

STEINWAY MUSICAL INSTRUMENTS, INC.

2000 Annual Report



Financial Highlights (In thousands except per share data)

Years Ended December 31,	Reported			Adjusted ¹		
	1999	2000	% change	1999	2000	% change
Net Sales	\$304,636	\$331,698	8.9%	\$304,636	\$331,698	8.9%
Operating Income	41,140	41,689	1.3%	41,140	43,179	5.0%
Net Income	17,345	16,904	(2.5%)	17,345	17,774	2.5%
Diluted Net Income Per Share	1.87	1.89	1.1%	1.87	1.99	6.4%
Compound Average Annual Growth Rate			1996–2000	1996–2000		
Net Sales			6.5%	6.5%		
Operating Income			5.9%	6.9%		
Net Income			22.9%	24.4%		
Diluted Net Income Per Share			17.3%	18.8%		

¹ Excludes non-recurring charges in 2000 related to the acquisition of United Musical Instruments.

Corporate Profile

Steinway Musical Instruments, through its operating subsidiaries, is a world leader in the design, manufacture and marketing of high quality musical instruments. The Company has one of the most valuable collections of brands in the music industry. Through a worldwide network of dealers, Steinway's instruments are sold to professional, amateur and student musicians, as well as orchestras and educational institutions. The Company employs a workforce of over 3,000 and operates 13 manufacturing facilities in the United States and Europe.

Pianos

Steinway & Sons produces the highest quality pianos in the world and has one of the most widely recognized and prestigious brand names. For over a century the Steinway concert grand has been the piano of choice for the world's greatest and most popular pianists. Steinway also offers a complete line of mid-priced pianos under the Boston and Essex brand names.

Band & Orchestral Instruments

Through its Selmer and United Musical Instruments subsidiaries, the Company is the largest domestic manufacturer of band and orchestral instruments and related accessories. The Company manufactures a full line of musical instruments—from trumpets, trombones, saxophones, tubas and French horns to clarinets, flutes, violins, and percussion instruments—and has leading domestic market shares in virtually all of these categories. Some of its most well known brands include Armstrong, Artley, Bach, Bengel, C.G. Conn, Emerson, Glaesel, King, Ludwig, Musser, Scherl & Roth, Selmer and William Lewis.

Message To Shareholders

2000 was a busy year at Steinway. We are pleased to report steady advancement toward our goal of becoming the undisputed worldwide leader in the musical instrument industry. Substantial improvements were made in the key areas of marketing, manufacturing and distribution. In addition, we are pleased to report the completion of a major acquisition. United Musical Instruments, particularly strong in the background brass instrument category, complements our existing band and orchestral operations by offering some of the most recognized brands in their class. Given our management team's proven ability to successfully integrate businesses, this acquisition provides substantial growth potential. Since 1993 we have transformed this Company from a band instrument business with sales of \$91 million to a full line musical instrument manufacturer with sales of over \$330 million.

Financial Results

Through a combination of acquisitions and internal growth, the Company had another year of solid results in 2000.

- Revenue increased 9%
- Adjusted operating profit was up 5%
- Adjusted earnings per share increased 6%, to \$1.99 per share

Most importantly, these overall results were achieved during a period when the band instrument industry was extremely competitive. While this environment caused others to strive for revenue growth at the expense of profitability, we maintained our disciplined approach. Instead of chasing short-term sales increases, we focused our efforts on the long-term, acquiring UMI, one of the leading manufacturers of band instruments in the U.S. As a result, we achieved a 14% increase in sales from band operations. This business will continue to contribute positively to our financial results in the years ahead.

This long-term approach has compelled us to undertake a major initiative to improve the productivity and profitability of our band operations. This project is well underway and will continue into 2002. While we expect this transformation to be gradual, we are pleased with the momentum generated in the fourth quarter, which yielded significant improvements in production. Although this project will increase costs over the short-term, we believe the initiative will further our goal of building a strong, healthy business, with long-term profitability and sustainable growth.

Bruce A. Stevens, President — Steinway; Dennis M. Hanson, Chief Financial Officer; Thomas T. Burzycki, President — Selmer; Kyle R. Kirkland, Chairman of the Board; and Dana D. Messina, Chief Executive Officer



Overall, our piano business had a tremendous year, both domestically and in Europe. Demand for Steinway & Sons pianos remained strong as we once again sold out our entire domestic production for the year. More significantly, foreign operations achieved a 20% increase in sales in local currency, reflecting the impact of our focused marketing efforts. Our operation in the United Kingdom had a record year, with revenue up 33% over the prior year. Sales of Boston pianos were down 4% as a result of unfavorable currency exchange rates and corresponding price increases.

Outlook for 2001

Despite the near-term softness in the U.S. economy, our long-term prospects remain excellent. Demand for band instruments continues to be largely driven by demographic trends and general attitudes toward music education. Both continue to be in our favor. In addition, through the acquisition of UMI, we can expect accelerated revenue and profitability growth in our band operations.

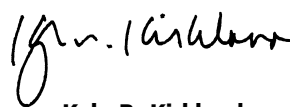
Management expects the piano business in Europe to be strong in the coming years. And while consumer demand for our pianos in the U.S. may be somewhat impacted by economic cycles, our very stable institutional piano business has grown into a significant revenue source for the Company.

While a soft economy in any market is never ideal, it often times presents excellent acquisition opportunities. The Company has the resources and experience to capitalize on any such opportunity. We have obtained adequate financial backing, allowing us to invest in our business and pursue our strategic vision without financial constraints. With the acquisition of UMI complete, we are prepared to utilize our increased cash flow to pay down debt and explore other possible opportunities, further increasing our financial stability and profitability in the coming years.

Our brands remain one of our Company's greatest strengths. Our customers know they can rely on a certain level of quality and consistency when they purchase one of our instruments. To satisfy the diverse needs of a global marketplace, our engineers will continue to develop new instrument features which will broaden our product offering. In 2001, we will introduce a number of new instrument models. In the forefront is the Essex, our new line of mid-priced pianos. These pianos will allow a larger number of customers the chance to become part of the Steinway family.

We believe that maintaining solid business fundamentals and strong cash flow will drive the long-term valuation of this business. To that end we will continue to focus on the long-term earnings power of the Company and anticipate a year of renewed earnings growth during 2001.

We are in the midst of a very exciting time at Steinway Musical Instruments. The Company has the right combination of quality brands, management experience and marketing expertise to keep growing the business. We are confident of our employees' ability to rise to the challenges ahead and look forward to reporting our progress to you during the next year. Thank you for your confidence and support.



Kyle R. Kirkland
Chairman of the Board



Dana D. Messina
Chief Executive Officer



The Steinway & Sons piano is the choice of the world's top musicians

*Year in Review*¹

Steinway Musical Instruments showed its support of music education by participating in VH1's Save the Music campaign. The Company made a donation of band instruments and pianos on NBC's Today Show in June. In addition, the band division continues to promote the program by offering assistance to dealers who work with band directors to develop school music programs.

The Company's stringed business slightly outpaced the domestic stringed market, which increased 5.6% over the prior year. However, the band business was highly competitive in 2000. Increases in industry shipments of band instruments for the last two years resulted in an oversupply of product in the U.S., causing domestic unit shipments to decline 5%. The Company resisted offering additional incentives to dealers and instead relied on its reputation and its well-established relationships

with dealers. As a result of the quality and craftsmanship of its instruments, the Company's band division experienced far less erosion than its competitors. Unit shipments decreased only 1.4% domestically.

Piano operations had another strong year, with domestic unit shipments of Steinway & Sons pianos increasing over 6%. Business in Europe rebounded after several years and shipments from foreign operations rose almost 14% over 1999. After many years of stable pricing and incredible growth, Boston piano unit sales declined 12% in 2000 due to foreign exchange driven price increases. However, the core Steinway & Sons business more than offset the Boston shortfall and revenues from piano operations increased 5% for the year.

¹Steinway acquired UMI in September of 2000. For comparative purposes, the results of band operations in the Year in Review include the pro forma combined operations of UMI and Selmer for the twelve month periods ending December 31, 1999 and 2000.

Band Operations

UMI Acquisition

In September, Steinway acquired United Musical Instruments, one of the largest manufacturers of band and orchestral instruments in the United States. UMI will complement the Company's product offering because of its strong market position in background brass instruments, including baritone, French horns and tubas. In addition, the acquisition of UMI enhances the Company's dominant market position in other categories. The Company will also benefit from UMI's experienced management team and advanced manufacturing technologies.

Subsequent to the acquisition, the production of Emerson brand flutes and piccolos was moved from a leased facility to UMI's Armstrong flute production plant, also in Elkhart, Indiana. This consolidation of flute production better utilizes existing capacity and helps achieve more efficient cost control. The Company has retained the best practices of each operation to achieve the highest quality standards for its instruments.

Music Education Market

The Gallup Organization's national survey on "American Attitudes Toward Music" indicates that Americans feel music should be part of everyday life. The study shows that support for music education and music participation have both strengthened over recent years.

- 95% of those surveyed stated that they feel music is part of a well-rounded education.
- 78% felt music education should be mandated for all students in public schools.
- 75% believe learning a musical instrument helps students perform better in math & science.
- 73% feel teens involved in participatory music are less likely to have discipline problems.

The name Selmer is synonymous with saxophone; Glaesel cellos are made by hand with a passion for craftsmanship



School music is the lifeblood of the Company's band operations. Historically, one in ten 11-year-olds in the United States has played a band or orchestral instrument. Recent studies on the benefits of music education, the proliferation of music advocacy programs and stable demographic trends of the school age population offer favorable growth opportunities in the school music market.

New Student Models

To capitalize on the entry-level student market, the Company is introducing a series of four new Selmer clarinets designed to make learning the instrument easier. Three of the models were developed for students with small hands. In addition, Armstrong student flutes are now available with a mechanism, normally reserved for professional models, which makes select notes easier to play for the younger player. Finally, the addition of a new competitively priced student violin, viola, and cello outfit as well as a $\frac{3}{4}$ -size beginner stringed bass broadened the Glaesel stringed instrument offering.

