personal guarantee of the remaining stockholder was released.

Pursuant to a Warehousing Agreement, the Company is obligated to provide warehouse services to the Related Company. Through April 30, 2010, the Company will receive a warehousing fee of 2.5% on the net sales price of goods sold by the Related Company up to \$27,640 of net delivered sales and 5% on net delivered sales over \$27,640. After April 30, 2010, the Company will receive a warehousing fee of 7.5% of all net delivered sales by the Related Company. On November 24, 2008, the Company entered into a fifth amendment to the Warehousing Agreement with the Related Company which provides that effective January 2009, the warehousing fee will be raised from 2.5% to 7.5% of all net delivered sales for a one-year period. In addition, during the full term of the agreement, the Company will receive a fee based on fabric protection sold and warranty services performed by the Related Company. For the fiscal years ended in 2009, 2008 and 2007, respectively, charges (included in net sales) to the Related Company for warehousing fees amounted to \$1,121, \$640 and \$933, based on net delivered sales and \$476, \$644 and \$829, based on sales of fabric protection and warranty services.

Pursuant to a Purchasing Agreement, the Company purchases merchandise for the Company and the Related Company. The Related Company has 85 days after the end of the month in which the transactions originate to pay the amounts due. The Purchasing Agreement provides the Company with the ability to terminate upon written notice of any material breach of the agreement, which is not cured within thirty days. On November 18, 2009, the Company received notice from the Related Company that it would be in default of its obligations with respect to a scheduled payment and such payment was not made within the related grace period. Consequently, on November 25, 2009, the Company terminated the Purchasing Agreement. On December 11, 2009, the Company entered into an agreement effective as of November 27, 2009, pursuant to which sales made on or after November 27, 2009 at the stores owned by the Related Company will be made on the Company’s behalf and the Related Company will be entitled to compensation equal to 35% of the sales price of the merchandise (excluding home delivery fees and taxes) for making such sales. With respect to sales made by the Related Company prior to November 27, 2009, the Related Company is obligated to pay the Company for the cost of the merchandise the day prior to the date the merchandise is shipped to the customer. The Related Company is obligated to continue paying for its operational costs, including the costs of its employees at its stores and its store lease costs, and to remit sales taxes on merchandise sold by it. The agreement is terminable by the Company upon 24 hours notice.

## JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements August 29, 2009, August 30, 2008 and August 25, 2007 (In thousands, except for share and per share amounts)

The Company has previously granted the Related Company a perpetual, royalty-free license to use and to sublicense and franchise the use of trademarks in the State of New York. The license is exclusive in such territory, subject to certain exceptions. Under a Management Agreement and License, the Company is responsible for managing the sales of the Related Company's stores so that the stores will be substantially the same as the Company's own stores, provided the Related Company is not obligated to spend more than \$25 per store or \$100 in any 12-month period on maintenance and improvements to its stores. If during any annual period the Related Company's net delivered sales exceed \$27,640 but do not surpass \$29,640, then the Related Company will pay to the Company an amount equal to ten percent (10%) of such excess and if the Related Company's net delivered sales exceed \$29,640, the Related Company must pay to the Company 48% of any excess over \$29,640. On October 13, 2006, the Management Agreement and License was amended to eliminate any future or prior shortfall payments that may be due from the Related Company.

The Company also has the right to open an unlimited number of stores in New York in exchange for a royalty to the Related Company of \$400 per year, which was paid to the Related Company for each of the fiscal years ended in 2009, 2008 and 2007.

Because the Company may negatively impact the Related Company's sales by opening additional stores within the State of New York, the Company has agreed to pay the Related Company 10% of the amount by which their net delivered sales for any 12-month period are below \$27,640, provided that if such net delivered sales fall below \$26,000, the Company will pay the Related Company 15% of such shortfall amount. However, such amounts together with amounts the Company may pay for advertising if the Related Company's net delivered sales drop below \$27,640 as described below, shall not, in the aggregate exceed \$2,700 in any 12-month period. On November 18, 2004, the Management Agreement and License pursuant to which the Company is required to make such payments to the Related Company was amended such that the Related Company agreed to waive its rights to receive the payments described above during the period commencing January 1, 2005 through August 31, 2007. On October 13, 2006, the Management Agreement and License was further amended to eliminate any future or prior shortfall payments that may be due to the Related Company.

The Related Company has the right to close stores and, if it does, the Company has the right to purchase them for the cost of the related inventory (estimated at approximately \$50 on average) and, subject to obtaining any necessary landlord's consent, continue the operations of the stores for the Company's own account.

The Related Company is to contribute \$126 per month to advertising, provided that such amount is to be reduced by the lesser of \$80 or 1% of the Company's sales in New York (other than sales of leather furniture and sales from six stores in New York which the Company has owned for many years). On November 24, 2008, the Company entered into a fifth amendment to the Management Agreement and License, pursuant to which the Related Company also agreed, for a one year period commencing in January 2009, to increase its advertising contribution from \$126 per month to \$150 per month and to eliminate the reductions to the Related Company's share of the advertising costs tied to the shortfalls in the Related Company's net delivered sales. In addition, subject to certain exceptions, if the Related Company's sales are less than \$27,640 in any 12-month period, the Company will pay the Related Company (or reduce the advertising payment the Related Company owes the Company by) an amount equal to 50% of the amount by which its sales are below such amount provided that such payment plus any payments of the 10-15% with respect to sales shortfalls as described above, will not exceed \$2,700 (in any 12-month period) in the aggregate. On November 18, 2004, the Management Agreement and License pursuant to which the Company is required to make such payments to the Related Company was amended such that the Related Company has agreed to waive its rights to receive the payments described above during the period commencing January 1, 2005 through August 31, 2007. On October 13, 2006, the Management Agreement and License was further amended to eliminate any future or prior shortfall payments that may be due to the Related Company. For the fiscal years ended in 2009, 2008 and 2007, contributions from the Related Company for advertising, which reduced selling, general and administrative expenses from continuing operations, amounted to \$1,883, \$1,509 and \$1,509, respectively.

## JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements August 29, 2009, August 30, 2008 and August 25, 2007 (In thousands, except for share and per share amounts)

The Management Agreement and License expires in 2049 and may be terminated prior to such date by an arbitrator for material breach. The Management Agreement also terminates upon purchase by the Company of the Related Company's stores pursuant to the Option Agreement described below. If terminated for a reason other than a purchase, the Company would be unable to sell furniture other than leather furniture in New York, except in certain counties and, accordingly, would have to either sell the Company's Jennifer Convertibles stores to the Related Company, close them or convert them to Jennifer Leather stores. In addition, in case of such termination, the Company would have to make up certain shortfalls, if any, in the Related Company sales in cash or by delivery of stores in New York meeting certain sales volume requirements.

