

**FINISHMASTER, INC. AND SUBSIDIARIES**

**Financial Statements**

**At June 30, 2004 and 2003**

# **FINISHMASTER, INC.**

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**FINISHMASTER, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except per share data)

	<b>June 30, 2004</b>	<b>December 31, 2003 <sup>(1)</sup></b>
	(unaudited)	
<b>ASSETS</b>		
<b>Current assets</b>		
Cash	\$ 807	\$ 2,022
Accounts receivable, net of allowance for doubtful accounts of \$1,633 and \$1,462, respectively	34,687	30,329
Inventory	57,323	69,710
Deferred income taxes	5,470	4,857
Prepaid expenses and other current assets	2,965	4,607
Total current assets	101,252	111,525
 <b>Property and equipment, net</b>	 4,739	 5,081
 <b>Other assets</b>		
Intangible assets, net	6,361	7,150
Goodwill, net	96,548	96,548
Other	5,128	2,712
	108,037	106,410
	\$ 214,028	\$ 223,016
 <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 25,016	\$ 44,119
Amounts due to LDI	688	796
Accrued compensation and benefits	7,726	7,114
Accrued expenses and other current liabilities	3,188	3,133
Current maturities of long-term debt	11,223	10,372
Total current liabilities	47,841	65,534
 <b>Long-term debt, less current maturities</b>	 64,536	 63,600
<b>Other long-term liabilities</b>	6,942	5,984
<b>Commitments and contingencies</b>	-	-
 <b>Shareholders' equity</b>		
Preferred stock, no par value, 1,000,000 shares Authorized; no shares issued or outstanding	-	-
Common stock, \$1 stated value, 25,000,000 shares authorized; 7,799,529 and 7,797,917 shares issued and outstanding	7,799	7,798
Treasury stock at cost; 98,506 shares	(948)	(948)
Additional paid-in capital	28,982	28,968
Accumulated comprehensive loss	(425)	(776)
Retained earnings	59,301	52,856
	94,709	87,898
	\$ 214,028	\$ 223,016

(1) The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles.

The accompanying notes are an integral part of the condensed consolidated financial statements.

## FINISHMASTER, INC.

### CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)  
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
<b>Net sales</b>	\$ 97,469	\$ 86,922	\$ 192,235	\$ 170,417
<b>Cost of sales</b>	67,678	59,498	133,354	116,286
<b>Gross margin</b>	29,791	27,424	58,881	54,131
<b>Expenses</b>				
Operating	9,895	9,504	19,989	18,690
Selling, general and administrative	12,336	11,032	23,988	21,869
Amortization of intangible assets	388	288	779	595
	22,619	20,824	44,756	41,154
<b>Income from operations</b>	7,172	6,600	14,125	12,977
<b>Interest expense, net</b>	1,564	1,609	3,109	3,327
<b>Income before income taxes</b>	5,608	4,991	11,016	9,650
<b>Income tax expense</b>	2,445	2,020	4,571	3,906
<b>Net income</b>	\$ 3,163	\$ 2,971	\$ 6,445	\$ 5,744
<b>Net income per share</b>				
Basic	\$ 0.41	\$ 0.38	\$ 0.84	\$ 0.74
Diluted	\$ 0.41	\$ 0.38	\$ 0.83	\$ 0.73
<b>Weighted average shares outstanding</b>				
Basic	7,701	7,797	7,701	7,794
Diluted	7,753	7,866	7,756	7,885

The accompanying notes are an integral part of the condensed consolidated financial statements.

**FINISHMASTER, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)  
(unaudited)

	<b>Six Months Ended June 30,</b>	
	<b>2004</b>	<b>2003</b>
<b>Operating activities</b>		
Net income	\$ 6,445	\$ 5,744
Adjustments to reconcile net income to net cash provided by operating activities:		
Issuance of stock grants	15	10
Depreciation and amortization	2,897	2,777
Changes in operating assets and liabilities (excluding the impact of acquisitions):		
Accounts receivable, net	(4,285)	366
Inventories	12,612	8,595
Prepaid expenses and other assets	(2,574)	(585)
Accounts payable and other liabilities	(12,648)	9,674
<b>Net cash provided by operating activities</b>	<b>2,462</b>	<b>26,581</b>
<b>Investing activities</b>		
Business acquisitions and payments under earn-out provisions of prior acquisition agreements	(370)	(1,089)
Purchases of property and equipment	(668)	(532)
<b>Net cash used in investing activities</b>	<b>(1,038)</b>	<b>(1,621)</b>
<b>Financing activities</b>		
Proceeds from exercise of stock options	-	85
Changes in cash overdrafts	(4,353)	(36)
Proceeds from debt	60,002	15,840
Repayment of debt	(58,288)	(39,608)
<b>Net cash used in financing activities</b>	<b>(2,639)</b>	<b>(23,719)</b>
<b>Increase (decrease) in cash</b>	<b>(1,215)</b>	<b>1,240</b>
<b>Cash at beginning of period</b>	<b>2,022</b>	<b>2,070</b>
<b>Cash at end of period</b>	<b>\$ 807</b>	<b>\$ 3,310</b>

The accompanying notes are an integral part of the condensed consolidated financial statements.