Step-Up & Professional Instruments

For several years, the Company has been focusing on developing its line of step-up instruments. These instruments are designed for the player who has two or more years of experience and are considered a "step-up" from a student's first instrument. Professional models are designed for the professional, university or advanced high school player. Success with the production and sales of step-up and professional instruments provides the Company higher margins, greater visibility in the market and opportunity for future growth.

Ludwig, the most famous name on drums, has been setting the tempo since the 1960s; C.G. Conn French horns are the only horns played in Hollywood film orchestras





*Armstrong flutes offer the finest
in performance at all levels of ability*

*Custom features make C.G. Conn the choice of
discriminating trombonists around the world*



Continued research and development is crucial to success in this area. The Company recently entered a new category with its American made orchestral tuba. Traditionally, these instruments have been produced overseas. In addition, the Company is offering enhanced customization on its C.G. Conn orchestral trombones, allowing the player to virtually build his own personalized instrument. While the new Vintage One trumpet has earned the respect of professional musicians, Selmer's flagship line, Bach Stradivarius Trumpets, captured the "Band & Orchestral Product Line of the Year" award, as voted by dealers in the U.S. for *Musical Merchandise Review*.

Limited Editions

The Company continued to build on its previous successes with limited edition instruments. The Musser Limited Edition Hampton Signature Vibraphone was designed as a tribute to Lionel Hampton, who was the first jazz musician to feature the vibraphone when he performed in the 1930s with Louis Armstrong. The Company honored another famous musician with its Ludwig Limited Edition FAB Four Drum Outfit. Designed in a 1960s style, the FAB Four is reminiscent of former Beatle Ringo Starr's famous Ludwig drum outfit. These limited edition instruments generate excitement in the marketplace and keep the Company in the forefront of the industry.



Bach, preferred by musicians at all skill levels, is the unquestioned leader in trumpets; Artley clarinets are where great sound begins



Piano Operations

300th Anniversary

It was an exciting year for all pianomakers as the world marked the 300th anniversary of the invention of the piano by Bartolomeo Cristofori. In celebration of this event the Smithsonian National Museum of American History opened a yearlong exhibit, “Piano 300,” featuring a collection of over 250 pianos and keyboards and other memorabilia. The exhibit illustrates the design history that resulted in the modern piano as well as Steinway & Sons’ important role in that history.

The celebration also included a PBS special, “Piano Grand!”, which aired nationwide. The program featured an impressive collection of great piano moments. As one might expect, the majority of the pianists featured were Steinway Artists, including host Billy Joel, Diana Krall, Marcus Roberts and Jean-Yves Thibeadet.

To further commemorate this anniversary, Steinway & Sons unveiled a special artcase piano, the Tricentennial. Developed by renowned furniture designer Dakota Jackson, only 300 of these pianos were produced through a collaborative effort by the manufacturing and marketing staffs of Steinway & Sons’ New York and Hamburg facilities. The success of this first significant joint venture opens the door to a world of possibilities for future global projects.

Launch of Essex Brand

In January of 2001, as an extension of its Boston line of pianos, the Company unveiled a third line of acoustic pianos under the brand name Essex. Similar to the Boston line, these instruments were designed by Steinway & Sons’ engineers and will be manufactured by a highly skilled Asian supplier. Management is excited about this new offering and optimistic about its success. With the Essex introduction the Company has broadened its product offering to include pianos for every level of musical ability and budget.

Markets in Asia

Steinway & Sons continues its penetration into Asian markets, with unit sales in Japan increasing 9% in 2000. The Company boosted its dealer network just prior to year-end by signing a distribution contract with one of that country's largest music retailers. The Company also plans to establish additional dealers in major Chinese markets. For over two years Steinway & Sons has been the only brand of concert grand piano sold to a performing arts center in China. As many new concert halls and music schools are being built, there is tremendous potential for further growth in this region.

Success in Europe

Business in Europe also gained momentum in 2000. Many of the marketing programs previously implemented are beginning to deliver improved results. This was most apparent at the Company's London branch, which ran the most successful promotion in its history. Steinway and Boston pianos were displayed at one of the largest performing arts complexes in Great Britain. While the sales results were record setting, the event is even more significant because of its success in attracting a different type of consumer. The fact that these customers were more hobbyists than highly skilled pianists is evidence of the opportunities that exist as the Company executes a strategy to expand its customer base.



*Musser vibraphones are preferred
by the world's leading artists*



Scherl & Roth stringed instruments boast seven generations of exquisite craftsmanship; King tubas are designed for faster response and ease of handling



Institutional Sales

Steinway & Sons' institutional program had many accomplishments in 2000. Seven new schools were added to the growing list of "All-Steinway" schools, including the first two in the Southern Hemisphere. A significant highlight included the largest donation of Steinway pianos on record. One of Steinway's authorized dealers facilitated the gift of 47 pianos by a well-known businessman to the University of Utah. With this success, the Company announced the Steinway Living Legacy Program, a campaign created to encourage alumni to donate pianos to their alma maters.

Steinway & Sons in the Spotlight

At an auction of Beatles memorabilia, famous pop star George Michael purchased a piano previously owned by John Lennon. The 1970 Steinway upright, which Lennon used to compose his worldwide hit "Imagine," sold for over \$2 million dollars, the highest price ever paid for a piano. In piano competitions, Steinway & Sons remains on top as well, as it was named the exclusive piano of the Van Cliburn International Piano Competition. The Company is also proud to announce that all performances at the prestigious competitions in Rome, Athens, Zurich and Leeds were on Steinway pianos. Most important, a survey of thirty of the world's major symphony orchestras revealed that 97% of piano soloists chose a Steinway grand piano during the 1999/2000 concert season. Steinway continues to be the piano of choice for the world's top musicians.

Selected Consolidated Financial Data (In Thousands Except Per Share Data)

Years Ended December 31,	1996	1997	1998	1999	2000 ¹
Income Statement Data:					
Net sales	\$257,903	\$277,848	\$293,251	\$304,636	\$331,698
Gross profit	84,235	93,281	98,479	100,748	104,958
Income from operations	33,124	38,249	41,813	41,140	41,689
Income before extraordinary item	7,421	13,700	16,651	17,345	16,904
Income per share before extraordinary item:					
Basic	1.00	1.45	1.78	1.88	1.89
Diluted	1.00	1.45	1.75	1.87	1.89
Other Financial Data:					
EBITDA ²	44,520	50,175	54,072	54,822	57,352
Capital expenditures	5,199	5,634	6,264	36,192	7,890
Balance Sheet Data (at year end):					
Cash	3,277	5,271	12,460	4,664	4,989
Current assets	140,353	151,622	170,381	171,954	265,453
Total assets	265,366	266,708	283,927	309,641	421,816
Current liabilities	37,720	40,429	42,243	44,959	56,575
Total debt	118,391	115,457	117,028	140,080	223,410
Stockholders' equity	67,878	75,761	91,757	98,202	113,207
¹ The Company acquired UMI in September 2000.					
² EBITDA represents earnings before depreciation and amortization, net interest expense and income tax expense (benefit), adjusted to exclude non-recurring charges. While EBITDA should not be construed as a substitute for operating income or a better indicator of liquidity than cash flow from operating activities, which are determined in accordance with accounting principles generally accepted in the United States of America, it is included herein to provide additional information with respect to the ability of the Company to meet its future debt service, capital expenditure and working capital requirements which the Company believes certain investors find to be useful. EBITDA is not necessarily a measure of the Company's ability to fund its cash needs.					

Independent Auditors' Report

To the Board of Directors and Stockholders of Steinway Musical Instruments, Inc.:

We have audited the accompanying consolidated balance sheets of Steinway Musical Instruments, Inc. and subsidiaries as of December 31, 1999 and 2000, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Steinway Musical Instruments, Inc. and subsidiaries as of December 31, 1999 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

Deloitte & Touche LLP
Boston, Massachusetts
February 22, 2001

Consolidated Statements of Income (In Thousands Except Share and Per Share Data)

Years Ended December 31,	1998	1999	2000
Net sales	\$293,251	\$304,636	\$331,698
Cost of sales	194,772	203,888	226,740
Gross profit	98,479	100,748	104,958
Operating expenses:			
Sales and marketing	35,533	37,527	37,342
General and administrative	16,961	17,790	19,694
Amortization	3,850	3,928	3,856
Other operating expense	322	363	887
Non-recurring charges	—	—	1,490
Total operating expenses	56,666	59,608	63,269
Income from operations	41,813	41,140	41,689
Other (income) expense:			
Other income, net	(1,155)	(1,881)	(1,825)
Interest income	(1,071)	(907)	(1,291)
Interest expense	12,982	14,183	17,401
Other expense, net	10,756	11,395	14,285
Income before income taxes	31,057	29,745	27,404
Provision for income taxes	14,406	12,400	10,500
Net income	\$ 16,651	\$ 17,345	\$ 16,904
Basic income per share	\$ 1.78	\$ 1.88	\$ 1.89
Diluted income per share	\$ 1.75	\$ 1.87	\$ 1.89
Weighted average shares:			
Basic	9,339,896	9,213,145	8,921,091
Diluted	9,505,640	9,277,798	8,921,108

See notes to consolidated financial statements.

