

**FINISHMASTER, INC.**

**Financial Statements  
with Report of Independent Auditors**

**At December 31, 2008 and 2007  
and for each of the  
Three Years in the Period Ended December 31, 2008**

# **FINISHMASTER, INC.**

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## Report of Independent Auditors

Board of Directors and Shareholders  
FinishMaster, Inc.

We have audited the accompanying consolidated balance sheets of FinishMaster, Inc. as of December 31, 2008 and 2007, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of FinishMaster, Inc. at December 31, 2008 and 2007, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2008 in conformity with U.S. generally accepted accounting principles.

*Ernst & Young LLP*

February 27, 2009

# CONSOLIDATED BALANCE SHEETS

## FinishMaster, Inc.

(In thousands, except share amounts)

### ASSETS

#### Current assets

Cash and cash equivalents	\$ 2,461	\$ 4,230
Accounts receivable, net of allowance for doubtful accounts and customer discounts of \$3,773 and \$3,032, respectively	39,969	40,103
Inventories	111,723	86,665
Deferred income taxes	6,254	5,976
Investments in customers, current portion	8,110	8,068
Prepaid expenses and other current assets	4,160	4,067
	172,677	149,109

#### Property and equipment

Land	454	454
Buildings and improvements	13,073	11,666
Vehicles	2,546	2,745
Machinery, equipment and fixtures	21,466	20,814
	37,539	35,679
Accumulated depreciation	(25,645)	(25,080)
	11,894	10,599

#### Other long-term assets

Intangible assets, net	16,016	23,257
Goodwill, net	101,288	96,548
Investments in customers, net of current portion	15,110	15,512
Other	375	388
	132,789	135,705
	\$ 317,360	\$ 295,413

### LIABILITIES AND SHAREHOLDERS' EQUITY

#### Current liabilities

Accounts payable	\$ 67,135	\$ 51,186
Amounts due to affiliates	297	435
Accrued compensation and benefits	7,363	7,522
Other accrued expenses and current liabilities	4,363	3,859
Current maturities of long-term debt	1,697	4,390
	80,855	67,392

#### Long-term debt, less current maturities

80,339 90,271

#### Deferred income taxes

7,864 7,116

#### Other long-term liabilities

5,810 5,346

#### Commitments and contingencies

#### Shareholders' equity

Preferred stock, no par value; 1,000,000 shares authorized; no shares issued and outstanding	-	-
Common stock, \$1 stated value; 25,000,000 shares authorized; 7,877,599 and 7,874,647 shares issued and outstanding	7,878	7,875
Additional paid-in capital	29,667	29,940
Accumulated comprehensive loss	(934)	(348)
Retained earnings	105,881	87,821
	142,492	125,288
	\$ 317,360	\$ 295,413

See accompanying notes.

# CONSOLIDATED STATEMENTS OF INCOME

## FinishMaster, Inc.

(In thousands, except per share data)

	<b>Year Ended December 31, 2008</b>	<b>Year Ended December 31, 2007</b>	<b>Year Ended December 31, 2006</b>
<b>Net sales</b>	\$ 486,013	\$ 466,626	\$ 450,452
<b>Cost of sales</b>	337,756	328,978	315,175
<b>Gross margin</b>	148,257	137,648	135,277
<b>Expenses</b>			
Operating	49,533	45,870	43,415
Selling, general and administrative	65,933	60,646	55,203
Amortization of intangible assets	3,914	2,816	1,644
	119,380	109,332	100,262
<b>Income from operations</b>	28,877	28,316	35,015
<b>Interest expense</b>	3,936	3,252	4,623
<b>Other income</b>	5,224	-	6,452
<b>Income before income taxes</b>	30,165	25,064	36,844
<b>Income tax expense</b>	12,105	10,130	14,382
<b>Net income</b>	\$ 18,060	\$ 14,934	\$ 22,462
<b>Net income per share</b>			
Basic	\$ 2.29	\$ 1.92	\$ 2.89
Diluted	\$ 2.29	\$ 1.91	\$ 2.87
<b>Weighted average shares outstanding</b>			
Basic	7,876	7,790	7,774
Diluted	7,888	7,837	7,826

