

FINISHMASTER, INC.

**Consolidated Financial Statements
With Report of Independent Auditors**

**At December 31, 2009 and 2008
and for each of the
Three Years in the Period Ended December 31, 2009**

FINISHMASTER, INC.

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Report of Independent Auditors

The Board of Directors and Shareholders
FinishMaster, Inc.

We have audited the accompanying consolidated balance sheets of FinishMaster, Inc. as of December 31, 2009 and 2008, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2009. 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, 2009 and 2008, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

March 4, 2010

CONSOLIDATED BALANCE SHEETS

FinishMaster, Inc.

(In thousands, except share amounts)

ASSETS

Current assets

Cash and cash equivalents	\$ 2,761	\$ 2,461
Accounts receivable, net of allowance for doubtful accounts and customer discounts of \$3,717 and \$3,773, respectively	34,286	39,969
Inventories	104,222	111,723
Deferred income taxes	6,523	6,254
Investments in customers, current portion	6,660	8,110
Prepaid expenses and other current assets	5,649	4,160
	160,101	172,677

Property and equipment

Land	454	454
Buildings and improvements	13,463	13,073
Vehicles	2,504	2,546
Machinery, equipment, and fixtures	20,972	21,466
	37,393	37,539
Accumulated depreciation	(26,449)	(25,645)
	10,944	11,894

Other long-term assets

Intangible assets, net	12,218	16,016
Goodwill, net	101,288	101,288
Investments in customers, net of current portion	12,010	15,110
Other	375	375
	125,891	132,789
	\$ 296,936	\$ 317,360

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities

Accounts payable	\$ 64,581	\$ 67,135
Amounts due to affiliates	220	297
Accrued compensation and benefits	6,663	7,363
Other accrued expenses and current liabilities	5,563	4,363
Current maturities of long-term debt	2,469	1,697
	79,496	80,855

Long-term debt, less current maturities

49,395 80,339

Deferred income taxes

10,314 7,864

Other long-term liabilities

3,948 5,810

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; 7,885,671 and 7,877,599 shares issued and outstanding, respectively	7,886	7,878
Additional paid-in capital	29,717	29,667
Accumulated comprehensive loss	(647)	(934)
Retained earnings	116,827	105,881
	153,783	142,492
	\$ 296,936	\$ 317,360

See accompanying notes.

CONSOLIDATED STATEMENTS OF INCOME

FinishMaster, Inc.

(In thousands, except per share data)

	Year Ended December 31, 2009	Year Ended December 31, 2008	Year Ended December 31, 2007
Net sales	\$ 421,391	\$ 486,013	\$ 466,626
Cost of sales	294,836	337,756	328,978
Gross margin	126,555	148,257	137,648
Expenses			
Operating	45,247	49,533	45,870
Selling, general, and administrative	56,957	65,933	60,646
Amortization of intangible assets	3,780	3,914	2,816
	105,984	119,380	109,332
Income from operations	20,571	28,877	28,316
Interest expense	2,426	3,936	3,252
Other income	-	5,224	-
Income before income taxes	18,145	30,165	25,064
Income tax expense	7,199	12,105	10,130
Net income	\$ 10,946	\$ 18,060	\$ 14,934
Net income per share			
Basic	\$ 1.39	\$ 2.29	\$ 1.92
Diluted	\$ 1.39	\$ 2.29	\$ 1.91
Weighted-average shares outstanding			
Basic	7,884	7,876	7,790
Diluted	7,890	7,888	7,837

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FinishMaster, Inc.

(In thousands)	Year Ended December 31, 2009	Year Ended December 31, 2008	Year Ended December 31, 2007
Operating activities			
Net income	\$ 10,946	\$ 18,060	\$ 14,934
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	14,549	14,294	12,993
Deferred income taxes	1,993	845	(3,623)
Issuance of stock grants	20	20	15
Loss on disposal of property and equipment	212	162	25
Changes in operating assets and liabilities (excluding the impact of acquisitions):			
Accounts receivable, net	5,708	385	75
Inventories	7,638	(24,423)	(15,099)
Prepaid and other assets	934	3,252	9,055
Investments in customers	(5,471)	(10,719)	(11,059)
Accounts payable and other liabilities	(4,963)	14,335	15,736
Net cash provided by operating activities	31,566	16,211	23,052
Investing activities			
Business acquisitions	(130)	(1,866)	(20,110)
Purchases of property and equipment	(2,312)	(3,690)	(2,499)
Net cash used by investing activities	(2,442)	(5,556)	(22,609)
Financing activities			
Proceeds from exercise of stock options	38	21	1,037
Payment of dividends	-	-	(31,499)
Change in cash overdrafts	1,310	897	(3,520)
Payment of debt issuance costs	-	(19)	(146)
Proceeds from debt	91,294	75,085	150,764
Repayment of debt	(121,466)	(88,408)	(116,634)
Net cash (used) provided by financing activities	(28,824)	(12,424)	2
Increase (decrease) in cash	300	(1,769)	445
Cash and cash equivalents at beginning of year	2,461	4,230	3,785
Cash and cash equivalents at end of year	\$ 2,761	\$ 2,461	\$ 4,230
Supplemental disclosure of cash flow information			
Cash paid during the years for:			
Interest	\$ 2,390	\$ 4,106	\$ 3,393
Income taxes	\$ 6,145	\$ 10,960	\$ 12,430