Consolidated Balance Sheets (In Thousands Except Share and Per Share Data)

December 31,	1999	2000
ASSETS		
Current assets:		
Cash	\$ 4,664	\$ 4,989
Accounts, notes and leases receivable, net of allowance for bad debts of \$6,765 and \$11,377 in 1999 and 2000, respectively	56,510	93,042
Inventories	102,116	160,296
Prepaid expenses and other current assets	2,605	3,005
Deferred tax assets	6,059	4,121
Total current assets	171,954	265,453
Property, plant and equipment, net	89,510	106,415
Other assets, net	17,308	20,645
Cost in excess of fair value of net assets acquired, net of accumulated amortization of \$4,449 and \$5,231 in 1999 and 2000, respectively	30,869	29,303
TOTAL ASSETS	\$309,641	\$421,816
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 7,286	\$ 9,516
Accounts payable	6,920	11,206
Other current liabilities	30,753	35,853
Total current liabilities	44,959	56,575
Long-term debt	132,794	213,894
Deferred tax liabilities	21,569	26,316
Non-current pension liability	12,117	11,824
Total liabilities	211,439	308,609
Commitments and contingent liabilities		
Stockholders' equity:		
Class A Common Stock, \$.001 par value, 5,000,000 shares authorized, 477,953 shares issued and outstanding	—	—
Common stock, \$.001 par value, 90,000,000 shares authorized, 8,438,074 and 8,453,547 shares outstanding in 1999 and 2000, respectively	9	9
Additional paid-in capital	71,031	71,724
Retained earnings	48,488	65,392
Accumulated other comprehensive income	(7,857)	(9,966)
Treasury stock, at cost (632,700 and 659,400 shares in 1999 and 2000, respectively)	(13,469)	(13,952)
Total stockholders' equity	98,202	113,207
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$309,641	\$421,816

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows (In Thousands)

Years Ended December 31,	1998	1999	2000
OPERATING ACTIVITIES			
Net income	\$16,651	\$17,345	\$16,904
Adjustments to reconcile net income to cash flows from operating activities:			
Depreciation and amortization	10,630	11,618	12,342
Deferred tax benefit	(2,509)	(2,079)	(2,349)
Other	380	274	240
Changes in operating assets and liabilities:			
Accounts, notes and leases receivable	(4,734)	(5,028)	4,739
Inventories	(6,406)	(8,883)	(20,242)
Prepaid expense and other current assets	775	(251)	365
Accounts payable	925	104	2,161
Other current liabilities	(1,485)	2,272	(895)
Cash flows from operating activities	14,227	15,372	13,265
INVESTING ACTIVITIES			
Capital expenditures	(6,264)	(36,192)	(7,890)
Proceeds from disposals of fixed assets	137	138	511
Changes in other assets	2,175	(615)	148
Business acquisitions (net of cash acquired)	(1,337)	(2,643)	(86,567)
Cash flows from investing activities	(5,289)	(39,312)	(93,798)
FINANCING ACTIVITIES			
Borrowing under lines of credit	245,774	289,715	328,486
Repayments under lines of credit	(243,918)	(287,846)	(287,189)
Proceeds from long-term debt	—	22,500	45,000
Repayments of long-term debt	(865)	(1,046)	(1,981)
Debt issuance costs	—	—	(3,942)
Proceeds from issuance of stock	1,039	786	693
Purchase of treasury stock	(3,748)	(7,805)	(483)
Cash flows from financing activities	(1,718)	16,304	80,584
Effects of foreign exchange rate changes on cash	(31)	(160)	274
Increase (decrease) in cash	7,189	(7,796)	325
Cash, beginning of year	5,271	12,460	4,664
Cash, end of year	\$ 12,460	\$ 4,664	\$ 4,989
Supplemental Cash Flow Information			
Interest paid	\$ 12,991	\$ 14,173	\$ 17,238
Income taxes paid	16,469	13,709	14,990

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity

(In Thousands Except Share Data)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance, January 1, 1998	\$9	\$69,206	\$14,492	\$(6,030)	\$ (1,916)	\$ 75,761
Comprehensive income:						
Net income			16,651			16,651
Foreign currency translation adjustment				2,054		2,054
Total comprehensive income						18,705
Issuance of 55,231 shares of common stock		1,039				1,039
Purchase of 151,500 shares of treasury stock					(3,748)	(3,748)
Balance, December 31, 1998	9	70,245	31,143	(3,976)	(5,664)	91,757
Comprehensive income:						
Net income			17,345			17,345
Foreign currency translation adjustment				(3,881)		(3,881)
Total comprehensive income						13,464
Issuance of 40,002 shares of common stock		786				786
Purchase of 395,300 shares of treasury stock					(7,805)	(7,805)
Balance, December 31, 1999	9	71,031	48,488	(7,857)	(13,469)	98,202
Comprehensive income:						
Net income			16,904			16,904
Foreign currency translation adjustment				(1,988)		(1,988)
Additional minimum pension liability				(121)		(121)
Total comprehensive income						14,795
Issuance of 42,173 shares of common stock		693				693
Purchase of 26,700 shares of treasury stock					(483)	(483)
Balance, December 31, 2000	\$9	\$71,724	\$65,392	\$(9,966)	\$(13,952)	\$113,207

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements (In Thousands Except Share and Per Share Data)

{ note 1

Nature of Business

Steinway Musical Instruments, Inc. and subsidiaries (the “Company”) is one of the world’s leading manufacturers of musical instruments. The Company, through its wholly-owned subsidiaries, The Steinway Piano Company, Inc. (“Steinway”), The Selmer Company, Inc. (“Selmer”) and United Musical Instruments Holdings, Inc. (“UMI”), manufactures and distributes products within the musical instrument industry. Steinway produces the highest quality piano in the world and has one of the most highly recognized and prestigious brand names. Selmer and UMI are the leading domestic manufacturers of band and orchestral instruments and related accessories, including a complete line of brasswind, woodwind, percussion and stringed instruments. Selmer Paris saxophones, Bach trumpets and trombones, C.G. Conn and King brasswind instruments and Ludwig snare drums are considered by many to be the finest such instruments in the world.

{ note 2

Significant Accounting Policies

PRINCIPLES OF CONSOLIDATION The consolidated financial statements of the Company include the accounts of all of its direct and indirect wholly-owned subsidiaries. Significant intercompany balances have been eliminated in consolidation.

USE OF ESTIMATES The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America necessarily requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

REVENUE RECOGNITION Revenue is generally recognized upon shipment. The Company provides for the estimated costs of warranties, discounts and returns at the time of sale.

INVENTORIES Inventories are stated at the lower of cost or market. The cost of approximately 76% of inventories has been determined by the first-in, first-out (“FIFO”) method. The cost of the remaining inventories has been determined by the last-in, first-out (“LIFO”) method.

DEPRECIATION AND AMORTIZATION Property, plant and equipment are recorded at cost or at fair value in the case of assets acquired through business acquisitions. Depreciation is provided using the straight-line method over the estimated useful lives of the respective assets. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the improvements or the remaining term of the respective lease, whichever is shorter. Estimated useful lives are as follows:

Building and improvements	15-40 years
Leasehold improvements	5-15 years
Machinery, equipment and tooling	3-10 years
Office furniture and fixtures	3-10 years
Concert and artist and rental pianos	15 years

Cost in excess of fair value acquired is amortized on a straight-line basis over 40 years. Trademarks acquired are recorded at appraised value and are amortized on a straight-line basis over 10 years. Deferred financing costs are amortized on a straight-line basis over the repayment periods of the underlying debt, which approximates the effective interest method.

When conditions indicate a need to evaluate recoverability, the Company evaluates the recoverability of its long-lived assets by comparison of the estimated future undiscounted cash flows expected to be generated by those assets to their carrying value. To date, no impairment losses have been noted or recorded as a result of this evaluation process.

ADVERTISING Advertising costs are expensed as incurred. Advertising expense was \$6,497, \$6,676 and \$7,684 for the years ended December 31, 1998, 1999 and 2000, respectively.

INCOME TAXES Income taxes are provided using an asset and liability approach to financial accounting and reporting for income taxes. Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

FOREIGN CURRENCY TRANSLATION Assets and liabilities of non-U.S. operations are translated into U.S. dollars at year-end rates, and revenues and expenses at average rates of exchange prevailing during the year. The resulting translation adjustments are reported as a separate component of comprehensive income. Foreign currency transaction gains and losses are recognized in the consolidated statements of income currently.

FOREIGN EXCHANGE CONTRACTS The Company enters into foreign exchange contracts as a hedge against foreign currency transactions. These contracts are not used for trading or speculative purposes. Gains and losses arising from fluctuations in exchange rates are recognized at the end of each reporting period. Such gains and losses directly offset the foreign exchange gains or losses associated with the hedged receivable or payable. Gains and losses on foreign exchange contracts which exceed the related balance sheet or firm purchase commitment exposure are included in foreign currency

gain or loss in the consolidated statements of income. The Company does have credit risk to the extent the counterparties are unable to fulfill their obligations on the foreign exchange contracts. However, the Company enters into these contracts with reputable institutions and the Company believes there is not a significant risk of loss.

STOCK-BASED COMPENSATION The Company accounts for stock-based awards to employees using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees".

INCOME PER COMMON SHARE Basic income per common share is computed using the weighted average number of common shares outstanding during each year. Diluted income per common share reflects the effect of the Company's outstanding options (using the treasury stock method), except when such items would be antidilutive.

A reconciliation of the weighted average shares used for the basic and diluted computations is as follows for the years ended December 31:

	1998	1999	2000
Weighted average shares for basic income per share	9,339,896	9,213,145	8,921,091
Dilutive effect of stock options	165,744	64,653	17
Weighted average shares for diluted income per share	9,505,640	9,277,798	8,921,108

Options to purchase 0, 30,500 and 618,800 shares of common stock at prices ranging from \$18.84 to \$21.94 per share were outstanding during the years ended December 31, 1998, 1999 and 2000, respectively, but were not included in the computation of diluted net income per share because the options' exercise prices were greater than the average market price of the common shares.

ENVIRONMENTAL MATTERS Potential environmental liabilities are accounted for in accordance with Statement of Financial Accounting Standards ("SFAS") No. 5, "Accounting for Contingencies", which requires a liability to be recorded when it is probable that a loss has been incurred and its amount can reasonably be estimated (see Note 17).