See accompanying notes.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

## FinishMaster, Inc.

(In thousands)	Year Ended December 31, 2008	Year Ended December 31, 2007	Year Ended December 31, 2006
<b>Operating activities</b>			
Net income	\$ 18,060	\$ 14,934	\$ 22,462
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	14,294	12,993	9,038
Deferred income taxes	845	(3,623)	3,997
Issuance of stock grants	20	15	10
Loss on disposal of property and equipment	162	25	79
Changes in operating assets and liabilities (excluding the impact of acquisitions):			
Accounts receivable, net	385	75	1,797
Inventories	(24,423)	(15,099)	(14,502)
Prepaid and other assets	3,252	9,055	(8,076)
Investments in customers	(10,719)	(11,059)	(7,224)
Accounts payable and other liabilities	14,335	15,736	(1,865)
<b>Net cash provided by operating activities</b>	16,211	23,052	5,716
<b>Investing activities</b>			
Business acquisitions	(1,866)	(20,110)	(693)
Purchases of property and equipment	(3,690)	(2,499)	(2,072)
<b>Net cash used by investing activities</b>	(5,556)	(22,609)	(2,765)
<b>Financing activities</b>			
Proceeds from exercise of stock options	21	1,037	-
Payment of dividends	-	(31,499)	-
Change in cash overdrafts	897	(3,520)	700
Payment of debt issuance costs	(19)	(146)	-
Proceeds from debt	75,085	150,764	99,909
Repayment of debt	(88,408)	(116,634)	(103,596)
<b>Net cash (used) provided by financing activities</b>	(12,424)	2	(2,987)
<b>(Decrease) increase in cash</b>	(1,769)	445	(36)
<b>Cash at beginning of year</b>	4,230	3,785	3,821
<b>Cash at end of year</b>	\$ 2,461	\$ 4,230	\$ 3,785
<b>Supplemental disclosure of cash flow information</b>			
Cash paid during the year for:			
Interest	\$ 4,106	\$ 3,393	\$ 4,470
Taxes	\$ 10,960	\$ 12,430	\$ 12,147

See accompanying notes.

# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

## FinishMaster, Inc.

(In thousands)	Common Stock	Additional Paid-in Capital	Accumulated Comprehensive Loss	Retained Earnings	Totals
<b>Balances at December 31, 2005</b>	\$ 7,773	\$ 28,377	\$ (19)	\$ 81,807	\$ 117,938
Comprehensive income:					
Net income	-	-	-	22,462	22,462
Other comprehensive income:					
Interest rate swap, net of tax of \$3	-	-	19	-	19
Total comprehensive income					22,481
Stock grants issued	1	9	-	-	10
<b>Balances at December 31, 2006</b>	7,774	28,386	-	104,269	140,429
Adjustment to initially apply FIN 48	-	-	-	117	117
Comprehensive income:					
Net income	-	-	-	14,934	14,934
Other comprehensive income:					
Interest rate swap, net of tax benefit of (\$237)	-	-	(348)	-	(348)
Total comprehensive income					14,586
Dividends paid	-	-	-	(31,499)	(31,499)
Stock grants issued and options exercised	101	1,554	-	-	1,655
<b>Balances at December 31, 2007</b>	7,875	29,940	(348)	87,821	125,288
Comprehensive income:					
Net income	-	-	-	18,060	18,060
Other comprehensive income:					
Interest rate swap, net of tax benefit of (\$375)	-	-	(586)	-	(586)
Total comprehensive income					17,474
Stock option adjustment	-	(311)	-	-	(311)
Stock grants issued and options exercised	3	38	-	-	41
<b>Balances at December 31, 2008</b>	\$ 7,878	\$ 29,667	\$ (934)	\$ 105,881	\$ 142,492

See accompanying notes.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## FinishMaster, Inc.

### 1. SIGNIFICANT ACCOUNTING POLICIES

**Nature of Business:** FinishMaster, Inc. (“the Company” or “FinishMaster”) is the largest national independent distributor of automotive paints, coatings and paint-related accessories to the automotive collision repair industry. As of December 31, 2008, the Company operated 172 branch locations and three major distribution centers in 28 states, and is organized into seven major geographical regions: Deep South, Mid-Atlantic, Midwest, Northeast, South, Southeast and West. The Company aggregates its seven geographic regions into a single reportable segment. The Company has approximately 12,500 customer credit accounts to which it provides a comprehensive selection of brand name products supplied by BASF, DuPont, PPG and 3M, in addition to its own FinishMaster private brand refinishing accessory products. The Company is highly dependent on the key suppliers outlined above, which account for approximately 86% of the Company’s purchases.