See accompanying notes.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

FinishMaster, Inc.

(In thousands)	Common Stock	Additional Paid-in Capital	Accumulated Comprehensive Loss	Retained Earnings	Totals
Balances at December 31, 2006	\$ 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
Balances at December 31, 2007	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
Balances at December 31, 2008	7,878	29,667	(934)	105,881	142,492
Comprehensive income:					
Net income	-	-	-	10,946	10,946
Other comprehensive income:					
Interest rate swap, net of tax of \$188	-	-	287	-	287
Total comprehensive income					11,233
Stock grants issued and options exercised	8	50	-	-	58
Balances at December 31, 2009	\$ 7,886	\$ 29,717	\$ (647)	\$ 116,827	\$ 153,783

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, 2009, the Company operated 163 branch locations and three major distribution centers in 28 states, and is organized into seven major geographical regions: East, Heartland, Midwest, Northwest, South, Southeast, and West. The Company aggregates its seven geographic regions into a single reportable segment. The Company has approximately 11,000 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 87% 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% of the outstanding shares at December 31, 2009 and 2008. 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 \$2,484,000, \$3,182,000, and \$3,268,000 for 2009, 2008, and 2007, respectively. In addition, the Company leases its corporate office space from LDI. Lease and repairs and maintenance payments to LDI totaled approximately \$491,000, \$454,000, and \$367,000 for 2009, 2008, and 2007, 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 and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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, 2009 and 2008, checks drawn on future deposits and borrowings of \$2,207,000 and \$897,000, respectively, 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, 2009 and 2008. The allowance for doubtful accounts is calculated based on the Company’s historical experience in the collection of aged invoices and was \$2,432,000 and \$2,356,000 at December 31, 2009 and 2008, respectively.

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 2009, 2008, and 2007 was \$3,107,000, \$2,456,000, and \$1,948,000, respectively.

Impairment of Long-Lived Assets: The Company evaluates long-lived assets, including intangible assets with finite lives, in compliance with Accounting Standards Codification Topic No. 360, "Property, Plant, and Equipment" (ASC 360). An impairment loss is recognized whenever events or changes in circumstances indicate the carrying amount of an asset is not recoverable. In applying ASC 360, 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 multi-year 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 Accounting Standards Codification Topic No. 605, "Revenue Recognition" (ASC 605). Amounts reflected as a reduction of revenue in 2009, 2008, and 2007 were \$7,933,000, \$8,745,000, and \$8,941,000, 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: The Company has adopted the provisions of Accounting Standards Codification subtopic No. 820-10, "Fair Value Measurements and Disclosures" (ASC 820-10). ASC 820-10 defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP, and expands disclosures about fair value measurements. ASC 820-10 was effective for the Company beginning January 1, 2008 for financial assets and liabilities, and January 1, 2009 for all nonfinancial assets and liabilities, except those recognized or disclosed at fair value in the financial statements on a recurring basis. Those assets and liabilities measured at fair value under ASC 820-10 at December 31, 2009 and 2008 did not 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 ASC 605, 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 \$23,670,000, \$28,655,000, and \$27,755,000 in 2009, 2008, and 2007, respectively.

Stock-based Compensation: The Company recognizes compensation expense related to its stock option plan in accordance with Accounting Standards Codification Topic No. 718, "Compensation – Stock Compensation" (ASC 718). 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 2009, 2008 and 2007.

Income Taxes: Deferred income taxes are recognized for the temporary differences between the tax basis of assets and liabilities and their financial reporting amounts in accordance with the provisions of Accounting Standards Codification Topic No. 740, "Income Taxes" (ASC 740). The income tax provision is the tax payable for the period and the change during the period in deferred tax assets and liabilities.