SEGMENT REPORTING The Company has determined that it has two distinct reportable segments: the piano segment and the band and orchestral instrument segment. The Company considers these two segments reportable as they are managed separately and the operating results of each segment are regularly reviewed and evaluated separately by the Company's senior management.

COMPREHENSIVE INCOME Comprehensive income is comprised of net income, foreign currency translation adjustments and additional minimum pension liabilities and is reported in the consolidated statements of stockholders' equity for all periods presented.

NEW ACCOUNTING PRONOUNCEMENTS In June 1998, the Financial Accounting Standards Board released SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", which was amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Hedging Activities" in 2000. These statements require that all derivatives be recognized at fair value in the balance sheet, and that the corresponding gains or losses be reported either in the statement of income or as a component of comprehensive income, depending on the type of hedging relationship that exists. The Company will adopt the amended standard January 1, 2001. Based on the results of the analysis to date, management does not expect the adoption of the amended standard to have a material effect on the Company's results of operations or financial position.

In December 1999, the Securities and Exchange Commission ("SEC") released Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition", which sets forth the SEC's views on appropriate revenue recognition practices. The Company believes that its current revenue recognition practices are in accordance with SAB No. 101.

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

note 3 **Acquisitions**

During the year ended December 31, 2000, the Company completed the following acquisitions, both of which have been accounted for as purchases. The results of the acquired businesses have been included with those of the Company from the date of acquisition. The purchase price paid has been allocated to the assets acquired and liabilities assumed based upon their estimated fair values. Certain of these estimates are preliminary and could change upon completion of the estimation process.

In January 2000, the Company acquired Pianohaus Karl Lang, located in Munich, Germany, for approximately \$2.3 million. The purchase price was allocated primarily to fixed assets.

In September 2000, the Company completed the acquisition of UMI pursuant to a stock purchase agreement dated as of July 20, 2000. The purchase price aggregated \$27 million in cash, funded through borrowings on the Company's lines of credit and a term loan. In addition, the Company assumed approximately \$57 million of debt, which was paid at closing with funds from the lines of credit and the term loan.

The preliminary purchase price allocation for UMI is as follows:

Inventories	\$ 40,041
Receivables and current assets	41,734
Property, plant and equipment	17,510
Trademarks	3,564
Accounts payable and other current liabilities	(18,622)
Purchase price	\$ 84,227

In connection with the acquisition, inventories were written up by \$11 million to net realizable value. Prior to the acquisition, UMI had utilized the LIFO method of determining cost; the Company will continue to utilize this method for UMI inventories, and such inventory items will constitute a separate pool for accounting and tax purposes.

Had the acquisition of UMI been consummated on January 1, 1999, it is estimated that the unaudited pro forma results of operations would have been as follows:

Years Ended December 31,	1999	2000
Revenues	\$368,090	\$379,369
Net income	18,222	18,522
Earnings per share:		
Basic	\$1.98	\$2.08
Diluted	\$1.96	\$2.08

{ note 4 Inventories

December 31,	1999	2000
Raw materials	\$ 15,791	\$ 20,961
Work in process	37,921	53,711
Finished goods	48,404	85,624
	\$102,116	\$160,296

Inventories held by UMI (see Note 3) are accounted for using the LIFO method. If the FIFO method of inventory valuation had been used to value all inventories, inventories would have been \$3,270 lower than reported at December 31, 2000. As a result of using the LIFO valuation method, net earnings were \$2,017 higher in 2000. For financial reporting purposes, the fair value of UMI inventories as of the acquisition date constitutes the base layer for purposes of applying the LIFO method. This layer includes the \$11 million allocated to state opening inventories at net realizable value.

{ note 5 Property, Plant and Equipment, net

December 31,	1999	2000
Land	\$16,680	\$ 18,378
Buildings and improvements	53,979	62,930
Leasehold improvements	1,870	1,864
Machinery, equipment and tooling	32,185	40,381
Office furniture and fixtures	6,242	7,786
Concert and artist and rental pianos	10,510	11,327
Construction in progress	646	509
	122,112	143,175
Less accumulated depreciation and amortization	32,602	36,760
	\$89,510	\$106,415

{ note 6 Income Taxes

The components of the provision for income taxes are as follows:

Years Ended December 31,	1998	1999	2000
U.S. Federal:			
Current	\$10,210	\$ 8,067	\$ 7,097
Deferred	(870)	(276)	(780)
U.S. State and local:			
Current	1,420	1,533	1,310
Deferred	(124)	(54)	(65)
Foreign:			
Current	5,076	4,092	4,442
Deferred	(1,306)	(962)	(1,504)
	\$14,406	\$12,400	\$10,500

The components of income before income taxes are as follows:

Years Ended December 31,	1998	1999	2000
U.S. operations	\$24,151	\$23,062	\$20,075
Non-U.S. operations	6,906	6,683	7,329
	\$31,057	\$29,745	\$27,404

The Company's provision for income taxes differed from that using the statutory U.S. federal rate as follows:

Years Ended December 31,	1998	1999	2000
Statutory federal rate applied to earnings before income taxes	\$10,870	\$10,412	\$ 9,591
Increase in income taxes resulting from:			
Foreign income taxes (net of federal benefit)	2,084	1,278	1,280
State income taxes (net of federal benefit)	933	996	802
Change in tax rate in:			
Germany	—	—	(570)
Other	519	(286)	(603)
	\$14,406	\$12,400	\$10,500

In 2000, Germany passed certain legislation which reduced the rate at which certain of the Company's operations will pay tax, commencing in 2001. Upon passage of the legislation, the Company recognized a reduction of \$570 in its deferred tax liabilities based on changes in the rates. This legislation has no impact on taxes currently payable.

At December 31, 2000, accumulated retained earnings of non-U.S. subsidiaries totaled \$2,244. No provision for U.S. income and foreign withholding taxes has been made because it is expected that such earnings will be reinvested indefinitely.

The components of net deferred taxes are as follows:

December 31,	1999	2000
Deferred tax assets:		
Uniform capitalization adjustment to inventory	\$ 2,581	\$ 2,488
Allowance for doubtful accounts	1,459	3,037
Book tax differences in LIFO reserves on inventory	—	(6,007)
Accrued expenses and other current assets and liabilities	2,843	4,085
Foreign tax credits	15,681	12,955
Valuation allowances	(14,233)	(12,366)
Total deferred tax assets	8,331	4,192
Deferred tax liabilities:		
Pension contributions	279	175
Fixed assets	(16,808)	(19,764)
Intangibles	(7,312)	(6,798)
Total deferred tax liabilities	(23,841)	(26,387)
	\$(15,510)	\$(22,195)

Valuation allowances provided relate to excess foreign tax credits generated over expected credit absorption. Of these valuation allowances, \$4,612 and \$4,051 relate to the acquisition of Steinway as of December 31, 1999 and 2000, respectively. Should the related tax benefits be recognized in the future, the effect of removing the valuation allowances associated with the acquisition of Steinway would generally be a decrease in goodwill. During 1999, the valuation allowance decreased due to the effects of currency exchange offset by an increase of \$1,056 due to the generation of additional excess foreign tax credits. During 2000, the valuation allowance decreased by \$1,867 primarily due to expiration of foreign tax credits which were written off against the related reserves. Foreign tax credit carryforwards expire in varying amounts through 2005.

{ note 7 Long-Term Debt

December 31,	1999	2000
Senior debt	\$ 692	\$ 43,087
Term loans (see Note 17)	22,286	66,025
11% Senior Subordinated Notes	110,000	110,000
Note payable to a foreign bank	1,177	367
Open account loans, payable on demand to a foreign bank	5,925	3,931
Total	140,080	223,410
Less current portion	7,286	9,516
	\$132,794	\$213,894

Scheduled maturities of long-term debt as of December 31, 2000 are as follows:

	Amount
2001	\$ 9,516
2002	5,307
2003	5,332
2004	5,360
2005	115,390
Thereafter	82,505
	\$223,410

On September 14, 2000, the Company entered into an amended and restated credit agreement (the "Credit Facility") with its existing lender to accommodate the acquisition of UMI. The Credit Facility, which expires on September 14, 2008, extended the due date of the real estate term loan, provided a new \$45.0 million acquisition term loan and increased the Company's potential borrowing capacity for its domestic seasonal borrowing requirements from \$60.0 million to \$120.0 million in revolving credit loans. The real estate term loan is payable in monthly installments of \$170, based on a twenty-five year amortization, and includes interest at average 30-day LIBOR plus 1.5%. This term loan is collateralized by all of the Company's interests in the Steinway Hall property. The acquisition term loan is repayable in monthly installments of \$0.4 million for the first five years and monthly installments of \$0.6 million in years six through eight. The acquisition term loan and revolving credit loans bear interest at average 30-day LIBOR plus 1.75%. Borrowings are collateralized by the Company's domestic accounts receivable, inventory and fixed assets. As of December 31, 2000, revolving credit loans outstanding were \$43.1 million and additional availability based on eligible accounts receivable and inventory balances was approximately \$68.6 million.

The 11% Senior Subordinated Notes, due May 15, 2005, became redeemable at the Company's option, in whole or in part, beginning June 1, 2000. The redemption prices (expressed as percentages of the principal amount) plus accrued and unpaid interest to the applicable redemption date, are as follows if redeemed during the twelve-month period beginning on June 1 of the years indicated below:

2000	104.125%
2001	102.750%
2002	101.375%
2003 and thereafter	100.000%

The note payable to a foreign bank is due in monthly installments of DM 127 (\$61 at the December 31, 2000 exchange rate) through June 1, 2001, and bears interest at 6.25%.