**Principles of Consolidation:** The Company’s consolidated financial statements include the accounts of FinishMaster and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. References to the Company or FinishMaster throughout this report relate to the consolidated entity.

**Majority Shareholder:** Lacy Distribution, Inc. (“Distribution”), an Indiana corporation, which is a wholly owned subsidiary of LDI Ltd., LLC (“LDI”), an Indiana limited liability corporation, owned 5,878,561 shares of the Company’s common stock, representing 74.6% and 74.7% of the outstanding shares at December 31, 2008 and 2007, respectively. Throughout the remainder of these financial statements, LDI and Distribution are collectively referred to as “LDI.”

**Transactions with Majority Shareholder:** The Company reimburses LDI for the cost of insurance, management fees and certain other expenses. Those expenses amounted to \$3,182,000, \$3,268,000 and \$2,820,000 for 2008, 2007 and 2006, respectively. In addition, the Company leases its corporate office space from LDI. Lease and repairs and maintenance payments to LDI totaled approximately \$454,000, \$367,000 and \$314,000 for 2008, 2007 and 2006, respectively.

**Use of Estimates:** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Cash and Cash Equivalents:** Cash and cash equivalents include cash and temporary investments with an initial maturity of three months or less. At December 31, 2008, checks drawn on future deposits and borrowings of \$897,000 were classified as accounts payable. This amount represents outstanding checks in excess of funds on deposit.

**Receivables:** Trade accounts receivable represents amounts due from customers. Trade receivables are typically not collateralized. No single customer exceeds 10% of the Company’s receivables at December 31, 2008 and 2007. The allowance for doubtful accounts reserve is calculated based on the Company’s historical experience in the collection of aged invoices.

**Inventories:** Inventories are stated at the lower of average cost or market and consist primarily of purchased paint and refinishing supplies. Substantially all inventories consist of finished goods.

**Properties and Depreciation:** Property and equipment is stated at cost and includes expenditures for new facilities, equipment and improvements that materially extend the useful lives of existing assets.

Expenditures for normal repairs and maintenance are charged to expense as incurred. Depreciation is computed using a straight-line method over the following range of estimated useful lives:

Buildings and improvements	Up to 30 years
Vehicles	Up to 5 years
Leasehold improvements	Life of lease
Machinery, equipment and fixtures	3 to 12 years

Depreciation expense for 2008, 2007 and 2006 was \$2,456,000, \$1,948,000 and \$1,725,000, respectively.

**Impairment of Long-Lived Assets:** The Company evaluates long-lived assets, including intangible assets with finite lives, in compliance with Statement of Financial Accounting Standards (“SFAS”) No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets.” An impairment loss is recognized whenever events or changes in circumstances indicate the carrying amount of an asset is not recoverable. In applying SFAS 144, assets are grouped and evaluated at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets. The Company considers historical performance and future estimated results in its evaluation of impairment. If the carrying amount of the asset exceeds expected undiscounted future cash flows, the Company measures the amount of impairment by comparing the carrying amount of the asset to its fair value.

**Investments in Customers:** The Company makes cash payments and consigns or invests inventory and equipment to certain customers as consideration for these customers entering into multiyear purchase commitments that include liquidated damages in the event that the customer breaches the commitment. These amounts are capitalized and amortized to their net realizable value over the purchase commitment period. The amortization is reflected as a reduction of revenue in accordance with Emerging Issues Task Force (“EITF”) Issue No. 01-09, “Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor’s Products.” Amounts reflected as a reduction of revenue in 2008, 2007 and 2006 were \$8,745,000, \$8,941,000 and \$6,255,000, respectively.

**Derivative Instruments and Hedging Activities:** The Company utilizes interest rate swaps to reduce its exposure to fluctuations in interest rates. These instruments are recorded on the balance sheet at their fair value. Changes in the fair value of the interest rate swaps are recorded each period in other long-term liabilities and in the accumulated comprehensive loss section of shareholders’ equity, net of tax.

**Fair Value of Financial Instruments:** In September 2006, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 157, “Fair Value Measurements,” which defines fair value, establishes a framework for measuring fair value in accordance with U.S. generally accepted accounting principles and expands disclosures about fair value measurements. For financial assets and liabilities, SFAS No. 157 was effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company has adopted the provisions of SFAS No. 157 as of January 1, 2008 for financial instruments. In February 2008, the FASB issued Staff Position (“FSP”) No. 157-2 which delays the effective date of SFAS No. 157 one year for all nonfinancial assets and nonfinancial liabilities, except those recognized or disclosed at fair value in the financial statements on a recurring basis. FSP 157-2 is effective for the Company beginning January 1, 2009.