Subsequent Events: The Company performed an evaluation of subsequent events for potential recognition and disclosure through the time of issuing the financial statements on March 4, 2010 in accordance with Accounting Standards Codification Subtopic No. 855-10-50, "Subsequent Events" (ASC 855-10-50). The adoption of ASC 855-10-50 did not affect the Company's consolidated financial position, results of operations, or cash flows.

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)	2009	2008
Accounts receivable	\$ 25	\$ 251
Inventories	137	635
Equipment and other	57	231
Intangible assets	46	1,563
	265	2,680
Less liabilities assumed	135	116
Net assets of businesses acquired	130	2,564
Notes payable issued to former owners	-	698
	\$ 130	\$ 1,866
Number of acquisitions	1	4

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

(In thousands)	2009	2008
Agreements not-to-compete	\$ 39	\$ 347
Customer lists	7	1,216
	\$ 46	\$ 1,563

The estimated weighted-average useful life of the intangible assets acquired is 5.2 years, with 5.0 years for the agreements not-to-compete and 6.0 years for the customer lists.

During 2009, the Company acquired the automotive paint operations of Automotive Fleet & Industrial Paint Supply, Inc. with one location in Duluth, Minnesota. This acquisition was funded with cash.

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.

3. GOODWILL AND INTANGIBLE ASSETS

Under the provisions of Accounting Standards Codification Topic No. 350, “Intangibles – Goodwill and Other” (ASC 350), 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 ASC 350, the Company completed its required annual impairment test as of June 30th 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)

	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Balance as of December 31, 2009			
Customer lists	\$ 17,183	\$ 7,632	\$ 9,551
Exclusive fulfillment contract	1,601	1,163	438
Agreements not-to-compete	4,212	2,155	2,057
Debt issuance costs	412	240	172
	\$ 23,408	\$ 11,190	\$ 12,218

(In thousands)

	Gross Carrying Amount	Accumulated Amortization	Net Book Value
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
Total	\$ 28,667	\$ 12,651	\$ 16,016

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 was originally being amortized over its ten-year life. In May 2009, the contract was amended for an early termination at December 31, 2010. The remaining net book value at the time of the amendment is being amortized on a straight-line basis over the remainder of the amended contract period.

Total amortization expense in 2009, 2008, and 2007 was \$3,780,000, \$3,914,000, and \$2,816,000, respectively. Estimated amortization expense for each of the five succeeding fiscal years based on intangible assets as of December 31, 2009 is expected to be as follows:

(In thousands)

2010	\$ 3,428
2011	2,615
2012	2,200
2013	1,202
2014	798

Debt issuance cost amortization is included in interest expense and in 2009, 2008, and 2007 was \$63,000, \$62,000, and \$47,000, respectively.

4. LONG-TERM DEBT

Long-term debt consists of the following:

(In thousands)	December 31, 2009	December 31, 2008
Revolving credit facility	\$ 46,480	\$ 74,940
Notes payable to former owners of acquired businesses with interest at various rates up to 7.00%, due at various dates through 2014	4,394	6,050
Other long-term financing at 8.28%, due in 2010	990	1,046
	51,864	82,036
Less current maturities	2,469	1,697
	<u>\$ 49,395</u>	<u>\$ 80,339</u>

Revolving Credit Facility: The Company has a variable rate revolving credit facility with a syndicate of banks. 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, 2009 and 2008 were 1.00% over LIBOR. Interest rates and payment dates are variable based upon interest rates and term options selected by management. Interest rates at December 31, 2009 and 2008 on outstanding revolving credit borrowings varied from 1.24% to 3.25% and 1.48% to 4.89%, 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, 2009 and 2008, the Company had \$59.3 million and \$30.7 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. At December 29, 2009, one swap agreement with a notional amount of \$5.0 million matured and was not renewed. The fixed interest rate under the remaining \$20.0 million swap agreement is 4.9%. 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 is recorded in the accumulated comprehensive loss section of the consolidated statements of shareholders' equity, net of tax, and for 2009 and 2008 was (\$0.6) million and (\$0.9) 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, 2009 and 2008, 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, 2009 are as follows:

(In thousands)	
2010	\$ 2,469
2011	1,421
2012	47,327
2013	488
2014	<u>159</u>

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 \$4,267,000 and \$4,367,000 at December 31, 2009 and 2008, 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 can contribute up to 50% of each \$1.00 contributed by employees up to 6% of their annual compensation. During 2009, the Company temporarily suspended this contribution. The Company contributions charged to operations under the Plan were approximately \$168,000, \$1,170,000, and \$998,000 for 2009, 2008, and 2007, 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 2009, 2008 and 2007.

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, 2009 became fully vested by December 31, 2004.