Pursuant to an Option Agreement, the Company has received the option to purchase the assets relating to the Related Company's stores for a period of 10 years beginning on July 6, 2011 at a purchase price starting at \$8,125, and decreasing over the term of the option, plus the assumption of approximately \$5,000 principal amount of notes due to each of Messers. Greenfield and Seidner, and declining over the term of the option. As of August 29, 2009, the principal balance on the notes due is an aggregate of approximately \$8,355.

A monitoring committee has been set up to review, on an on-going basis, the relationships between the Related Company and the Company in order to avoid potential conflicts of interest between the parties. The monitoring committee will remain in effect through April 30, 2010.

Effective June 23, 2002, the Company amended the warehousing agreement with the Related Company whereby the Related Company became the sole obligor on all lifetime fabric and leather protection plans sold by the Company or the Related Company on and after such date through August 30, 2008 and assumed all performance obligations and risk of loss there under. In addition, the Related Company also assumed responsibility to service and pay any claims related to sales made by the Company or the Related Company prior to June 23, 2002. On August 18, 2008, the Company entered into a fourth amendment to the warehousing agreement extending the terms effective August 30, 2008 through August 29, 2009. On September 4, 2009, the Company entered into a sixth amendment to the warehousing agreement further extending the terms effective August 30, 2009 through August 28, 2010. The Company has no obligation with respect to such plans. The Related Company is entitled to receive a monthly payment of \$50, payable by the Company 85 days after the end of the month, subject to an adjustment based on the volume of annual sales of the plans. The Company retains any remaining revenue from the sales of the plans. During fiscal 2009, the Company transitioned to an independent outside company, which assumes all performance obligations and risks of any loss under the protection plans for all Jennifer segment stores, except for certain stores located in New York and New Jersey. As a result thereof and the decrease in sales, the Company suspended the monthly payment of \$50 during March 2009 through August 2009. Payments to the Related Company amounted to \$250, \$400 and \$550 for the fiscal years ended in 2009, 2008 and 2007 respectively. Effective as of November 29, 2009, the Company transitioned all of its stores to the independent outside company and no longer sells fabric protection to be serviced by the Related Company. If the Related Company were no longer able to provide the services previously contracted for, the Company would, as a matter of customer relations, likely have to pay for and arrange to supply services with respect to such previously sold fabric protection services.

#### **Transactions with the Related Company:**

The Company purchases merchandise for itself, its wholly owned subsidiaries, unconsolidated licensees and the Related Company. During the fiscal years ended in 2009, 2008 and 2007, approximately \$8,683, \$11,531 and \$14,200, respectively, of inventory at cost was purchased by the Related Company and the unconsolidated licensees through the Company. These transactions are not reflected in the consolidated statements of operations of the Company and do not impact the Company's earnings. The Company receives the benefit of any vendor discounts and allowances in respect of merchandise purchased by the Company on behalf of its subsidiaries and certain other licensees. The Related Company receives the benefit of any discounts refunded or credited by suppliers in respect of merchandise purchased by the Related Company through the Company. Except for "special orders" representing goods with fabric specially ordered by a customer of a Related Company store, which are transferred to the Related Company when the merchandise is received by the Company at its warehouse, the Company maintains title to inventory purchased on behalf of the Related Company until the Related Company sells it. The Company is solely responsible for payment to the merchandise vendors.

**JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES**

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During the year ended August 29, 2009, the Related Company failed to make payment in full of the amount due by the required due date in five instances. The shortfalls were paid off in full within the permitted grace periods no later than 22 days after the original due date. Any amounts due from the Related Company, that are not paid when due bears interest at the rate of 9% per annum until paid. In November 2009, the Related Company defaulted on its payment obligation by not paying the remaining outstanding balance of the receivable due to the Company as of August 29, 2009 within the 30 day grace period. As a result thereof, the Company provided an allowance for loss of \$947 as of August 29, 2009, representing the unpaid balance of the receivable from the Related Company as of such date after giving effect to payments received through December 11, 2009, and an offset for \$400 payable to the Related Company. In addition, in the quarter ended November 28, 2009, the Company will provide an allowance for loss of approximately \$3,000 related to increases in the receivable from the Related Company principally resulting from transfers of inventory and charges for warehousing services and advertising costs in the quarter then ended. Further, effective as of November 27, 2009, the Company has discontinued granting credit to the Related Company and as collectibility is not reasonably assured, discontinued recognizing warehousing fee revenue and advertising expense reimbursement from the Related Company.

Included in the consolidated statements of operations are the following amounts charged by and to the Related Company:

	Increase (Decrease)		
	Year Ended		
	August 29, 2009	August 30, 2008	August 25, 2007
<b>Net sales:</b>			
Royalty income	\$ 102	\$ 143	\$ 177
Warehouse fees	1,597	1,284	1,762
Delivery charges	2,633	3,557	4,169
<b>Total charged to the Related Company</b>	<b>\$ 4,332</b>	<b>\$ 4,984</b>	<b>\$ 6,108</b>
<b>Revenue from service contracts:</b>			
Fabric protection fees charged by the Related Company	\$ (250)	\$ (400)	\$ (550)
<b>Selling, general and administrative expenses:</b>			
Administrative fees paid by the Related Company	\$ (110)	\$ (112)	\$ (110)
Advertising reimbursement paid by the Related Company	(1,883)	(1,509)	(1,509)
Royalty expense paid to the Related Company	400	400	400
<b>Net charged to the Related Company</b>	<b>\$ (1,593)</b>	<b>\$ (1,221)</b>	<b>\$ (1,219)</b>

As of December 11, 2009, the Company is negotiating with the Related Company with respect to modification or termination of its remaining agreements.

The Company has no equity interest in the Related Company.

**JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES**

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**(5) AUCTION RATE SECURITIES**

The auction rate securities (“ARS”) held by the Company were marketable securities with maturities ranging from 12 to 39 years for which the interest rates were reset through a Dutch auction every 28 days. The auctions had historically provided a liquid market for these securities as investors historically could readily sell their investments at auction. During the year ended August 30, 2008, the Company sold \$5,350 of auction rate municipal bonds and \$1,550 of auction market preferred stock at face value; however, as a result of liquidity issues experienced in global credit and capital markets, the remaining ARS held by the Company had experienced multiple failed auctions, beginning in February 2008, as the amount of securities submitted for sale has exceeded the amount of purchase orders.