Those assets and liabilities measured at fair value under SFAS No. 157 at December 31, 2008 did not have a material impact on the consolidated financial statements. In accordance with FSP 157-2, the Company will measure the remaining assets and liabilities beginning in 2009. The Company does not expect the adoption of SFAS No. 157, as amended by FSP 157-2, will have a material impact on the consolidated financial statements.

**Revenue Recognition:** Revenues from product sales are recognized at the time of delivery (FOB destination) to customers, which is typically the same day as the shipment. These recorded sales are net of estimated returns and allowances. Customers may receive discounts from the standard list price based upon their level of purchases. These discounts may be offered at the point-of-sale, end-of-month or any other negotiated time period. They may be in the form of standard invoice discounts, statement discounts, cash disbursements or recurring customer credits. These discounts are recorded as a reduction of revenue at the time of sale. Discounts that are earned over the course of several accounting periods are accrued based upon customer purchases.

**Transactions with Vendors:** The Company is offered by certain vendors volume-related discounts based upon purchases of their products over a specific time period. The purchase of these products is recorded net of these discounts based upon actual and estimated purchases compared to the contractual volume targets. Adjustments are made through cost of sales to reflect changes in these estimates.

The Company also receives reimbursements from vendors for specific expenses incurred. These reimbursements are recorded in accordance with EITF Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor," and are used to offset the actual incurred costs and are included in the line items where the incurred costs are recorded.

**Cost of Sales:** The Company includes product costs, vendor discounts and rebates, and shipping and handling costs in cost of sales. Shipping costs include those costs incurred to physically move the products from the Company's locations to its customers. These costs include vehicle expenses, wages and benefits of personnel responsible for moving the products from the branches to the customer, and all associated freight costs. Handling costs are those costs incurred to store, move and prepare the products for shipment. Shipping and handling costs were approximately \$28,655,000, \$27,755,000 and \$24,766,000 in 2008, 2007 and 2006, respectively.

**Stock-based Compensation:** The Company recognizes compensation expense related to its stock option plan in accordance with SFAS No. 123(R), "Share-Based Payment." Options are granted at a price not less than the fair market value of the Company's common stock on the date of grant. There were no stock options granted during 2008, 2007 and 2006.

**Income Taxes:** Deferred income taxes are recognized for the temporary differences between the tax bases of assets and liabilities and their financial reporting amounts in accordance with the provisions of SFAS No. 109, "Accounting for Income Taxes." The income tax provision is the tax payable for the period and the change during the period in deferred tax assets and liabilities.

The Company adopted the provisions of FASB Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" as of January 1, 2007. See Note 8, "Income Taxes" for additional information.

**Reclassifications:** Certain amounts in the 2006 consolidated financial statements have been reclassified to conform to the current year presentation.

## 2. ACQUISITIONS

The following table summarizes the assets acquired and liabilities assumed in acquisitions made by the Company in each of the years presented. All acquisitions have been accounted for as asset purchases and, accordingly, the acquired assets and liabilities have been recorded at their estimated fair values at the date of acquisition. Intangible assets such as agreements not-to-compete, customer lists and goodwill are recorded with each acquisition, if appropriate. Operating results of acquired businesses have been included in the Company's consolidated financial statements from the respective date of purchase.

(In thousands)	<b>2008</b>	<b>2007</b>	<b>2006</b>
Accounts receivable	\$ 251	\$ 3,451	\$ 171
Inventories	635	4,806	213
Equipment and other	231	1,930	251
Intangible assets	1,563	21,833	428
	<b>2,680</b>	<b>32,020</b>	<b>1,063</b>
Less liabilities assumed	116	2,452	185
Net assets of businesses acquired	2,564	29,568	878
Notes payable issued to former owners	698	9,458	185
	<b>\$ 1,866</b>	<b>\$ 20,110</b>	<b>\$ 693</b>
Number of acquisitions	4	8	2

Intangible assets recorded as a result of these acquisitions, subject to finalization during the allocation period, are as follows:

(In thousands)	<b>2008</b>	<b>2007</b>	<b>2006</b>
Agreements not-to-compete	\$ 347	\$ 11,875	\$ 183
Customer lists	1,216	9,958	245
	<b>\$ 1,563</b>	<b>\$ 21,833</b>	<b>\$ 428</b>

The estimated weighted-average useful life of the intangible assets acquired is 5.8 years, with 5.0 years for the agreements not-to-compete and 6.0 years for the customer lists.