Stock option activity for the three years ended December 31, 2009 is summarized as follows:

	2009		2008		2007	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding – beginning of year	29,130	\$ 7.83	31,130	\$ 8.00	141,630	\$ 9.58
Granted	-	-	-	-	-	-
Exercised	7,112	5.34	2,000	10.50	100,500	10.32
Cancelled	-	-	-	-	-	-
Forfeited	-	-	-	-	10,000	7.00
Outstanding – end of year	22,018	\$ 8.63	29,130	7.83	31,130	\$ 8.00
Exercisable – end of year	22,018	\$ 8.63	29,130	7.83	31,130	\$ 8.00

	Exercise Price Range		
	\$6.23-\$7.65	\$9.22-\$11.97	Total
Options outstanding and exercisable	11,068	10,950	22,018
Weighted average exercise price	\$ 6.87	\$ 10.41	\$ 8.63
Average remaining contractual life	0.9 years	3.4 years	2.4 years

7. OTHER INCOME

The Company was one of multiple plaintiffs in litigation that was settled in 2008. 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)	2009	2008	2007
Current:			
Federal	\$ 4,364	\$ 9,296	\$ 11,216
State	842	1,964	2,537
	5,206	11,260	13,753
Deferred:			
Federal	1,799	726	(3,110)
State	194	119	(513)
	1,993	845	(3,623)
	<u>\$ 7,199</u>	<u>\$ 12,105</u>	<u>\$ 10,130</u>

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

	2009	2008	2007
Federal statutory tax rate	34.3%	35.0%	35.0%
State tax provision, net of federal benefit	4.9%	5.0%	5.0%
Other	0.5%	0.1%	0.4%
Effective tax rate	<u>39.7%</u>	<u>40.1%</u>	<u>40.4%</u>

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

(In thousands)	2009	2008
Deferred tax assets:		
Property and equipment	\$ -	\$ 245
Allowances	2,389	2,552
Inventories	2,292	2,224
Accrued expenses and other	2,638	3,269
Total deferred tax assets	7,319	8,290
Deferred tax liabilities:		
Property and equipment	(247)	-
Intangibles	(10,863)	(9,900)
Total deferred tax liabilities	(11,110)	(9,900)
Net deferred tax liability	<u>\$ (3,791)</u>	<u>\$ (1,610)</u>

The Company's uncertain tax positions are recorded in accordance with Accounting Standards Codification Topic No. 740, "Income Taxes" (ASC 740). The provisions of ASC 740 regarding uncertain tax positions became effective for the Company on January 1, 2007 and require 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 a result, the adoption of ASC 740 increased the January 1, 2007 balance of retained earnings by \$117,000. As of December 31, 2009 and 2008, the Company's total unrecognized tax positions were \$1,021,000 and \$1,505,000, respectively, of which \$298,000 and \$539,000, 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)	2009	2008
Unrecognized tax benefits – January 1	\$ 1,505	\$ 1,972
Gross increases to current-period tax positions	87	146
Settlements paid	(126)	-
Gross decreases to tax positions in prior periods	(445)	(613)
Unrecognized tax benefits – December 31	<u>\$ 1,021</u>	<u>\$ 1,505</u>

The Company accrues interest and penalties related to unrecognized tax benefits in income tax expense. During 2009, 2008, and 2007, the Company recognized (\$169,000), \$222,000, and \$78,000 in interest and penalties, respectively. The Company had accrued for the payment of interest and penalties of \$184,000 and \$453,000 at December 31, 2009 and 2008, 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 2006 and state tax examinations for years before 2002. The Company does not anticipate that total unrecognized tax benefits will significantly change within the next twelve 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, 2009:

(In thousands)	
2010	\$ 9,678
2011	7,821
2012	5,582
2013	3,231
2014	1,621
Thereafter	1,316
	<u>\$ 29,249</u>

Rent expense charged to operations, including short-term leases, totaled approximately \$10,291,000, \$10,587,000, and \$9,807,000 for 2009, 2008, and 2007, 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. 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 consolidated financial condition, results of operations, or cash flows.

10. NET INCOME PER SHARE

The Company follows the provisions of Accounting Standards Codification Topic No. 260, "Earnings Per Share" (ASC 260). ASC 260 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 ASC 260.

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

(In thousands, except per share data)

	2009	2008	2007
Numerator:			
Net income	\$ 10,946	\$ 18,060	\$ 14,934
Denominator:			
Basic – weighted-average shares	7,884	7,876	7,790
Effect of dilutive stock options	6	12	47
Diluted – weighted-average shares	7,890	7,888	7,837
Net income per share:			
Basic	\$ 1.39	\$ 2.29	\$ 1.92
Diluted	\$ 1.39	\$ 2.29	\$ 1.91