Of the \$1,400 ARS held by the Company on August 30, 2008, \$800 were auction rate municipal bonds collateralized by student loans, which were insured and guaranteed by the United States Federal Department of Education. The balance of ARS consisted of auction market preferred stock issued by closed end mutual funds with a par value of \$600, of which \$550 was invested in a fund whose underlying investments consisted primarily of a diversified portfolio of preferred securities issued by companies in the banking, utilities, and insurance industries. Such fund was required to maintain asset coverage of at least 200% with respect to the auction market preferred stock. Substantially all of the Company’s ARS carried AAA ratings and had not experienced any payment defaults. Further, ARS that did not successfully auction reset to maximum interest rates as prescribed in the underlying indenture or prospectus.

Based on the Company’s assessment of the credit quality of the underlying collateral and credit support available to the securities in which the Company was invested, the Company believed no impairment had occurred at August 30, 2008, as the Company had the ability and the intent to hold these investments long enough to avoid realizing any significant loss.

As of August 30, 2008, the \$1,400 of ARS were classified in non-current assets due to the fact that they were not trading at such date and conditions in the general debt markets created uncertainty as to when successful auctions would be reestablished.

On November 21, 2008, pursuant to an offer to purchase dated September 30, 2008, the Company sold \$1,350 of ARS to Morgan Stanley & Co. Incorporated, the Company’s broker, at face value. During January 2009, under a settlement agreement, the Company transferred and sold \$50 of the ARS to Citi Smith Barney, the Company’s former broker, at face value.

**(6) ACCOUNTS RECEIVABLE**

Accounts receivable in the accompanying balance sheets represent amounts due from credit card processors and a finance company. Credit card processors pay the Company shortly after credit card purchases by customers and before merchandise is delivered. However, credit card companies have indicated to the Company that in light of current economic and credit conditions they are reexamining their payment policies. In this connection, in November 2008, the Company was notified by a credit card company that the credit card processor will, through December 17, 2008, hold back a minimum of \$500 as a reserve against delivery by the Company of merchandise ordered by its credit card customers. During December 2008, the parties executed an agreement, which increased the amount of the holdback to \$800, extended processing services through June 2009 and modified certain other terms and conditions. As of December 11, 2009, the agreement has not been extended, however, the credit card processor is continuing to provide services to the Company. As of August 29, 2009, the credit card company has held back approximately \$800, which is included in accounts receivable.

Prior to March 2009, the Company financed sales and sold financed receivables on a non-recourse basis to an independent finance company. The Company did not retain any interests in or service the sold receivables. The selling price of the receivables was dependent upon the payment terms with the customer and resulted in either a payment to or receipt from the finance company of a percentage of the receivable as a fee. Proceeds received from the sale of the receivables amounted to \$10,901, \$22,323 and \$21,176, for the fiscal years ended in 2009, 2008 and 2007, respectively.

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During January 2009, the finance company terminated its dealer agreement with the Company effective March 8, 2009. On February 6, 2009, the parties executed a termination addendum pursuant to which the finance company may maintain a reserve equal to any pending disputes or claims. As of August 29, 2009, the finance company has reserved \$31, which is included in accounts receivable.

Net fees paid to the credit card and finance companies, which amounted to \$1,315, \$1,410 and \$1,597, for the fiscal years ended in 2009, 2008 and 2007, respectively, are included in selling, general and administrative expenses from continuing operations.

**(7) STORE FIXTURES, EQUIPMENT AND LEASEHOLD IMPROVEMENTS**

Store fixtures, equipment and leasehold improvements consist of the following:

	Year Ended		Estimated Useful Lives (in Years)
	August 29, 2009	August 30, 2008	
Store fixtures and furniture	\$ 5,458	\$ 5,642	5 to 10
Leasehold improvements	10,089	10,144	1 to 15
Computer equipment and software	1,961	1,947	3 to 10
Equipment under capital leases	247	247	5 to 10
	<u>17,755</u>	<u>17,980</u>	
Less: accumulated depreciation and amortization	<u>(15,400)</u>	<u>(14,778)</u>	
	<u>\$ 2,355</u>	<u>\$ 3,202</u>	

**(8) TRANSACTIONS WITH CAYE AND CHINESE SUPPLIER**

In July 2005, the Company entered into a Credit Agreement (“Agreement”) with Caye Home Furnishings, LLC and its affiliates (“Caye”) who is also a vendor of the Company. Under the Agreement, as amended, the Company was able to draw down up to \$13.5 million for the purchase from Caye of merchandise subject to a formula based on eligible accounts receivable, inventory and cash in deposit accounts. The borrowings under the Agreement were due 105 days from the date goods were received by the Company and bore interest for the period between 75 and 105 days at prime plus .75%. If the borrowings were not repaid after 105 days the interest rate increased to prime plus 2.75%. The credit facility, which provided for certain financial covenants, was collateralized by a security interest in all of the Company’s assets, excluding restricted cash and required the Company to maintain deposit accounts of no less than \$1 million.

On July 10, 2009, the Company and Caye entered into a letter agreement pursuant to which the Company agreed to pay down its debt to Caye by approximately \$400 in exchange for Caye releasing their security interest in all of the Company’s assets and terminating all obligations under the Agreement. In addition, the amount required to be maintained in deposit accounts of no less than \$1 million (which is classified as restricted cash on the accompanying consolidated balance sheet at August 30, 2008) became unrestricted and available for operating purposes. In exchange for this release, Caye has provided the Company with approximately \$500 of trade credit. Neither the Company nor Caye incurred any termination costs or penalties as a result of the termination of the Credit Facility.

Approximately 40%, 69% and 71% of the Company’s purchases of merchandise were from Caye during fiscal 2009, 2008 and 2007, respectively. As of August 29, 2009 and August 30, 2008, the Company owed Caye approximately \$582 and \$9,050, respectively. Such amounts are included in accounts payable, trade on the respective accompanying consolidated balance sheets.