During 2008, the Company completed four acquisitions: Auto Paint and Supply, Inc. with two locations in Florida; Cave Auto Body & Supply, Inc. with two locations in South Carolina; Texas Automotive Paint and Supply, L.P. with one location in San Antonio, Texas; and Oklahoma Paint & Body Supply, LLC with one location in Oklahoma City, Oklahoma. These acquisitions were funded with cash and issuance of notes payable to owners of \$698,000.

During 2007, the Company completed eight acquisitions: Motorways House of Color, LLC with one location in Glen Burnie, Maryland; C/Y South Suburban Body Shop Supplies, Inc. with one location in Orland Park, Illinois; Chuck's Bumper & Glass, Inc. with one location in Greenville, South Carolina; Eline Automotive Finishes with one location in Lester, Pennsylvania; Miller Bumper & Supply, Inc. with one location in Amarillo, Texas; Auto Color Co., Inc. with seventeen locations in Georgia, Alabama and South Carolina; the Pompano, Florida automotive paint operations of Parts Depot, Inc.; and the Memphis, Tennessee automotive paint operations of Mattos Profinishes. These acquisitions were funded with cash and issuance of notes payable to owners of \$9,458,000.

In accordance with SFAS No. 141, "Business Combinations," the preliminary allocation of the total purchase price may be adjusted within one year from the date of the acquisition when improved information of assets and liability valuations becomes available. As of December 31, 2007, the Company was in the process of finalizing the purchase price allocation for the largest two acquisitions for 2007.

During 2008, the Company adjusted the initial purchase price allocation of the October 2007 acquisition of Auto Color Co., Inc. to reflect additional refinement in the valuation of the acquisition. The following table summarizes the assets acquired and liabilities assumed in the acquisition, which are included in the tables above, including the final adjustment made during the allocation period.

(In thousands)

	<b>December 31, 2008</b>	<b>Adjustments</b>	<b>December 31, 2007</b>
Accounts receivable	\$ 2,299	\$ -	\$ 2,299
Inventories	3,030	-	3,030
Equipment and other	1,237	-	1,237
Agreement not-to-compete	2,450	(9,042)	11,492
Customer lists	8,300	4,193	4,107
Goodwill	4,740	4,740	-
	<b>22,056</b>	<b>(109)</b>	<b>22,165</b>
Less liabilities assumed	2,111	-	2,111
Net assets of businesses acquired	19,945	(109)	20,054
Notes payable issued to former owners	5,071	-	5,071
	<b>\$ 14,874</b>	<b>\$ (109)</b>	<b>\$ 14,983</b>

During 2006, the Company completed two acquisitions: Spectrum Auto Paint & Supply, Inc. with one location in Conway, South Carolina and the Raleigh, North Carolina automotive paint operations of Barnes Motor & Parts Company, Inc. These acquisitions were funded with cash and issuance of notes payable to owners of \$185,000.

### 3. GOODWILL AND OTHER INTANGIBLE ASSETS

Under the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill and indefinite-lived assets are tested for impairment at the reporting unit level at least annually. An impairment charge is recognized only when the calculated fair value of a reporting unit, including goodwill, is less than its carrying amount. In accordance with SFAS No. 142, the Company completed its required annual impairment test as of June 30 each year and determined the fair value of goodwill and indefinite-lived intangible assets to be in excess of the carrying value of these assets.

Information regarding the Company's intangible assets with finite lives are as follows:

(In thousands)

	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Net Book Value</b>
Balance as of December 31, 2008			
Customer lists	\$ 22,480	\$ 10,112	\$ 12,368
Exclusive fulfillment contract	1,601	841	760
Agreements not-to-compete	4,174	1,521	2,653
Debt issuance costs	412	177	235
	<b>\$ 28,667</b>	<b>\$ 12,651</b>	<b>\$ 16,016</b>

(In thousands)

	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Net Book Value</b>
Balance as of December 31, 2007			
Customer lists	\$ 15,300	\$ 6,695	\$ 8,605
Exclusive fulfillment contract	1,601	680	921
Agreements not-to-compete	14,638	1,185	13,453
Debt issuance costs	393	115	278
Total	<u>\$ 31,932</u>	<u>\$ 8,675</u>	<u>\$ 23,257</u>

Amortization lives for intangible assets with finite lives range from 3 to 10 years.