The open account loans provide for borrowings by foreign subsidiaries of up to DM 40,000 (\$19,273 at the December 31, 2000 exchange rate) payable on demand. A portion of the open account loan can be converted into a maximum of £1,049 (\$1,566 at the December 31, 2000 exchange rate) for use by the Company's UK branch and ¥396,704 (\$3,469 at the December 31, 2000 exchange rate) for use by the Company's Japanese subsidiary. Demand borrowings bear interest at rates of 8.2-8.35% for the Deutsche mark loans, 5.7-5.85% for Euromoney-market short-term loans (DM based) and 1.695% for Japanese yen loans. The Company has also purchased two interest rate

caps. One cap limits the base interest rate to 5% on DM 5,000 (\$2,409 at the December 31, 2000 exchange rate) declining to DM 1,000 (\$481 at the December 31, 2000 exchange rate) in 2004. The other cap limits the base interest rate to 6.25% on DM 3,000 (\$1,446 at the December 31, 2000 exchange rate) and expires in 2005.

All of the Company's debt agreements contain certain financial covenants which, among other things, require the maintenance of certain financial ratios and net worth, place certain limitations on additional borrowings and capital expenditures, and prohibit the payment of cash dividends. The Company is in compliance with all such covenants.

{note 8 Fair Values of Financial Instruments

The following disclosures of the estimated fair values of financial instruments are made in accordance with the requirements of SFAS No. 107, "Disclosures about Fair Values of Financial Instruments". The estimated fair values have been developed using appropriate methodologies; however, considerable judgment is required to develop these estimates. Accordingly, the estimates presented herein are not necessarily indicative of amounts that could be realized in a current market exchange. Use of different assumptions or methodologies could have a significant effect on these estimates.

The net carrying value and estimated fair value of the Company's financial instruments is as follows:

December 31,	1999		2000	
	Net Carrying Value	Estimated Fair Value	Net Carrying Value	Estimated Fair Value
Financial liabilities:				
Long-term debt	\$140,080	\$145,556	\$223,410	\$226,554
Foreign currency contracts		(199)		(228)
Interest rate caps		44		16

The carrying amount of cash, accounts, notes and leases receivable, and accounts payable approximate fair value because of the short maturity of these instruments.

The estimated fair value of existing long-term debt is based on rates currently available to the Company for debt with similar terms and remaining maturities.

The estimated fair value of foreign currency contracts (used for hedging purposes) has been determined as the difference between the current spot rate and the contract rate multiplied by the notional amount of the contract or upon the estimated fair value of purchased option contracts. The net carrying value of these contracts approximates zero as any gains or losses on the contracts are generally offset by losses or gains on the related hedged asset or liability.

{note 9 Other Assets, net

December 31,	1999	2000
Trademarks	\$19,718	\$22,213
Deferred financing costs	9,294	13,234
Other assets	2,578	2,235
	31,590	37,682
Less accumulated amortization	14,282	17,037
	\$17,308	\$20,645

{note 10 Other Current Liabilities

December 31,	1999	2000
Accrued payroll and related benefits	\$12,157	\$15,266
Current portion of pension liability	502	685
Accrued warranty expense	2,330	2,355
Accrued income taxes	1,882	1,678
Accrued interest	1,518	1,675
Other accrued expenses	12,364	14,194
	\$30,753	\$35,853

{note 11 Other (Income) Expense, net

Years Ended December 31,	1998	1999	2000
West 57th Building income \$	—	\$(3,516)	\$(4,653)
West 57th Building expenses	—	2,452	3,254
Foreign exchange (gain) loss, net	(384)	(116)	462
Miscellaneous	(771)	(701)	(888)
	\$(1,155)	\$(1,881)	\$(1,825)

{note 12 Stockholders' Equity

The Company's common stock is comprised of two classes: Class A and Ordinary. With the exception of disparate voting power, both classes are substantially identical. Each share of Class A common stock entitles the holder to 98 votes. Holders of Ordinary common stock are entitled to one vote per share. Class A common stock shall automatically convert to Ordinary common stock if, at any time, the Class A common stock is not owned by an original Class A holder.

EMPLOYEE STOCK PURCHASE PLAN The Company has an employee stock purchase plan (the "Purchase Plan") under which substantially all employees may purchase common stock through payroll deductions at a purchase price equal to 85% of the lower of the fair market values as of the beginning or end of each twelve-month offering period. Stock purchases under the Purchase Plan are limited to 5% of an employee's annual base earnings. During 1998, 1999 and 2000, 30,431, 29,502 and 31,773 shares, respectively, were issued under the Purchase Plan. Of the 500,000 shares originally reserved for issuance under the Purchase Plan, 378,737 shares remain reserved for future issuance as of December 31, 2000.

STOCK PLAN The 1996 stock plan (the "Stock Plan") provides for the granting of 778,250 stock options (including incentive stock options and non-qualified stock options), stock appreciation rights and other stock awards to certain key employees, consultants and

advisors of the Company and its subsidiaries. Common stock reserved for issuance under the Stock Plan was 731,550 shares as of December 31, 2000.

Option activity for the years ended December 31 is as follows:

	1998		1999		2000	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding at beginning of year	586,730	\$19.14	562,344	\$19.31	536,020	\$19.26
Granted	41,645	20.72	36,078	22.19	152,851	18.13
Exercised	(55,231)	18.61	(40,002)	22.80	(42,173)	16.43
Canceled, forfeited or expired	(10,800)	19.00	(22,400)	18.97	(14,300)	19.21
Outstanding at end of year	562,344	19.31	536,020	19.26	632,398	19.09
Exercisable at end of year	200,700	\$19.09	300,800	\$19.14	382,700	\$19.17

The following table sets forth information regarding outstanding and exercisable options at December 31, 2000:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number of Options	Weighted Average Remaining Contract Life	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
\$15.49	13,598	.6 years	\$15.49		
18.84 to 21.94	618,800	6.3	19.17	382,700	\$19.17
\$15.49 to 21.94	632,398	6.2	\$19.09	382,700	\$19.17

STOCK-BASED COMPENSATION EXPENSE As described in Note 2, the Company uses the intrinsic value method to measure compensation expense associated with grants of stock options to employees. Had the Company used the fair value method to measure compensation, as set forth in SFAS No. 123, "Accounting for Stock-Based Compensation", reported net income and net income per share would have been as follows for the years ended December 31:

	1998	1999	2000
Net income	\$15,929	\$16,465	\$15,933
Basic income per share	\$1.71	\$1.79	\$1.79
Diluted income per share	\$1.68	\$1.77	\$1.79

The fair value of options on their grant date, including the valuation of the option feature implicit in the Purchase Plan, was measured using the Black-Scholes option pricing model. Key assumptions used to apply this pricing model are as follows:

	1998	1999	2000
Range of risk-free interest rates	4.66-5.35%	4.99-5.10%	6.05-6.41%
Range of expected life of option grants (in years)	1 to 6	1 to 6	1 to 6
Expected volatility of underlying stock	26.4%	26.8%	26.0%

The weighted average fair value of options on their grant date, including the valuation of the option feature implicit in the Purchase Plan, is as follows:

	1998	1999	2000
Stock Plan	\$7.69	\$7.79	\$7.64
Purchase Plan	\$7.41	\$6.10	\$4.79

It should be noted that the Black-Scholes option pricing model was designed to value readily tradable options with relatively short lives and no vesting restrictions. In addition, option valuation models require the input of highly subjective assumptions including the expected price volatility. Because the options granted are not tradable and have contractual lives of up to ten years, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of the options issued under the Company's Stock Plan and Purchase Plan.

{ note 13 Retirement Plans

The Company has defined benefit pension plans covering the majority of its employees, including certain employees in foreign countries. Plan assets are invested primarily in common stocks and fixed income securities. The Company makes contributions generally equal to the

minimum amounts required by federal laws and regulations. Foreign plans are funded in accordance with the requirements of regulatory bodies governing each plan.

The following table sets forth the funded status and amounts recognized as of December 31, 1999 and 2000 for the Company's domestic and foreign defined benefit pension plans:

	Domestic Plans		Foreign Plans	
	1999	2000	1999	2000
Change in benefit obligation:				
Benefit obligation, beginning of year	\$23,599	\$22,049	\$ 17,785	\$ 16,304
Service cost	1,256	1,133	528	517
Interest cost	1,528	1,883	1,006	916
Plan participants' contributions	23	23	—	—
Amendments	130	1,978	—	—
Actuarial (gain) loss	(3,633)	46	(115)	(143)
Foreign currency exchange rate changes	—	—	(2,063)	(1,040)
Acquisition	—	4,886	—	123
Benefits paid	(854)	(1,030)	(837)	(754)
Benefit obligation, end of year	22,049	30,968	16,304	15,923
Change in plan assets:				
Fair value of plan assets, beginning of year	23,048	27,084	3,548	3,996
Return on plan assets	3,067	(785)	526	(336)
Acquisition	—	3,938	—	—
Employer contribution	1,800	1,685	805	731
Employee contributions	23	23	50	47
Foreign currency exchange rate changes	—	—	(96)	(300)
Benefits paid	(854)	(1,030)	(837)	(754)
Fair value of plan assets, end of year	27,084	30,915	3,996	3,384
Funded status	5,035	(53)	(12,308)	(12,539)
Unrecognized net actuarial (gain) loss	(6,569)	(3,292)	(311)	173
Unrecognized prior service cost	1,708	3,323	—	—
Net amount recognized	\$ 174	\$ (22)	\$(12,619)	\$(12,366)
Amounts recognized in the balance sheet consist of:				
Prepaid (accrued) benefit cost	\$ 174	\$ (143)	\$(12,619)	\$(12,366)
Additional minimum pension liability	—	121	—	—
Net amount recognized	\$ 174	\$ (22)	\$(12,619)	\$(12,366)

	Domestic Plans			Foreign Plans		
	1998	1999	2000	1998	1999	2000
Weighted average assumptions as of December 31:						
Discount rate	7.0%	7.75%	7.75%	5.5-6.5%	5.75-6.5%	5.75-6.5%
Expected return on assets	8.5	8.5	9.0	6.5	6.75	6.75
Rate of compensation increase	4.0	4.0	4.0	2.5-4.0	2.5-4.5	2.5-4.5

The components of net pension expense for the years ended December 31 are as follows:

	1998	1999	2000
Domestic Plans:			
Service cost	\$1,155	\$1,256	\$1,133
Interest cost	1,437	1,528	1,883
Expected return on plan assets	(1,490)	(1,778)	(2,323)
Amortization of prior service cost	216	216	362
Recognized actuarial (gain) loss	18	14	(122)
Net pension expense	\$1,336	\$1,236	\$ 933
Foreign Plans:			
Service cost	\$ 456	\$ 528	\$ 517
Interest cost	1,014	1,006	916
Expected return on plan assets	(289)	(225)	(232)
Net pension expense	\$1,181	\$1,309	\$1,201

The projected benefit obligation, accumulated benefit obligation, and fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets were \$11,994, \$11,510 and \$0, respectively, as of December 31, 1999 and \$16,467, \$15,974 and \$3,912, respectively, as of December 31, 2000.