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During January 2009, the Company began to transition from Caye to a Chinese supplier. The Chinese company which currently manufactures approximately 95% of what the Company historically ordered through Caye, provided a letter agreement in November 2008 to the effect that if Caye stopped supplying the Company prior to November 12, 2009, it would supply the Company goods without interest and penalty and provide 75 days to pay for those goods and an additional 30 days grace period on amounts over 75 days at a per annum rate of 0.75% over prime, provided that in no event will the amount payable by the Company exceed \$10 million. On April 13, 2009, the Company and the Chinese supplier amended and restated the terms of the letter agreement to provide, that effective August 1, 2009, the Company has up to 150 days to pay for the goods without interest or penalty. The amended and restated letter agreement terminates on September 30, 2010, provided that the parties have an understanding that they will review certain terms on October 31, 2009. After review of the terms, the Chinese supplier has continued to supply the Company goods under the terms of the amended and restated letter agreement. On December 10, 2009, the Chinese supplier further amended the terms of the letter agreement extending the terms from 150 days to 180 days. Any amounts due that are not paid within the additional 30 day grace period, will be charged interest at a per annum rate of 2% until payment is made. Amounts payable to the Chinese supplier for purchases are denominated in U.S. dollars. Approximately 33% of the Company's purchases of merchandise were from the Chinese supplier during fiscal 2009. As of August 29, 2009, the Company owed the Chinese supplier approximately \$8,426, which is included in accounts payable, trade on the accompanying consolidated balance sheet.

(9) INCOME TAXES

Components of income tax expense (benefit) applicable to continuing operations are as follows:

	Year Ended		
	August 29, 2009	August 30, 2008	August 25, 2007
Current:			
Federal	\$ —	\$ (4) (a)	\$ 59
State	9	14	65
	<u>\$ 9</u>	<u>\$ 10</u>	<u>\$ 124</u>

(a) Represents an over accrual of federal alternative minimum taxes at August 25, 2007.

Expected income tax expense (benefit) applicable to continuing operations based on the statutory rate is reconciled with actual income tax expense as follows:

	Year Ended		
	August 29, 2009	August 30, 2008	August 25, 2007
“Expected” tax expense (benefit)	(34.0)%	(34.0)%	34.0%
Increase (reduction) in taxes resulting from:			
State and local income tax, net of federal income tax effect	0.1%	0.3%	1.0%
Non-deductible items	0.1%	0.5%	0.5%
Other	0.0%	0.0%	0.4%
Utilization of net operating loss carryforwards	0.0%	0.0%	(32.9)%
Increase in valuation allowance	33.9%	33.7%	0.0%
Actual tax expense	<u>0.1%</u>	<u>0.5%</u>	<u>3.0%</u>

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The principal components of deferred tax assets, liabilities and the valuation allowance are as follows:

	Year Ended	
	August 29, 2009	August 30, 2008
<b>Deferred tax assets:</b>		
Net operating loss carryforward	\$ 6,533	\$ 3,399
Alternative minimum tax credit carryforward	140	142
Allowance for loss on receivable from Related Company	365	—
Liability related to litigation	501	—
Deferred rent expense	1,135	1,362
Goodwill (tax deductible)	35	—
Excess of tax over book basis of leasehold improvements and store fixtures and equipment	2,197	2,196
Inventory capitalization	263	258
Deferred lease costs and other intangibles	53	81
Other expenses for financial reporting, not yet deductible for taxes	103	79
Total deferred tax assets, before valuation allowance	11,325	7,517
Less: valuation allowance	(11,237)	(7,097)
Total deferred tax assets	88	420
<b>Deferred tax liabilities:</b>		
Excess of book over tax basis of store fixtures and equipment	88	46
Goodwill (tax deductible)	—	374
Net deferred tax assets	\$ —	\$ —

As of August 29, 2009, the Company has a net operating loss carryforward of \$16,970, which expires in years 2023 through 2029.

A valuation allowance has been established to offset the deferred tax asset to the extent the Company has not determined that it is more likely than not that the future tax benefits will be realized. During the years ended August 29, 2009 and August 30, 2008, the valuation allowance increased by \$4,140 and \$1,125, respectively resulting principally from net operating losses incurred by the Company during such years. During the year ended August 25, 2007, the valuation allowance decreased by \$1,292 due principally to utilization of net operating loss carryforwards.

Effective August 26, 2007, the Company adopted FASB Interpretation No. 48 “Accounting for Uncertainty in Income Taxes (an Interpretation of FASB Statement No. 109)” (“FIN 48”). This interpretation was issued in July 2006 to clarify the uncertainty in income taxes recognized in the financial statements by prescribing a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. As required by FIN 48, the Company applied the “more-likely-than-not” recognition threshold to all tax provisions, commencing at the adoption date, which resulted in no unrecognized tax benefits as of such date. Additionally, there have been no unrecognized tax benefits subsequent to adoption. Accordingly, the adoption of FIN 48 had no effect on the Company’s financial statements. Pursuant to FIN 48, the Company has opted to classify interest and penalties that would accrue according to the provisions of relevant tax law as selling, general, and administrative expense, in the consolidated statement of operations.

The Company files income tax returns in the U.S. federal jurisdiction and various states. For federal and state income tax purposes, the 2006 through 2009 tax years remain open for examination by the tax authorities under the normal three-year statute of limitations. For state tax purposes, the 2005 through 2009 tax years remain open for examination by the tax authorities under a four-year statute of limitations.

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(10) WARRANT

On March 30, 2005, in connection with the settlement of the derivative litigation (see Note 14 – Consulting agreement), as additional compensation for consulting services, the Company issued to a consultant a warrant to purchase 150,000 shares of common stock, at an exercise price of \$2.37 per share. The warrant expires ten years from the date of issuance and vests as follows: 50,000 shares upon issuance, 50,000 shares on the first anniversary thereof, and 50,000 shares on the second anniversary thereof. The warrant will become fully vested if the closing price of the Company’s common stock exceeds \$7.00 per share for five consecutive trading days. On October 30, 2006, the warrant became fully vested since the Company’s common stock exceeded \$7.00 for five consecutive days. The fair value of the warrant on the date of issuance was approximately \$146 utilizing the Black-Scholes option-pricing model which value is being amortized over the five year term of the consulting agreement.

(11) STOCK OPTION PLANS

At the Company’s annual meeting of stockholders, which was held on February 6, 2007, the 2006 Equity Incentive Plan (the “2006 Plan”) was adopted allowing the Company, under the direction of its Compensation and Option Committee, to make grants of stock options, and restricted and unrestricted stock awards to employees, consultants and directors of the Company. The 2006 Plan also authorizes the grant of other types of stock-based compensation including, but not limited to stock appreciation rights, phantom stock awards, and stock units in which shares of the Company’s common stock are not issued until the performance or vesting period is satisfied. The 2006 Plan allows for the issuance of up to 600,000 shares of the Company’s common stock, 300,000 of which were previously authorized but will not be issued under a 2003 Stock Option Plan. The adoption of the 2006 Plan terminates the 2003 Stock Option Plan and all outstanding options under the 2003 Stock Option Plan will remain in effect, but no additional option grants may be made. The exercise price of a stock option may not be less than 100% of the fair market value of our common stock on the date of grant. If an incentive stock option is granted to an individual who owns more than 10% of the combined voting power of all classes of our capital stock, the exercise price may not be less than 110% of the fair market value of our common stock on the date of grant and the term of the option may not be longer than five years. The 2006 Plan expires on December 17, 2016.