The intangible asset related to the exclusive fulfillment contract arises from an exclusive fulfillment agreement with BASF recorded as a result of the acquisition of Automotive Refinish Technologies completed during 2003. This asset is being amortized over its ten-year life.

Total amortization expense in 2008, 2007 and 2006 was \$3,915,000, \$2,816,000 and \$1,644,000, respectively. Estimated amortization expense for each of the five succeeding fiscal years based on intangible assets as of December 31, 2008 is expected to be as follows:

(In thousands)

2009	\$ 3,676
2010	3,141
2011	2,746
2012	2,356
2013	<u>1,318</u>

Debt issuance cost amortization is included in interest expense, and in 2008, 2007 and 2006 was \$62,000, \$47,000 and \$73,000, respectively.

#### 4. LONG-TERM DEBT

Long-term debt consists of the following:

(In thousands)	<b>December 31, 2008</b>	<b>December 31, 2007</b>
Revolving credit facility	\$ 74,940	\$ 83,500
Notes payable to former owners of acquired businesses with interest at various rates up to 7.00%, due at various dates through 2014	6,050	10,063
Other long-term financing at 8.28%, due in 2010	1,046	1,098
	<u>82,036</u>	<u>94,661</u>
Less current maturities	1,697	4,390
	<u>\$ 80,339</u>	<u>\$ 90,271</u>

**Revolving Credit Facility:** The Company has a variable rate revolving credit facility with a syndicate of banks. The credit facility was refinanced on December 20, 2005 and amended on December 14, 2007. The facility expires on December 13, 2012. Aggregate commitments under the facility total \$110 million. Revolving credit borrowings are subject to interest rates, which fluctuate based on the Company's Leverage Ratio, as defined in the credit facility, which as of December 31, 2008 and 2007 were 1.00% over LIBOR and 0.75% over LIBOR, respectively. Interest rates and payment dates are variable based upon interest rates and term options selected by management. Interest rates at December 31, 2008 and 2007 on outstanding revolving credit borrowings varied from 1.48% to 4.89% and 5.60% to 7.00%, respectively. The Company is charged an annual administrative fee of \$25,000 and an annual commitment fee, payable quarterly, that ranges between 0.15% and 0.25% of the unused portion of the revolving line of credit. At December 31, 2008 and 2007, the Company had \$30.7 million and \$22.3 million, respectively, of available borrowings under its revolving credit facility.

To convert a portion of the Company's outstanding revolving credit borrowings from a floating to a fixed interest rate obligation, the Company entered into interest rate swap agreements in March and December 2007 with notional amounts totaling \$25.0 million. The weighted-average fixed interest rate under these agreements is 4.71%. In order to maintain effectiveness, the quarterly settlement terms of the swap agreements are established to match the interest payments on a corresponding amount of outstanding revolving credit borrowings. The change in the fair market value of the interest rate swaps was recorded in the accumulated comprehensive loss section of the consolidated statements of shareholders' equity, net of tax, and for 2008 and 2007 was (\$0.9) million and (\$0.3) million, respectively.

Substantially all of the Company's personal property serves as collateral for the revolving credit facility. The credit agreement contains various quarterly covenants pertaining to, among other things, achieving a minimum fixed charge coverage ratio, a maximum leverage ratio and a minimum consolidated net worth level. The covenants also impose limitations on asset divestitures, investments, guarantees, loans, advances and additional indebtedness. Dividends are permitted under certain circumstances. If any default as described in the revolving credit facility occurs with respect to the Company, the obligations of the lenders to make additional loans automatically terminate and the outstanding obligations become immediately due and payable.

As of December 31, 2008 and 2007, the Company was in compliance with its covenants.

The aggregate principal payments on long-term debt for the next five years subsequent to December 31, 2008 are as follows:

(In thousands)

2009	\$	1,697
2010		2,469
2011		1,421
2012		75,802
2013		488

The carrying amounts of certain financial instruments such as cash, accounts receivable, accounts payable and long-term debt approximate their fair values. The fair value of long-term debt is estimated using discounted cash flows and the Company's current incremental borrowing rates for similar types of arrangements.