**FINISHMASTER, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

(in thousands)

(unaudited)

(In thousands)	Common Stock	Treasury Stock	Paid-in Capital	Retained Earnings	Accumulated Comprehensive Loss	Totals
<b>Balances at December 31, 2002</b>	\$ 7,783	\$ -	\$ 28,879	\$ 41,004	\$ (1,286)	\$ 76,380
Comprehensive income:						
Net income for the year	-	-	-	11,852	-	11,852
Other comprehensive income:						
Interest rate swap, net of tax of \$344	-	-	-	-	510	510
Total comprehensive income						\$ 12,362
Repurchases of stock, at cost	-	(948)	-	-	-	(948)
Stock grants issued and options exercised	15	-	89	-	-	104
<b>Balances at December 31, 2003</b>	\$ 7,798	\$ (948)	\$ 28,968	\$ 52,856	\$ (776)	\$ 87,898
Comprehensive income:						
Net income through June 30, 2004	-	-	-	6,445	-	6,445
Other comprehensive income:						
Interest rate swap, net of tax of \$235	-	-	-	-	351	351
Total comprehensive income						6,796
Stock grants issued	1	-	14	-	-	15
<b>Balances at June 30, 2004</b>	\$ 7,799	\$ (948)	\$ 28,982	\$ 59,301	\$ (425)	\$ 94,709

The accompanying notes are an integral part of the consolidated financial statements.

## FINISHMASTER, INC.

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

#### 1. ORGANIZATION

**Basis of Presentation:** The interim financial statements are unaudited but, in the opinion of management, reflect all adjustments necessary for a fair presentation of financial position, results of operations and cash flows for the periods presented. These adjustments consist of normal recurring items. The results of operations for any interim period are not necessarily indicative of results for the full year.

**Nature of Business:** FinishMaster, Inc. ("FinishMaster") is the leading national distributor of automotive paints, coatings, and paint-related accessories to the automotive collision repair industry. As of June 30, 2004, we operated 166 sales branches and three major distribution centers in 28 states and were organized into six major geographical regions – East, Midwest, Upper Midwest, West, South and Southeast. We aggregate these six geographical regions into a single reportable segment. We have approximately 13,000 customer credit accounts to which we provide a comprehensive selection of brand name products supplied by BASF, DuPont, PPG and 3M, in addition to our own FinishMaster PrivateBrand refinishing accessory products. We are highly dependent on the key suppliers outlined above, which account for approximately 85% of our purchases.

**Principles of Consolidation:** Our consolidated financial statements include the accounts of FinishMaster and its wholly owned subsidiaries from the dates of their respective acquisition. All significant intercompany accounts and transactions have been eliminated. References to FinishMaster throughout this report relate to the consolidated entity.

**Majority Shareholder:** Lacy Distribution, Inc. ("Distribution"), an Indiana corporation, is a wholly owned subsidiary of LDI Ltd., LLC, an Indiana limited liability corporation, and is our majority shareholder with 5,587,516 shares of common stock, representing 72.6% of the outstanding shares at June 30, 2004. LDI and Distribution are collectively referred to herein as "LDI."

**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.

**Derivative Instruments and Hedging Activities:** We utilize derivative financial instruments, principally interest rate swaps, to reduce our exposure to fluctuations in interest rates. These instruments are recorded on the balance sheet at their fair value. Changes in the fair value of interest rate swaps are recorded each period in Other Long Term Liabilities and the net of tax effect is recorded in the Accumulated Comprehensive Loss section of Shareholders' Equity.

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

#### 2. ACQUISITIONS

During the first half of 2004, we completed one acquisition: Hutchins Auto Supply Company, Inc. in North Carolina, effective May 21, 2004. The acquisition was funded with cash and debt.

During 2003, we completed three acquisitions: Rankin Auto Body Supplies, Inc. in New Jersey, effective March 28, 2003; Advance Paint, LLC in Denver, effective June 27, 2003; and Automotive Refinish Technologies in ten new geographic locations, effective September 18, 2003. The acquired locations were in Atlanta, Georgia; Augusta, Georgia; Austin, Texas; Buffalo, New York; Huntsville, Alabama; Las Vegas, Nevada; Memphis, Tennessee; Oklahoma City, Oklahoma; St. Louis, Missouri; and Springfield, Illinois. These acquisitions were funded with cash and debt.