At the Company’s annual stockholders’ meeting, which was held on February 17, 2009, the stockholders approved an increase in the aggregate number of shares available for issuance under the 2006 Plan from 600,000 to 1,200,000. There were no stock awards granted under the 2006 Plan during the years ended August 29, 2009, August 30, 2008 and August 25, 2007. Outstanding stock options at August 29, 2009 represent options granted under plans which have expired, plus options granted outside plans pursuant to individual stock option agreements.

A summary of option activity as of August 29, 2009 and changes during the fiscal year then ended is presented below:

	Options		Weighted	
	Number of Shares	Weighted Average Price Per Share	Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at August 30, 2008	2,353,725	\$ 3.49		
Expired	(300,000)	3.52		
<b>Outstanding at August 29, 2009</b>	<b>2,053,725</b>	<b>\$ 3.49</b>	<b>2.81</b>	<b>\$ —</b>

There were no options granted or exercised during the fiscal years ended in 2009 and 2008. Cash received from options exercised during fiscal year 2007 was \$527. The total intrinsic value of options exercised during the fiscal year 2007 was \$731. Tax benefits related to option exercises were not deemed to be realized as net operating loss carryforwards are available to offset taxable income computed without giving effect to tax deductions related to option exercises. Tax benefits related to option exercises will be recognized through an increase in additional paid-in capital when they are deemed to have reduced taxes currently payable.

The Company generally issues new shares upon the exercise of stock options.

JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
 August 29, 2009, August 30, 2008 and August 25, 2007  
 (In thousands, except for share and per share amounts)

(12) DISCONTINUED OPERATIONS

During fiscal 2009, the Company closed seven stores consisting of two in Illinois, two in Missouri, one in Virginia, one in Arizona and one in New York. During fiscal 2008, the Company closed ten stores, of which six were located in Ohio, one in New York, two in Georgia and one in Florida. During fiscal 2007, the Company closed eight stores of which one was located in New Jersey, one in California, four in Illinois, one in Michigan and one in Indiana. In accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the results of stores closed have been reported as discontinued operations in the consolidated statement of operations, except for four stores closed during fiscal 2009 (two in Illinois, one in Virginia and one New York), four stores closed during fiscal 2008 (one in New York, two in Georgia and one in Florida) and six stores closed during fiscal 2007 (one in New Jersey, one in California and four in Illinois), where in management's judgment there will be significant continuing sales to customers of the closed stores from other stores in the area. The consolidated statements of operations for years ended August 30, 2008 and August 25, 2007, have been restated to include the results of the three closed stores reported as discontinued operations during fiscal 2009.

Revenues from stores reported as discontinued operations, amounted to \$354, \$2,150 and \$4,305 for the fiscal years ended August 29, 2009, August 30, 2008 and August 25, 2007, respectively.

Loss related to store closings consist of the following:

	Year Ended		
	August 29, 2009	August 30, 2008	August 25, 2007
Write-off of store fixtures and leasehold improvements	\$ (6)	\$ (18)	\$ —
Lease termination costs	(110)	(66)	—
Total loss on store closings	<u>\$ (116)</u>	<u>\$ (84)</u>	<u>\$ —</u>

(13) SEGMENT INFORMATION

On October 27, 2006, the Company's wholly-owned subsidiary, Hartsdale Convertibles, Inc. ("Hartsdale"), entered into the Ashley Homestores, Ltd. Trademark Usage Agreement (the "Trademark Usage Agreement") with Ashley Homestores, Ltd. ("Ashley"), pursuant to which Hartsdale was granted a 5-year nonexclusive, limited sublicense to use the image, technique, design, concept, trademarks and business methods developed by Ashley for the retail sale of Ashley products and accessories. During the 5-year term of the agreement, Hartsdale will use its best efforts to solicit sales of Ashley products and accessories at the authorized location, and in consultation with Ashley, develop annual sales goals and marketing objectives reasonably designed to assure maximum sales and market penetration of the Ashley products and accessories in the licensed territory. The Company has guaranteed the obligations of Hartsdale under the Trademark Usage Agreement. On May 26, 2007, the Company opened its first Ashley Furniture HomeStore and on May 7, 2008, opened its second Ashley store. Subsequent to August 29, 2009 through December 11, 2009, the Company opened two additional stores and executed a lease agreement to open an additional store.

Prior to the Trademark Usage Agreement, the Company operated in a single reportable segment, the operation of Jennifer specialty furniture retail stores. Subsequent thereto, the Company has determined that it has two reportable segments organized by product line: Jennifer – specialty furniture retail stores and Ashley – a big box, full line home furniture retail store. The accounting policies of the segments are the same as those described in Note 2. There are no inter-company sales between segments. The Company does not allocate indirect expenses such as compensation to executives and corporate personnel, corporate facility costs, professional fees, information systems, finance, insurance, and other non-operating costs to the individual segments. These costs apply to all of the Company's businesses and are reported and evaluated as corporate expenses for segment reporting purposes.

**JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements  
August 29, 2009, August 30, 2008 and August 25, 2007  
(In thousands, except for share and per share amounts)**

The following tables present segment level financial information for the years ended August 29, 2009, August 30, 2008 and August 25, 2007:

	<u>Jennifer</u>	<u>Ashley</u>	<u>Totals</u>
<b>2009</b>			
Revenue	\$ 81,396	\$ 12,781	\$ 94,177
Segment income (loss) from continuing operations before income taxes (a)	(5,471)	1,293	(4,178)
Depreciation and amortization	950	185	1,135
Segment assets	16,034	2,456	18,490
Segment capital expenditures	237	58	295
<b>2008</b>			
Revenue	\$ 108,325	\$ 11,806	\$ 120,131
Segment income from continuing operations before income taxes	3,565	907	4,472
Depreciation and amortization	853	132	985
Segment assets	19,599	3,629	23,228
Segment capital expenditures (c)	612	279	891
<b>2007</b>			
Revenue	\$ 130,846	\$ 1,837	\$ 132,683
Segment income (loss) from continuing operations before income taxes	12,349	(677)	11,672
Depreciation and amortization	846	28	874
Segment assets	24,576	2,785	27,361
Segment capital expenditures	654	957	1,611