The Company had letters of credit outstanding for a total of \$4,367,000 and \$4,194,000 at December 31, 2008 and 2007, respectively.

## 5. EMPLOYEE SAVINGS PLAN

The Company has an Employee Savings Plan (the "Plan"), which covers substantially all employees who have met certain requirements as to date of service. The Company currently contributes up to 50% of each \$1.00 contributed by employees up to 6% of their annual compensation. The Company contributions charged to operations under the Plan were approximately \$1,170,000, \$998,000 and \$1,012,000 for 2008, 2007 and 2006, respectively. In addition, the Company may make an additional contribution to the Plan, at the discretion of the Board of Directors. No discretionary contributions were made in 2008, 2007 and 2006.

## 6. STOCK OPTIONS

The Company has a stock option plan under which officers, key employees and directors may be granted options to purchase stock. There are 750,000 shares of common stock reserved for issuance under the plan. All options granted under this plan have been granted at a price not less than the fair market value of the Company's common stock on the date of grant and have a maximum life of ten years from the date of the grant. All stock options outstanding as of December 31, 2008 became fully vested by December 31, 2004.

Stock option activity for the three years ended December 31, 2008 is summarized as follows:

	2008		2007		2006	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding - beginning of year	31,130	\$ 8.00	141,630	\$ 9.58	141,630	\$ 9.58
Granted	-	-	-	-	-	-
Exercised	2,000	10.50	100,500	10.32	-	-
Cancelled	-	-	-	-	-	-
Forfeited	-	-	10,000	7.00	-	-
Outstanding - end of year	29,130	\$ 7.83	31,130	\$ 8.00	141,630	\$ 9.58
Exercisable - end of year	29,130	\$ 7.83	31,130	\$ 8.00	141,630	\$ 9.58

	Exercise Price Range		
	\$5.34-\$7.65	\$9.22-\$11.97	Total
Options outstanding and exercisable	18,180	10,950	29,130
Weighted - average exercise price	\$ 6.27	\$ 10.41	\$ 7.83
Average remaining contractual life	1.6 years	2.9 years	2.4 years

## 7. OTHER INCOME

The Company was one of multiple plaintiffs in litigation that was settled in 2008. An initial settlement amount of \$6,452,000 was received in January 2007, representing the Company's court-approved, pro rata share distribution from the net settlement fund produced from settlements with three of five defendants. This amount was recorded within other income in the accompanying consolidated statement of income for 2006. The final settlement amount of \$5,224,000 was received and recorded within other income in the accompanying consolidated statement of income for 2008.

## 8. INCOME TAXES

The provision for federal and state income taxes consists of the following:

(In thousands)	2008	2007	2006
<b>Current:</b>			
Federal	\$ 9,296	\$ 11,216	\$ 8,522
State	1,964	2,537	1,863
	11,260	13,753	10,385
<b>Deferred:</b>			
Federal	726	(3,110)	3,429
State	119	(513)	568
	845	(3,623)	3,997
	\$ 12,105	\$ 10,130	\$ 14,382

The reconciliation of income taxes computed at the federal statutory tax rate to the Company's effective tax rate is as follows:

	2008	2007	2006
Federal statutory tax rate	35.0%	35.0%	35.0%
State tax provision, net of federal benefit	5.0%	5.0%	5.0%
Other	0.1%	0.4%	(1.0%)
Effective tax rate	40.1%	40.4%	39.0%

The significant components of the Company's deferred tax assets and liabilities as of December 31 are as follows:

(In thousands)	2008	2007
<b>Deferred tax assets:</b>		
Property and equipment	\$ 245	\$ 168
Allowances	2,552	1,957
Inventory	2,224	2,183
Accrued expenses and other	3,269	3,280
Total deferred tax assets	8,290	7,588
<b>Deferred tax liabilities:</b>		
Intangibles	(9,900)	(8,728)
Total deferred tax liabilities	(9,900)	(8,728)
Net deferred tax liability	\$ (1,610)	\$ (1,140)

In July 2006, the FASB issued FIN 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109," which clarifies the accounting for uncertainty in tax positions. The provisions of FIN 48 became effective for the Company on January 1, 2007. FIN 48 requires the recognition of a tax position when it is more likely than not that the tax position will be sustained upon examination by relevant taxing authorities, based on the technical merits of the position. The amount recognized is measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. As of January 1, 2007, the Company's total unrecognized tax positions were \$1,830,000, of which \$810,000, if recognized, would impact the effective tax rate. As a result, the adoption of FIN 48 increased the January 1, 2007 balance of retained earnings by \$117,000. As of December 31, 2008 and 2007, the Company's total unrecognized tax positions were \$1,505,000 and \$1,972,000, of which \$539,000 and \$830,000, if recognized, would impact the effective tax rate, respectively.