The Company provides postretirement health care and life insurance benefits to eligible hourly retirees and their dependents. The health care plan is contributory, with retiree contributions adjusted every three years as part of a union contract agreement. The plans are unfunded and the Company pays part of the health care premium and the full amount of the life insurance cost.

The following table sets forth the funded status of the Company's postretirement benefit plans and accrued postretirement benefit cost reflected in the Company's consolidated balance sheet at year end:

December 31,	1999	2000
Change in benefit obligation:		
Benefit obligation, beginning of year	\$1,343	\$1,233
Service cost	41	47
Interest cost	88	106
Actuarial (gain) loss	(188)	165
Benefits paid	(51)	(63)
Benefit obligation, end of year	1,233	1,488
Fair value of plan assets	—	—
Funded status	(1,233)	(1,488)
Unrecognized net actuarial gain	(193)	(28)
Unrecognized prior service cost	703	652
Accrued postretirement benefit cost	\$ (723)	\$ (864)

The assumed weighted average discount rate as of December 31 was 6.75% in 1998 and 7.75% in 1999 and 2000. The annual assumed rate of increase in the per capita cost of covered health care benefits is 8.5% for retirees under age 65 in 2000 and is assumed to decrease gradually to 5.5% in 2006, and remain at that level thereafter.

Net postretirement benefit costs are as follows:

Years Ended December 31,	1998	1999	2000
Service cost	\$ 39	\$ 42	\$ 47
Interest cost	87	88	107
Amortization of transition obligation	50	50	50
Net postretirement benefit cost	\$176	\$180	\$204

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plan. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	1% Increase	1% Decrease
Effect on total of service and interest cost components	\$ 9	\$ (8)
Effect on the postretirement benefit obligation	70	(62)

The Company also sponsors 401(k) retirement savings plans for eligible employees. Discretionary employer contributions, as determined annually by the Board of Directors, are made to one of these plans. The 1998, 1999 and 2000 contribution approximated \$433, \$477 and \$590, respectively.

{ note 14 **Foreign Exchange Contracts**

At December 31, 1999, the Company's German divisions, whose functional currency is the Deutsche mark, had forward contracts and purchased options to sell ¥392,665 and £1,100 and to buy \$430 in order to manage any currency exchange fluctuations on its intercompany transactions. These instruments matured at various dates through November 2000.

At December 31, 2000, these instruments, maturing at various dates through April 2002, consisted of forward contracts and purchased options to sell ¥37,252 and £1,600. The Company's only use of purchased options is to manage currency exchange fluctuations.

{ note 15 **Related Party Transactions**

The principals of Kirkland Messina LLC, a merchant banking firm, control 85% of the voting power of the Company's common stock. Kirkland Messina LLC and its principals received annual payments of \$400 in 1998 for ongoing management and other services to the Company. In 1999, the management agreements were terminated and the principals entered into employment agreements with the Company.

{ note 16

Quarterly Financial Data (Unaudited)

The following is a summary of unaudited results of operations for the years ended December 31, 1999 and 2000:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1999				
Net sales	\$83,134	\$76,160	\$72,707	\$72,635
Gross profit	27,427	24,718	22,059	26,544
Net income	5,188	4,566	3,469	4,122
Basic income per share	\$.56	\$.49	\$.38	\$.45
Diluted income per share	.56	.49	.37	.45
Weighted average shares:				
Basic	9,265,163	9,236,363	9,241,350	9,108,935
Diluted	9,337,044	9,341,506	9,323,630	9,109,043
2000				
Net sales	\$87,775	\$77,824	\$75,702	\$90,397
Gross profit	26,604	24,934	23,442	29,978
Net income	5,207	4,513	2,800	4,384
Basic income per share	\$.58	\$.51	\$.31	\$.49
Diluted income per share	.58	.51	.31	.49
Weighted average shares:				
Basic	8,924,535	8,906,604	8,921,724	8,931,500
Diluted	8,934,965	8,906,606	8,921,724	8,931,500

{ note 17

Commitments and Contingent Liabilities

LEASE COMMITMENTS The Company leases various facilities and equipment under noncancelable operating lease arrangements. These leases expire at various times through 2016 with various renewal options. Rent expense was \$3,638, \$3,921 and \$3,979 for the years ended December 31, 1998, 1999 and 2000, respectively.

In March 1999, the Company acquired the building that includes the Steinway Hall retail store on West 57th Street in New York City for approximately \$30.8 million. The Company entered into a ninety-nine year land lease as part of the transaction. Annual rent payable under the land lease is \$2,170 in the first ten years, \$2,790 for the subsequent ten year period and will be adjusted every twenty years thereafter to the greater of the existing rent or 4% of the fair market value of the land and building combined. The Company also entered into a ten year master lease whereby all of the Company's interest in the land and building was leased back to the owner of the land. Rental expense and rental income associated with these leases was \$1,874 and \$3,516, respectively, for the year ended December 31, 1999 and \$2,480 and \$4,653, respectively, for the year ended December 31, 2000 and are included, along with other real estate costs, in other income/expense (see Note 11).

Future minimum lease payments for the Company's noncancelable operating leases, excluding the land lease discussed above, and future rental income under the master lease for the years ending December 31 are as follows:

	Lease Payments	Rental Income
2001	\$ 3,972	\$ 4,653
2002	3,528	4,653
2003	3,426	4,653
2004	3,119	4,653
2005	2,966	4,653
Thereafter	7,128	13,959
Minimum total	\$24,139	\$37,224

NOTES RECEIVABLE SOLD WITH RECOURSE The Company sells notes receivable on a recourse basis to a financing company under a facility that expires in August 2001. Pursuant to the terms of the facility, the financing company may, at its option, purchase up to an aggregate principal amount outstanding at any time of \$16 million of the Company's notes receivable. The Company received proceeds of approximately \$14.1 million and \$10.1 million from the sales of such notes during the years ended December 31, 1999 and 2000, respectively. Other current liabilities include a recourse obligation of \$1.4 million and \$1.1 million as of December 31, 1999 and 2000, respectively, for the notes sold with recourse.

ENVIRONMENTAL MATTERS The Company is continuing existing environmental remediation projects at facilities acquired in 2000. Management believes that established reserves, which approximated \$500 at December 31, 2000 and are included in other current liabilities, are adequate to cover the remaining cost of these remediation projects. Other environmental matters are pending against the Company, which might result in monetary damages, the amount of which, if any, cannot be determined at the present time. Philips Electronics, a previous owner of the Company, has agreed to hold the Company harmless from any financial liability arising from these environmental matters which were pending as of December 29, 1988. Management believes that these matters will not have a material adverse impact on the Company's consolidated results of operations or financial condition.

LITIGATION In the ordinary course of its business, the Company is party to various legal actions that management believes are routine in nature and incidental to the operation of its business. While the outcome of such actions cannot be predicted with certainty, management believes that, based on the experience of the Company

in dealing with these matters, the ultimate resolution of these matters will not have a material adverse impact on the financial condition or consolidated results of operations of the Company.

{note 18 **Business Segments**

As discussed in Note 2, the Company has identified two distinct and reportable segments: the piano segment and the band and orchestral instrument segment. The Company considers these two segments reportable as they are managed separately and the operating results of each segment are regularly reviewed and evaluated separately by the Company's senior management.

The accounting policies of each segment are the same as those described in Note 2. Intercompany transactions are generally recorded at cost plus a predetermined markup.