**Reconciliations:**

	<u>Year Ended</u>		
	<u>August 29,</u>	<u>August 30,</u>	<u>August 25,</u>
	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Profit or loss</b>			
(Loss) income from continuing operations before income taxes for reportable segments	\$ (4,178)	\$ 4,472	\$ 11,672
Corporate expenses and other	(6,578)	(7,456)	(7,498)
Consolidated (loss) income from continuing operations before income taxes	<u>\$ (10,756)</u>	<u>\$ (2,984)</u>	<u>\$ 4,174</u>
<b>Depreciation and amortization</b>			
Total depreciation and amortization for reportable segments	\$ 1,135	\$ 985	\$ 874
Corporate depreciation and amortization	16	20	27
	<u>\$ 1,151</u>	<u>\$ 1,005</u>	<u>\$ 901</u>

JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
August 29, 2009, August 30, 2008 and August 25, 2007  
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	Year Ended		
	August 29, 2009	August 30, 2008	August 25, 2007
<b>Assets</b>			
Total assets for reportable segments	\$ 18,490	\$ 23,228	\$ 27,361
Corporate assets (b)	5,979	10,884	17,438
Total consolidated assets	<u>\$ 24,469</u>	<u>\$ 34,112</u>	<u>\$ 44,799</u>

	Year Ended		
	August 29, 2009	August 30, 2008	August 25, 2007
<b>Capital expenditures</b>			
Total capital expenditures for reportable segments	\$ 295	\$ 891(c)	\$ 1,611
Corporate capital expenditures	11	12	24
Discontinued operations capital expenditures	—	(7)	—
	<u>\$ 306</u>	<u>\$ 896</u>	<u>\$ 1,635</u>

- (a) The loss from continuing operations before income taxes in 2009 for the Jennifer segment includes a pre-tax charge of approximately \$1,167 related to the impairment of goodwill, \$947 charge related to provision for loss on amounts due from Related Company and a \$1,300 charge related to litigation. See Notes 3, 4 and 15.
- (b) Corporate assets consist primarily of cash and cash equivalents, restricted cash, marketable auction rate securities and prepaid expenses and other current assets.
- (c) Includes equipment under capital leases of \$68 in 2008.

**(14) COMMITMENTS AND OTHER**

**Leases:**

The Company leases retail store, warehouse and executive office locations under operating leases for varying periods through fiscal 2020, which are generally renewable at the option of the lessee. Certain leases contain provisions for additional rental payments based on increases in certain indexes. During fiscal 2009, the Company renegotiated certain provisions of retail store lease agreements consisting of reductions in rent payments, shorter or month-to-month lease terms and lease extensions, as well as the abatement of other rental costs. In addition, seven stores closed, two stores relocated, option periods were exercised for certain stores and new leases were negotiated for those stores whose term expired during fiscal 2009.

Rental expense from continuing operations for all operating leases amounted to approximately \$22,125, \$24,252 and \$23,471, net of sublease income of \$8, \$80 and \$214 for the years ended August 29, 2009, August 30, 2008 and August 25, 2007, respectively.

The Company also leases warehouse equipment under capital leases expiring through 2018. The capital leases are included with store fixtures, equipment and leasehold improvements on the balance sheet in the amount of \$247 at August 29, 2009. Related accumulated depreciation amounted to \$122.

At August 29, 2009, minimum payments due under leases consisted of the following:

JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
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Year Ending August	Operating	Capital
	Leases	Leases
2010	\$ 15,945	\$ 54
2011	12,196	44
2012	9,321	27
2013	6,304	17
2014	4,293	10
2015 and thereafter	12,336	14
	<u>\$ 60,395</u>	<u>\$ 166</u>

The total minimum lease payments for capital leases in the amount of \$166 include \$26 of interest. The present value of the above future capital lease payments is included in the liability section of the balance sheet. As of August 29, 2009, \$44 was classified in accrued expenses and other current liabilities and \$96 as obligations under capital leases, net of current portion.

**Accrued expenses and other current liabilities:**

The components of accrued expenses and other current liabilities are as follows:

	Year Ended	
	August 29, 2009	August 30, 2008
Payroll and bonuses	\$ 613	\$ 778
Advertising	1,883	1,522
Litigation	1,300	—
Rent	949	13
Sales tax	307	458
Accounting	198	256
Insurance	161	112
Freight	103	39
Warranty	70	62
Finance fees	—	81
Franchise and minimum taxes	4	5
Home delivery	55	218
Other	358	348
	<u>\$ 6,001</u>	<u>\$ 3,892</u>

**JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**  
**August 29, 2009, August 30, 2008 and August 25, 2007**  
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**Warranties:**

The aggregate changes in the liability for product warranties during the fiscal years ended 2009, 2008, and 2007 are as follows:

	Year Ended		
	August 29, 2009	August 30, 2008	August 25, 2007
Warranty payable at beginning of year	\$ 62	\$ 107	\$ 248
Amount paid during fiscal year	(265)	(332)	(295)
Amount expensed during fiscal year	273	287	154
Warranty payable at end of year	\$ 70	\$ 62	\$ 107

**Employment agreements:**

On August 15, 1999, the Chief Executive Officer of the Company entered into a five-year renewable employment agreement, which provides for a base salary of \$400 per annum, subject to certain cost of living increases, and bonuses based on earnings and revenues. The agreement automatically renews annually and is cancellable on six months notice by either party. Effective December 28, 2008, the Chief Executive Officer voluntarily reduced his annual salary by \$300.

On August 15, 1999, the President, Chief Financial Officer and Chief Operating Officer of the Company entered into a five-year renewable employment agreement which provides for a base salary of \$400 per annum for the first three years and \$500 per annum thereafter, subject to certain cost-of-living increases and bonuses based on earnings and revenues. The agreement automatically renews annually and is cancellable on six months notice by either party.

**Consulting agreement:**

The Company executed a five-year consulting agreement expiring on March 30, 2010 with an individual. Pursuant to the agreement, the individual shall perform consulting services including, among other things, providing advice with respect to the operation and financing of the Company's business; assisting the Company in identifying and communicating with potential market makers and investors; assisting the Company with strategic planning and capital-raising activities; and identifying potential strategic partners. In consideration for his services, the individual is to be paid a fee of \$50 per annum and was issued a warrant to purchase 150,000 shares of the Company's common stock, as more fully described in Note 10. In addition, the Company established a monitoring committee to review the relationship between the Related Company and the Company. The aforementioned individual is a member of the committee.