### 3. NET INCOME PER SHARE

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

(in thousands, except per share data)

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
Numerator:				
Net income	\$ 3,163	\$ 2,971	\$ 6,445	\$ 5,744
Denominator:				
Basic-weighted average shares	7,701	7,797	7,701	7,794
Effect of dilutive stock options	52	69	55	91
Diluted-weighted average shares	<u>7,753</u>	<u>7,866</u>	<u>7,756</u>	<u>7,885</u>
Net income per share				
Basic	\$ 0.41	\$ 0.38	\$ 0.84	\$ 0.74
Diluted	<u>\$ 0.41</u>	<u>\$ 0.38</u>	<u>\$ 0.83</u>	<u>\$ 0.73</u>

### 4. COMMITMENTS AND CONTINGENCIES

We are dependent on four main suppliers for the purchases of the paint and related supplies that we distribute. A loss of one of these suppliers or a disruption in the supply of their products provided could have a material adverse effect on our operating results. These suppliers also provide purchase discounts, prompt payment discounts, extended terms, and other incentive programs to us. To the extent these programs are changed or terminated, there could be a material adverse impact on our results of operations or cash flows.

We are 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. We are involved in three superfund site investigations, two in Florida and one in Georgia. We believe 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 our financial condition, results of operations or cash flows.

We have 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 price 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 us. We believe that the class action is without merit. We intend to vigorously defend our position. At the same time the amount of damages has not been specified.

In the normal course of business we also enter into various guarantees and indemnities in our relationships with suppliers, service providers, customers and others. We do not believe these guarantees and indemnifications will have a material impact on our financial condition or results of operations, although indemnification associated with our actions generally have no dollar limitations.

### 5. LONG-TERM DEBT

On March 29, 2001, we entered into a \$100.0 million senior secured credit facility with a syndicate of banks and a \$20.0 million senior subordinated term credit facility with LDI. The senior secured credit facility consisted of a \$40.0 million term credit facility and a \$60.0 million revolving credit facility. The term credit facility, which expires on June 30, 2006, requires quarterly principal payments that increase in amount over the term of the loan. Quarterly principal payments began on June 30, 2001, and are \$2.0 million per quarter in 2004. The revolving credit facility is limited to the lesser of (1) \$60.0 million less letter of credit obligations, or (2) 80 percent of eligible accounts receivable plus 65 percent of eligible inventory less letter of credit obligations and a reserve for three months facility rent. Principal is

due on June 30, 2006. Both the revolving credit and term facilities are subject to interest rates, which fluctuate based on our Leverage Ratio, as defined in the Credit Facility. During the second quarter of 2004, our interest rates were 2.00% over LIBOR (1.09% to 1.59%) or 0.00% over prime in the case of Floating Rate Advances.

To convert our senior term credit facility from a floating to a fixed interest rate obligation, we entered into interest rate swap agreements with notional amounts of \$40.0 million. The weighted average fixed interest rate under these agreements is 5.43%. In order to maintain effectiveness, the quarterly settlement terms of the swap agreements are established to match the interest payments on the term credit facility. The changes in the fair value of the interest rate swaps was \$0.5 million and \$0.1 million for the second quarter 2004 and 2003, respectively and was \$0.6 million and \$0.1 million for the first half of 2004 and 2003, respectively. The amounts, net of tax, were recorded in the Accumulated Comprehensive Loss section of Shareholders' Equity.

Concurrent with funding the senior secured credit facility, we repaid our \$30.0 million senior subordinated term credit facility and entered into a new \$20.0 million senior subordinated term credit facility with LDI. All outstanding principal is due on March 29, 2007, and interest is payable quarterly at a rate of 12.0% per annum.

## 6. GOODWILL AND OTHER INTANGIBLE ASSETS

The carrying amount of goodwill did not change during the six months ended June 30, 2004.

(In thousands)

Balance as of June 30, 2004 and December 31, 2003	<b>Net Book Value</b>
Goodwill, net	<u>\$ 96,548</u>

Information regarding the other intangible assets is as follows:

(In thousands)

	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Net Book Value</b>
Balance as of June 30, 2004			
Customer lists	\$ 5,584	\$ 2,052	\$ 3,532
Exclusive fulfillment contract	1,601	120	1,481
Agreements not to compete	13,161	12,317	844
Debt issuance costs	1,328	824	504
Total	<u>\$ 21,674</u>	<u>\$ 15,313</u>	<u>\$ 6,361</u>

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

Total intangible amortization expense for the second quarter of 2004 and 2003 was \$0.4 million and \$0.3 million, respectively.

Total intangible amortization expense for the first half of 2004 and 2003 was \$0.8 million and \$0.6 million, respectively.

Estimated amortization for each of the five succeeding fiscal years based on intangible assets as of December 31, 2003 is expected to be as follows:

(In thousands)

2004	\$ 1,564
2005	1,564
2006	1,432
2007	1,173
2008	597
	<u>\$ 6,330</u>

Debt issuance cost amortization is included in interest expense, and for the second quarter of 2004 and 2003 was \$0.1 million, respectively. Debt issuance cost amortization for the first half of 2004 and 2003 was \$0.1 million, respectively.