The following tables present information about the Company's operating segments:

1998	Piano Segment				Band and Orchestral Segment			Other & Elim	Consolidated Total
	U.S.	Germany	Other	Total	U.S.	Other	Total		
Revenues from									
external customers	\$104,209	\$40,753	\$16,162	\$161,124	\$127,943	\$4,184	\$132,127	\$ —	\$293,251
Interest income	—	31	19	50	824	—	824	197	1,071
Interest expense	8,887	221	227	9,335	19,597	—	19,597	(15,950)	12,982
Depreciation & amortization	4,427	2,573	186	7,186	3,392	14	3,406	38	10,630
Income tax expense	3,884	2,707	696	7,287	1,025	37	1,062	6,057	14,406
Net income	3,008	2,405	1,004	6,417	485	57	542	9,692	16,651
Capital expenditures	3,164	387	36	3,587	2,663	—	2,663	14	6,264
Total assets	91,960	66,774	9,556	168,290	277,107	2,962	280,069	(164,432)	283,927
1999									
	U.S.	Germany	Other	Total	U.S.	Other	Total	Other & Elim	Consolidated Total
Revenues from									
external customers	\$117,428	\$39,115	\$17,041	\$173,584	\$126,781	\$4,271	\$131,052	\$ —	\$304,636
Interest income	—	15	18	33	820	—	820	54	907
Interest expense	10,247	358	215	10,820	20,035	—	20,035	(16,672)	14,183
Depreciation & amortization	5,435	2,568	187	8,190	3,383	—	3,383	45	11,618
Income tax expense (benefit)	4,305	2,455	731	7,491	(510)	12	(498)	5,407	12,400
Net income (loss)	4,332	2,287	1,175	7,794	(1,124)	23	(1,101)	10,652	17,345
Capital expenditures	34,064	861	209	35,134	1,012	—	1,012	46	36,192
Total assets	128,466	55,902	11,964	196,332	278,712	3,444	282,156	(168,847)	309,641
2000									
	U.S.	Germany	Other	Total	U.S.	Other	Total	Other & Elim	Consolidated Total
Revenues from									
external customers	\$123,528	\$38,630	\$20,686	\$182,844	\$143,904	\$4,950	\$148,854	\$ —	\$331,698
Interest income	—	16	25	41	1,250	—	1,250	—	1,291
Interest expense	11,372	454	219	12,045	23,020	—	23,020	(17,664)	17,401
Depreciation & amortization	6,074	2,343	218	8,635	3,659	—	3,659	48	12,342
Income tax expense (benefit)	3,972	1,735	1,192	6,899	(671)	(132)	(803)	4,404	10,500
Net income (loss)	4,723	2,837	1,514	9,074	(3,076)	(266)	(3,342)	11,172	16,904
Capital expenditures	4,524	1,053	39	5,616	2,184	55	2,239	35	7,890
Total assets	144,014	54,008	11,444	209,466	407,958	3,868	411,826	(199,476)	421,816

Management's Discussion and Analysis

Introduction

The following discussion provides an assessment of the results of operations and liquidity and capital resources for the Company and should be read in conjunction with the consolidated financial statements of the Company and the notes thereto included elsewhere in this report.

Overview

The Company, through its operating subsidiaries, is one of the world's leading manufacturers of musical instruments. The Company's strategy is to capitalize on its strong brand names, leading market positions and quality products. The Company's net sales of \$332 million for the year ended December 31, 2000 were comprised of piano sales of \$183 million and band and orchestral instrument sales of \$149 million.

Piano sales are influenced by general economic conditions, demographic trends and general interest in music and the arts. The operating results of this segment are primarily affected by Steinway & Sons grand piano sales. Given the total number of these pianos sold in any year (3,647 sold in 2000), a slight change in units sold can have a material impact on the Company's business and operating results. Grand piano unit shipments have increased 16% from 1997 to 2000, largely attributable to the strong U.S. economy, increased selling and marketing efforts, and recent improvements in the international markets. In 2000, approximately 64% of piano sales were in the United States, 26% in Europe and the remaining 10% primarily in Asia.

Student band instrument sales are strongly influenced by trends in school enrollment and general attitudes toward music and the arts. The school instrument business is generally resistant to macroeconomic cycles and strongly correlated to the number of school children in the United States, which after increasing steadily over the past several years, will stabilize and remain relatively consistent over the next few years. Beginner instruments accounted for 77% of band and orchestral unit shipments and 52% of instrument revenues in 2000, with advanced and professional instruments representing the balance. In 2000, approximately 86% of band sales were in the United States, 7% in Europe and the remaining 7% primarily in Asia.

Although the Company cannot accurately predict the precise effect of inflation on its operations, it does not believe that inflation has had a material effect on sales or results of operations in recent years. Sales to customers outside the United States represent approximately 26% of consolidated sales, with international piano sales accounting for over 75% of these international sales. A significant portion of international piano sales originate from its German manufacturing facility, resulting in sales, cost of sales and related operating expenses denominated in Deutsche marks. While currency translation has affected international sales, cost of sales and related operating expenses, it has not had a material impact on operating income. The Company utilizes financial instruments such as forward exchange contracts and currency options to reduce the impact of exchange rate fluctuations on firm and

anticipated cash flow exposures and certain assets and liabilities denominated in currencies other than the functional currency. The Company does not purchase currency related financial instruments for purposes other than exchange rate risk management.

The Company's effective tax rates vary depending on the relative proportion of foreign to U.S. income (foreign income generally, and German income in particular, bear higher rates of tax) and absorption of foreign tax credits in the U.S. In 2000, a one-time tax benefit associated with the reduction of deferred tax balances caused by a rate reduction in Germany lowered the Company's effective tax rate from 42% in 1999 to 38% in 2000.

The Company has historically grown through strategic acquisitions of complementary businesses. Recent acquisitions have included the Kluge group of companies in December 1998 and O.S. Kelly in November 1999. In January 2000, the Company acquired Pianohaus Karl Lang ("PKL") for approximately \$2.3 million. PKL, located in Munich, is Germany's largest retail piano store and is expected to strengthen Steinway's foreign distribution network. In September 2000, the acquisition of United Musical Instruments Holdings, Inc. ("UMI") was completed with an aggregate purchase price of approximately \$84.0 million, including the assumption of approximately \$57.0 million of debt. UMI, a domestic manufacturer of band and orchestral instruments, produces instruments under the C.G. Conn, King, Armstrong, and Scherl & Roth brand names. UMI's strength in background brass instruments is expected to complement current product offerings and will enhance the Company's dominant market position in the other categories in which it competes. The following discussion includes each of these businesses since its date of acquisition.

Results of Operations

2000 vs. 1999

NET SALES Net sales increased \$27.1 million (8.9%) to \$331.7 million in 2000. Piano sales increased \$9.3 million (5.3%), reflecting higher Steinway shipments which increased 14% overseas and more than 8% overall. This strong performance by Steinway more than offset a 12% decline in Boston units which were negatively impacted by significant price increases necessitated by the strengthening Japanese yen. Band and orchestral sales increased \$17.8 million (13.6%). The acquisition of UMI added \$19.8 million of sales, which offset a decline in average selling prices attributable to a change in the volume incentive program offered to band dealers. Rebate programs previously offered, the cost of which had been included in operating expenses, were replaced with price discount programs. Overall unit shipments increased 17%.

GROSS PROFIT Gross profit increased \$4.2 million (4.2%) to \$105.0 million. Gross margins declined from 33.1% in 1999 to 31.6% in 2000. Piano margins increased slightly, from 35.2% to 35.6%, as a result of the higher proportion of Steinway units sold. Band instrument margins declined from 30.2% to 26.8% primarily due to the change to a volume-based price discount program from a

rebate program. Manufacturing inefficiencies that occurred in the first half of 2000, as well as additional costs associated with the reengineering of two manufacturing plants, also negatively impacted gross margins.

OPERATING EXPENSES Operating expenses increased only \$3.7 million (6.1%) despite the additions of UMI and PKL in 2000. Operating expenses decreased as a percentage of sales from 19.6% in 1999 to 19.1% in 2000. Operating expenses for existing operations declined primarily due to the replacement of rebate programs which generated \$3.6 million of expense in 1999. This reduction was offset by the addition of \$5.3 million in operating expenses from UMI and PKL, as well as \$1.5 million of non-recurring charges associated with the UMI acquisition.

OTHER EXPENSE, NET Other expense increased \$2.9 million (25.4%) to \$14.3 million in 2000. This increase is the result of higher interest expenses associated with higher average outstanding debt balances throughout the year and the acquisition of UMI.

1999 vs. 1998

NET SALES Net sales increased \$11.4 million (3.9%) to \$304.6 million in 1999. Piano sales increased \$12.5 million (7.7%). Total piano shipments increased nearly 9%, comprised of a 14% increase in Boston units and a 3% increase in Steinway units. Band and orchestral instrument sales decreased \$1.1 million (0.8%) to \$131.0 million in 1999. A decline in foreign shipments and a highly competitive domestic market, coupled with production difficulties, caused a 3% decrease in band and orchestral instrument shipments for the year.

GROSS PROFIT Gross profit increased \$2.3 million (2.3%) to \$100.7 million. Gross margins declined from 33.6% in 1998 to 33.1% in 1999. Piano margins declined slightly, from 35.4% to 35.2%, as a result of the higher proportion of Boston sales coupled with a yen driven cost increase on those instruments. These negative factors were almost entirely offset by a higher mix of retail sales and the cost savings derived from the integration of Kluge. Band instrument margins declined from 31.3% to 30.2% primarily due to manufacturing inefficiencies. The most significant problems occurred at the brasswind plant where bottlenecks due to a lack of trained workers caused production levels to decline in the second half of the year.

OPERATING EXPENSES Operating expenses increased \$2.9 million (5.2%) to \$59.6 million in 1999. Operating expenses increased as a percentage of sales from 19.3% in 1998 to 19.6% in 1999. The majority of the increase occurred in the sales and marketing area which was up nearly \$2.0 million over the prior year. This increase was primarily due to aggressive band instrument marketing programs and expenses attributable to the higher level of piano sales. In addition, Kluge, which was not part of the operations in 1998, incurred \$0.6 million of operating expenses in 1999.

OTHER EXPENSE, NET Other expense increased \$0.6 million (5.9%) to \$11.4 million in 1999. This increase is the result of higher interest expenses offset by income generated from the leasing of the Steinway Hall building.

Liquidity and Capital Resources

The Company has relied primarily upon cash provided by operations, supplemented as necessary by seasonal borrowings under its working capital line, to finance its operations, repay long-term indebtedness and fund capital expenditures.

Cash provided by operations was \$14.2 million in 1998, \$15.4 million in 1999 and \$13.3 million in 2000. During 2000, the Company embarked on a major initiative to effect fundamental changes in its band instrument manufacturing operations. Approximately \$1.8 million of expense related to the project was incurred during the year. The long-term benefits of the project, which will be completed by mid-2002, are expected to be improved production flow, efficiency and quality.