**Related party transactions:**

Klaussner Furniture Industries Inc. ("Klaussner"), is one of the Company's suppliers and the owner of the outstanding shares of the Company's Series A convertible preferred stock. As of August 29, 2009 and August 30, 2008, the Company owed Klaussner \$1,255 and \$892, respectively. The Company purchased approximately \$4,027, \$6,785 and \$10,156 of its inventory from Klaussner during fiscal 2009, 2008 and 2007, respectively.

**(15) LITIGATION**

On July 16, 2009, a complaint styled as a putative class action was filed against the Company in the United States District Court of the Northern District of California by an individual and on behalf of all others similarly situated. The complaint seeks unspecified damages for alleged violations of the California Labor Code, the California Business and Professions Code and the federal Fair Labor Standards Act. Such alleged violations include, among other things, failure to pay overtime, failure to reimburse certain expenses, failure to provide adequate rest and meal periods and other labor related complaints. Before engaging in discovery and extensive pre-trial proceedings, the parties participated in an early mediation. The plaintiff offered to settle for 20% of the Company's outstanding common stock in an amount guaranteed to be worth at least \$2,000 on the date of distribution. If the value of the stock as of the date of distribution is less than \$2,000 the Company would distribute cash to make up the difference between the value of the stock and \$2,000. In addition, the Company would pay \$400 over a five-year period. During November 2009, the Company proposed a counter offer for \$300 in cash over a five-year period, with \$100 to be paid up front and the balance to be secured by the Company's assets, and between 600,000 and 800,000 shares of stock. The number of shares to be issued would be shares sufficient to reach a value of \$1,000 as of the time of issuance, subject to a cap of 800,000 shares and a minimum distribution of 600,000 shares, regardless of the actual value at the time of issuance. The plaintiff rejected the Company's counter offer but made a new proposal, which included the stock component proposed by the Company, but increased the cash component to a total of \$1,500 paid in equal installments over a five-year period, with \$300 to be paid up front and the balance to be secured. The Company has determined that it is probable that it has some liability. Based on the offer and counter offer, the Company estimates the liability ranges between \$1,300 and \$2,500, with no amount within that range a better estimate than any other amount. Accordingly, in accordance with FASB Interpretation No. 14 "Reasonable Estimation of the Amount of a Loss", the Company has accrued \$1,300 as of August 29, 2009. In the event the litigation is not settled, the Company intends to defend the matter vigorously.

## JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements August 29, 2009, August 30, 2008 and August 25, 2007 (In thousands, except for share and per share amounts)

The Company is subject to other litigation in the normal course of business, including a claim for unspecified damages for sexual harassment, discrimination, retaliation, mental infliction of emotional stress, false imprisonment and collateral claims. The Company denies liability and does not believe that this matter or any of its other litigation will have a material adverse effect on its financial condition, results of operations or cash flows.

#### (16) PREFERRED STOCK

The 6,490 outstanding shares of Series A convertible preferred stock ("Series A Stock"), which are owned by Klaussner, are non-voting, have a liquidation preference of \$3,245, do not pay dividends (except if declared on the common stock) and are convertible into 924,500 shares of the Company's common stock. In addition, as long as Klaussner owns at least 10% of the Company's outstanding common stock, assuming conversion, it has the right of first refusal to purchase any common stock or equivalents sold by the Company at less than \$3.51 per share. In connection therewith, and as a result of the Company granting options to employees to purchase shares of common stock at \$2.00 per share, on January 18, 2001, the Company granted Klaussner an option to purchase 18,730 shares of common stock at an exercise price of \$2.00 per share. The option expires in January 2011.

On December 15, 2004, Klaussner granted to the Company's Chief Executive Officer, options which expire on November 30, 2009, to purchase 2,106 shares of the Company's Series A Stock, at an exercise price of \$712.25 per share. Such shares are convertible into an aggregate of 300,000 shares of the Company's common stock. The exercise price of the options is equivalent to \$5.00 per share of underlying common stock, which was greater than the quoted market price of the common stock on the date of grant.

In connection with the settlement of class action litigation, the Company issued 88,880 shares of Series B convertible preferred stock ("Series B Stock") having a value of \$370. Each share of Series B Stock is convertible, at the option of the holder, into seven-tenths of a share of the Company's common stock. In addition, holders of the Series B Stock are entitled to receive, upon surrender of their stock certificates, \$0.10 in cash for each pre-conversion share of the Company's Series B Stock held by such holder. The Series B shares are non-voting, have a liquidation preference of \$5.00 per share and accrue dividends at the rate of \$.35 per share per annum. The Series B Stock is convertible at the option of the Company at any time after the common stock trades at a price of at least \$7.00 per share.

During March 2007, as a result of a discrepancy between a court settlement stipulation and the Company's certificate of incorporation, and in order to avoid a dispute, the Company rescinded their option which had previously been exercised, to require the conversion of the Series B Stock. However, so as not to unduly inconvenience preferred stockholders who wished to convert to common stock, the Company permitted holders of the preferred stock who wanted to convert to common stock to do so on the same terms by delivering their Series B Stock certificates to their transfer agent by May 15, 2007.

On May 15, 2007, certain holders of Series B Stock elected to convert 40,891 shares into 28,523 shares of the Company's common stock. Fractional shares of the Company's common stock were not issued as a result of the conversion. Instead, holders of the Series B Stock who otherwise would have been entitled to receive a fractional share received an amount in cash equal to \$5.00 per post conversion share (calculated on a pro rata basis) for such fractional shares. Dividends earned on the Company's Series B Stock tendered for conversion up until and including May 15, 2007 were paid. During May 2007, the Company paid an aggregate of \$4 for each pre-conversion share of the Company's Series B Stock held by such holders and \$1 for fractional shares of common stock. In addition, accumulated unpaid dividends for the period October 30, 2005 through May 15, 2007 in the amount of \$48 were paid to all holders of Series B Stock. All such amounts were charged to additional paid in capital. Accumulated unpaid dividends for the period May 16, 2007 through August 29, 2009 amounted to \$39.

**JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**  
**August 29, 2009, August 30, 2008 and August 25, 2007**  
(In thousands, except for share and per share amounts)

**(17) QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)**

The following is a summary of the quarterly results of operations for the years ended August 29, 2009 and August 30, 2008:

	Thirteen Weeks Ended			
	November 29, 2008	February 28, 2009	May 30, 2009	August 29, 2009
	(b)	(b)		
<b>Revenue:</b>				
Net sales	\$ 25,039	\$ 21,471	\$ 20,765	\$ 21,570
Revenue from service contracts	1,478	1,278	1,328	1,248
	<u>26,517</u>	<u>22,749</u>	<u>22,093</u>	<u>22,818</u>
Cost of sales, including store occupancy warehousing, delivery and service costs	18,817	16,367	15,808	16,014
Loss from continuing operations before income taxes	(1,818)	(2,170)	(1,509)	(5,259)
Income tax expense (benefit)	1	—	5	3
Loss from continuing operations	(1,819)	(2,170)	(1,514)	(5,262)
Loss from discontinued operations	(50)	(174)	(18)	(1)
Net loss	(1,869)	(2,344)	(1,532)	(5,263)(a)
Basic net loss per share	\$ (0.26)	\$ (0.33)	\$ (0.22)	\$ (0.74)(a)
Diluted net loss per share	\$ (0.26)	\$ (0.33)	\$ (0.22)	\$ (0.74)(a)

	Thirteen Weeks Ended			
	November 24, 2007	February 23, 2008	May 24, 2008	August 30, 2008
	(b)	(b)	(b)	(b)
<b>Revenue:</b>				
Net sales	\$ 31,727	\$ 25,855	\$ 26,586	\$ 28,905
Revenue from service contracts	1,998	1,631	1,664	1,765
	<u>33,725</u>	<u>27,486</u>	<u>28,250</u>	<u>30,670</u>
Cost of sales, including store occupancy warehousing, delivery and service costs	23,589	19,946	20,128	21,175
Loss from continuing operations before income taxes	(439)	(1,152)	(620)	(773)
Income tax expense (benefit)	53	(47)	—	4
Loss from continuing operations	(492)	(1,105)	(620)	(777)
Loss from discontinued operations	(13)	(141)	(91)	(90)
Net loss	(505)	(1,246)	(711)	(867)
Basic net loss per share	\$ (0.07)	\$ (0.18)	\$ (0.10)	\$ (0.12)
Diluted net loss per share	\$ (0.07)	\$ (0.18)	\$ (0.10)	\$ (0.12)

JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES

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- (a) Includes a charge of \$1,167 (\$0.17 per share) related to the impairment of goodwill, a charge of \$1,300 (\$0.18 per share) related to litigation and a charge of \$947 related to provision for loss on amounts due from Related Company (\$0.13 per share).
- (b) During the first, second and third quarters of fiscal 2009, the Company closed seven stores of which three stores have been classified as discontinued operations. As a result, revenue and cost of sales for the first two quarters of fiscal 2009 and each of the quarters in fiscal 2008 have been restated to reflect only the Company's continuing operations. There was no effect on previously reported net loss for any of the quarters as a result of the above. Below is a reconciliation of amounts as previously reported in the Company's quarterly reports on Form 10Q with respect to the first and second quarters of fiscal 2009 and in the Company's 2008 annual report on Form 10K with respect to the four quarters of fiscal 2008 to the restated amounts reported above.

	Thirteen Weeks Ended	
	November 29, 2008	February 28, 2009
<b>Revenue:</b>		
As previously reported	\$ 26,676	\$ 22,800
Stores closed in subsequent periods	(159)	(51)
As restated	<u>\$ 26,517</u>	<u>\$ 22,749</u>
<b>Cost of sales:</b>		
As previously reported	\$ 18,951	\$ 16,412
Stores closed in subsequent periods	(134)	(45)
As restated	<u>\$ 18,817</u>	<u>\$ 16,367</u>
<b>Loss from continuing operations:</b>		
As previously reported	\$ (1,850)	\$ (2,184)
Stores closed in subsequent periods	31	14
As restated	<u>\$ (1,819)</u>	<u>\$ (2,170)</u>
<b>Loss from discontinued operations</b>		
As previously reported	\$ (19)	\$ (160)
Stores closed in subsequent periods	(31)	(14)
As restated	<u>\$ (50)</u>	<u>\$ (174)</u>

	Thirteen Weeks Ended			
	November 24, 2007	February 23, 2008	May 24, 2008	August 30, 2008
<b>Revenue:</b>				
As previously reported	\$ 33,971	\$ 27,638	\$ 28,250	\$ 30,844
Stores closed in subsequent periods	(246)	(152)	—	(174)
As restated	<u>\$ 33,725</u>	<u>\$ 27,486</u>	<u>\$ 28,250</u>	<u>\$ 30,670</u>
<b>Cost of sales:</b>				
As previously reported	\$ 23,770	\$ 20,042	\$ 20,128	\$ 21,331
Stores closed in subsequent periods	(181)	(96)	—	(156)
As restated	<u>\$ 23,589</u>	<u>\$ 19,946</u>	<u>\$ 20,128</u>	<u>\$ 21,175</u>
<b>Loss from continuing operations:</b>				
As previously reported	\$ (476)	\$ (1,073)	\$ (620)	\$ (828)
Stores closed in subsequent periods	(16)	(32)	—	51
As restated	<u>\$ (492)</u>	<u>\$ (1,105)</u>	<u>\$ (620)</u>	<u>\$ (777)</u>
<b>Loss from discontinued operations</b>				
As previously reported	\$ (29)	\$ (173)	\$ (91)	\$ (39)
Stores closed in subsequent periods	16	32	—	(51)
As restated	<u>\$ (13)</u>	<u>\$ (141)</u>	<u>\$ (91)</u>	<u>\$ (90)</u>

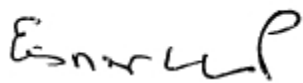
**JENNIFER CONVERTIBLES, INC. AND SUBSIDIARIES  
SCHEDULE II**

**VALUATION AND QUALIFYING ACCOUNTS  
(In thousands)**

	Balance at Beginning of Period	Charged to Expenses	Charged to Other Accounts	Deductions	Balance at End of Period
<b>2009</b>					
Deducted from asset accounts:					
Allowance for loss on amounts due from the Related Company	\$ —	\$ 947	\$ —	\$ —	\$ 947
Allowance for inventory obsolescence	32	—	—	11	21
<b>2008</b>					
Deducted from asset accounts:					
Allowance for inventory obsolescence	\$ 37	\$ —	\$ —	\$ 5	\$ 32
<b>2007</b>					
Deducted from asset accounts:					
Allowance for inventory obsolescence	\$ 133	\$ —	\$ —	\$ 96	\$ 37

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-140727, 333-101024 and 333-135948) and on Form S-3 (No. 333-133202) of Jennifer Convertibles, Inc. of our report dated December 11, 2009, with respect to the consolidated financial statements and schedule of Jennifer Convertibles, Inc. included in this Annual Report on Form 10-K for the year ended August 29, 2009.

A handwritten signature in black ink, appearing to read "Esner LLP".

New York, New York  
December 11, 2009

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