A reconciliation of the beginning and ending amount of the gross unrecognized tax benefits is as follows:

(In thousands)	2008	2007
Unrecognized tax benefits – January 1	\$ 1,972	\$ 1,830
Gross increases to current-period tax positions	146	252
Audit settlements paid	-	(110)
Gross decreases to tax positions in prior periods	(613)	-
Unrecognized tax benefits – December 31	<u>\$ 1,505</u>	<u>\$ 1,972</u>

The Company accrues interest and penalties related to unrecognized tax benefits in income tax expense. During 2008, 2007 and 2006, the Company recognized \$222,000, \$78,000 and \$13,000 in interest and penalties, respectively. The Company had accrued for the payment of interest and penalties of \$453,000 and \$230,000 at December 31, 2008 and 2007, respectively.

The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. The Company is no longer subject to U.S. federal tax examinations for years before 2005 and state tax examinations for years before 2001. The Company does not anticipate that total unrecognized tax benefits will significantly change within the next 12 months.

## 9. COMMITMENTS AND CONTINGENCIES

The Company occupies facilities and uses equipment and vehicles under operating lease agreements requiring annual rental payments approximating the following amounts for the five years subsequent to December 31, 2008:

(In thousands)	
2009	\$ 8,535
2010	6,147
2011	3,882
2012	2,193
2013	941
Thereafter	447
	<u>\$ 22,145</u>

Rent expense charged to operations, including short-term leases, totaled approximately \$10,587,000, \$9,807,000 and \$9,414,000 for 2008, 2007 and 2006, respectively.

The Company is dependent on four main suppliers for the purchases of the paint and related supplies that it distributes. A loss of one of these suppliers or a disruption in the supply of the products provided could have a material adverse effect on the Company's operating results. The suppliers also provide purchase discounts, prompt payment discounts, extended payment terms and other incentive programs to the Company. To the extent these programs are changed or terminated, there could be a material adverse impact to the Company.

The Company is subject to various claims and contingencies arising out of the normal course of business, including those relating to commercial transactions, environmental, product liability, automobile, taxes, discrimination, employment and other matters. The Company is involved in a superfund site investigation in Florida. Management believes that the ultimate liability, if any, in excess of amounts already provided or covered by insurance, is not likely to have a material adverse effect on its financial condition, results of operations or cash flows.

The Company has been named as one of a number of defendants in the automotive refinishing industry in a class action complaint by a group of collision repair centers in California. The plaintiffs claim to represent similar businesses throughout the state of California and allege that paint manufacturers engaged in a horizontal price fixing conspiracy. The plaintiffs further allege that the manufacturers together with paint distributors engaged in a vertical price fixing conspiracy. Specifically, the plaintiffs allege that manufacturers and distributors agreed not to extend their most favorable pricing terms to the collision repair centers. The court has stayed the vertical pricing fixing component of the class action pending resolution of the horizontal price fixing allegations. Consequently, there are no pending deadlines or trial dates with respect to the Company. The Company believes that the class action is without merit and it intends to vigorously defend its position. At this time the amount of damages has not been specified.

## 10. NET INCOME PER SHARE

The Company follows the provisions of SFAS No. 128, "Earnings Per Share." SFAS 128 requires disclosure of basic and diluted earnings per share. Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted earnings per share is computed based upon the weighted-average number of common shares outstanding, adjusted for the effect of dilutive stock options. All net income per share amounts reported herein are in accordance with the provisions of SFAS No. 128.

The following table sets forth the computation of basic and diluted net income per share:

(In thousands, except per share data)

	2008	2007	2006
Numerator:			
Net income	\$ 18,060	\$ 14,934	\$ 22,462
Denominator:			
Basic weighted - average shares	7,876	7,790	7,774
Effect of dilutive stock options	12	47	52
Diluted weighted - average shares	7,888	7,837	7,826
Net income per share:			
Basic	\$ 2.29	\$ 1.92	\$ 2.89
Diluted	\$ 2.29	\$ 1.91	\$ 2.87