Cash used for the acquisitions of Kluge, O.S. Kelly, PKL and UMI was \$1.3 million in 1998, \$2.6 million in 1999 and \$86.6 million in 2000, respectively. The Company acquired the building that includes the Steinway Hall retail showroom in New York City in March 1999 for \$30.8 million. Funds for the acquisition were provided from cash on hand and a new \$22.5 million real estate term loan provided by the Company's existing lender. This loan is due in monthly installments of \$0.2 million, including principal and interest based on a twenty-five year amortization. The term loan bears interest at average 30-day LIBOR plus 1.5%.

Additional capital expenditures of \$6.3 million, \$5.4 million and \$7.9 million in 1998, 1999 and 2000, respectively, were primarily used for purchasing new machinery and building improvements. The Company expects to maintain this level of capital spending in the future as it continues to modernize its equipment and renovate its facilities in order to improve its production efficiency.

Consistent with industry practice, the Company sells band instruments almost entirely on credit utilizing the two financing programs described below. These programs create large working capital requirements during the year when band instrument receivable balances reach highs of approximately \$65-70 million in August and September, and lows of approximately \$35-40 million in January and February. The financing options, intended to assist dealers with the seasonality inherent in the industry and to facilitate the rent-to-own programs offered to students by many retailers, also allow the Company to match its production and delivery schedules. The following forms of financing are offered to qualified band instrument dealers:

- A) **RECEIVABLE DATING** Purchases made from January through August have payment due in October. Purchases made from September to December have payment due in January. Dealers are offered discounts for early payment.
- B) **NOTE RECEIVABLE FINANCING** Qualified dealers may convert open accounts to a note payable to the Company. The note program is offered in January and October, and coincides with the receivable dating program. The note receivable is secured by dealer inventories and receivables. The majority of notes receivable are purchased by a third-party financing company, on a full recourse basis. The

Company's current arrangement, which allows the financing company to purchase, at its option, up to an aggregate amount outstanding at any time of \$16.0 million of notes receivable, expires in August 2001. Net notes receivable sales generated approximately \$14.1 million and \$10.1 million in cash in 1999 and 2000, respectively.

Unlike many of its competitors in the piano industry, the Company does not provide extended financing arrangements to its dealers. To facilitate long-term financing required by some dealers, financing has been arranged through a third-party provider which generally involves no guarantee by the Company.

On September 14, 2000, the Company entered into an amended and restated credit agreement (the "Credit Facility") with its existing lender to accommodate the acquisition of UMI. The Credit Facility, which expires on September 14, 2008, extended the due date of the real estate term loan, provided a new \$45.0 million acquisition term loan and increased the Company's potential borrowing capacity from \$60.0 million to \$120.0 million in revolving credit loans. The acquisition term loan is repayable in monthly installments of \$0.4 million for the first five years and monthly installments of \$0.6 million in years six through eight. The acquisition term loan and revolving credit loans bear interest at average 30-day LIBOR plus 1.75%. Borrowings are secured by a first lien on the Company's domestic inventory, receivables, and fixed assets. As of December 31, 2000, revolving credit loans outstanding were \$43.1 million and additional availability, based on eligible accounts receivable and inventory balances, was approximately \$68.6 million. Open account loans with foreign banks also provide for borrowings by Steinway's foreign subsidiaries of up to 40 million Deutsche marks.

At December 31, 2000, the Company's total outstanding indebtedness amounted to \$223.4 million, consisting of \$110.0 million of 11% Senior Subordinated Notes (the "Notes"), \$21.8 million on the real estate term loan, \$44.2 million on the acquisition term loan, \$43.1 million under the Credit Facility and \$4.3 million of notes payable to foreign banks. Cash interest paid was \$14.2 million and \$17.2 million in 1999 and 2000, respectively. All of the Company's debt agreements contain covenants that place certain restrictions on the Company, including its ability to incur additional indebtedness, to make investments in other entities, and to pay cash dividends.

The Company's share repurchase program authorizes management to make discretionary repurchases of its ordinary common stock up to a limit of \$25.0 million. Repurchased shares are being held as treasury shares to be used for corporate purposes. The Company repurchased 395,300 shares at a cost of \$7.8 million in 1999 and 26,700 shares at a cost of \$0.5 million in 2000.

Management believes that cash on hand, together with cash flows anticipated from operations and available borrowings under the Credit Facility, will be adequate to meet debt service requirements, fund continuing capital requirements and satisfy working capital and general corporate needs through the next twelve months.

New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board released Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities", which was amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Hedging Activities" in 2000. These statements require that all derivatives be recognized at fair value in the balance sheet, and that the corresponding gains or losses be reported either in the statement of income or as a component of comprehensive income, depending on the type of hedging relationship that exists. The Company will adopt the amended standard January 1, 2001. Based on the results of the analysis to date, management does not expect the adoption of the amended standard to have a material effect on the Company's results of operations or financial position.

In December 1999, the Securities and Exchange Commission ("SEC") released Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition", which sets forth the SEC's views on appropriate revenue recognition practices. The Company believes that its current revenue recognition practices are in accordance with SAB No. 101.

Quantitative and Qualitative Disclosures About Market Risk

The Company is subject to market risk associated with changes in foreign currency exchange rates and interest rates. The Company mitigates its foreign currency exchange rate risk by holding forward foreign currency contracts. These contracts are used as a hedge against intercompany transactions and are not used for trading or speculative purposes. The fair value of the forward foreign currency exchange contracts is sensitive to changes in foreign currency exchange rates. As of December 31, 2000, a 10% adverse change in foreign currency exchange rates from market rates would increase the fair value of the contracts by approximately \$0.3 million. Gains and losses on the foreign currency exchange contracts are defined as the difference between the contract rate at its inception date and the current exchange rate. However, any such gains and losses would generally be offset by corresponding losses and gains, respectively, on the related hedged asset or liability.

The Company's interest rate exposure is limited primarily to interest rate changes on its variable rate debt. The Credit Facility and term loans bear interest at rates that fluctuate with changes in LIBOR. For the year ended December 31, 2000, a hypothetical 10% increase in interest rates would have increased the Company's interest expense by approximately \$0.5 million. The Company uses interest rate caps to manage interest rate risk on foreign debt. The carrying value of the cap is not material and a 10% change in interest rates would not have a material effect on the fair value of the cap.

The Company's long-term debt includes \$110.0 million of Notes with a fixed interest rate. Accordingly, there would be no immediate impact on the Company's interest expense associated with these Notes due to fluctuations in market interest rates. However, based on a hypothetical 10% immediate decrease in market interest rates, the fair value of the Company's Notes, which would be sensitive to such interest rate changes, would be increased by approximately \$1.2 million as of December 31, 2000. Such fair value changes may affect the Company's determination whether to retain, replace or retire these Notes.

Shareholder Information

Officers and Directors

Kyle R. Kirkland
Chairman of the Board; Director

Dana D. Messina
Chief Executive Officer; Director

Thomas T. Burzycki
President – Selmer; Director

Bruce A. Stevens
President – Steinway; Director

Dennis M. Hanson
Senior Executive Vice President,
Chief Financial Officer and
General Counsel

Michael R. Vickrey
Executive Vice President

Thomas Kurrer
Managing Director, Steinway –
Germany

Peter McMillan
Director; Managing Partner, Willow
Brook Capital Group, LLC

A. Clinton Allen
Director; Chairman and Chief
Executive Officer, A.C. Allen and
Company

Annual Meeting of Shareholders

The annual meeting of shareholders will be held on Friday, May 4, 2001 at 10:00 a.m. at Double Tree Guest Quarters Hotel, Waltham, MA 02453

Additional Financial Information

Additional copies of this annual report and the Company's Form 10-k, as filed with the Securities and Exchange Commission, are available without charge to interested shareholders upon request to:

Investor Relations
Steinway Musical Instruments, Inc.
800 South Street
Suite 305
Waltham, MA 02453

Internet Address

The Steinway Musical Instruments, Inc. home page on the World Wide Web is located at www.steinwaymusical.com. Recent financial data, historical information and the e-mail address for Steinway Investor Relations are available at this site.

Shareholders of Record

The Company's common stock is comprised of two classes: Class A and Ordinary. With the exception of disparate voting power, both classes are substantially identical. There are approximately 374 holders of record and 1,700 beneficial owners of the Company's Ordinary common stock. There are two holders of record of the Class A common stock.

General Counsel

Millbank, Tweed, Hadley & McCloy
601 South Figueroa Street
Los Angeles, CA 90017

Independent Auditors

Deloitte & Touche LLP
200 Berkeley Street
Boston, MA 02116

Transfer Agent & Registrar

Continental Stock Transfer & Trust Company
Two Broadway
New York, NY 10004

Price Range of Common Stock	High	Low
Fiscal Year Ended December 31, 1999		
First Quarter	\$26.00	\$20.06
Second Quarter	27.00	21.19
Third Quarter	25.69	20.75
Fourth Quarter	\$21.50	\$15.88
Fiscal Year Ended December 31, 2000		
First Quarter	\$20.94	\$17.50
Second Quarter	20.00	14.50
Third Quarter	18.75	16.38
Fourth Quarter	\$19.63	\$16.81

Stock Exchange Listing

New York Stock Exchange, Common Stock



Dividend Policy

The Company has paid no dividends since its inception and intends to continue its policy of retaining earnings to finance future growth. See Note 7 of Notes to Consolidated Financial Statements regarding limitations on the payment of dividends.

Forward-Looking Statements

This annual report contains "forward-looking statements" which represent the Company's present expectations or beliefs concerning future events. The Company cautions that such statements are necessarily based on certain assumptions which are subject to risks and uncertainties, including, but not limited to, changes in general economic conditions, increased competition, exchange rate fluctuations, and the availability of production capacity which could cause actual results to differ materially from those indicated herein. Further information on these risk factors is included in the Company's filings with the Securities and Exchange Commission.



*Steinway & Sons' limited edition
Tricentennial, celebrating the 300th anniversary
of the invention of the piano*



STEINWAY MUSICAL INSTRUMENTS, INC.

800 South Street	Suite 305	Waltham, MA 02453
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