

**FINISHMASTER, INC.**

**Financial Statements**

**At June 30, 2006 and 2005**

# **FINISHMASTER, INC.**

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**FINISHMASTER, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except per share data)

	<b>June 30, 2006</b>	<b>December 31, 2005 <sup>(1)</sup></b>
<b>ASSETS</b>	(unaudited)	
<b>Current assets</b>		
Cash	\$ 4,001	\$ 3,821
Accounts receivable, net of allowance for doubtful accounts of \$1,532 and \$1,468, respectively	40,074	38,353
Inventory	59,839	52,045
Deferred income taxes	4,593	4,542
Prepaid expenses and other current assets	11,009	8,773
Total current assets	119,516	107,534
 <b>Property and equipment, net</b>	 8,763	 8,799
 <b>Other assets</b>		
Intangible assets, net	4,923	5,430
Goodwill, net	96,548	96,548
Other	13,424	13,461
	114,895	115,439
	\$ 243,174	\$ 231,772
 <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 39,480	\$ 37,204
Amounts due to LDI	1,680	1,028
Accrued compensation and benefits	6,987	9,079
Other accrued expenses and current liabilities	2,646	2,824
Current maturities of long-term debt	21,575	2,039
Total current liabilities	72,368	52,174
 <b>Long-term debt, less current maturities</b>	 33,282	 52,536
<b>Other long-term liabilities</b>	9,855	9,124
<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; 7,773,651 and 7,773,153 shares issued and outstanding	7,774	7,773
Additional paid-in capital	28,386	28,377
Accumulated comprehensive loss	-	(19)
Retained earnings	91,509	81,807
	127,669	117,938
	\$ 243,174	\$ 231,772

(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,	
	2006	2005	2006	2005
<b>Net sales</b>	\$ 115,345	\$ 108,217	\$ 228,802	\$ 209,749
<b>Cost of sales</b>	80,426	75,256	160,404	147,381
<b>Gross margin</b>	34,919	32,961	68,398	62,368
<b>Expenses</b>				
Operating	10,994	10,852	22,107	21,092
Selling, general and administrative	13,803	12,801	27,385	24,883
Amortization of intangible assets	423	380	835	767
	25,220	24,033	50,327	46,742
<b>Income from operations</b>	9,699	8,928	18,071	15,626
<b>Interest expense, net</b>	1,237	1,356	2,380	2,759
<b>Income before income taxes</b>	8,462	7,572	15,691	12,867
<b>Income tax expense</b>	3,091	3,317	5,989	5,367
<b>Net income</b>	\$ 5,371	\$ 4,255	\$ 9,702	\$ 7,500
<b>Net income per share</b>				
Basic	\$ 0.69	\$ 0.55	\$ 1.25	\$ 0.97
Diluted	\$ 0.69	\$ 0.54	\$ 1.24	\$ 0.96
<b>Weighted average shares outstanding</b>				
Basic	7,773	7,770	7,773	7,744
Diluted	7,822	7,808	7,819	7,781

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>2006</b>	<b>2005</b>
<b>Operating activities</b>		
Net income	\$ 9,702	\$ 7,500
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,487	3,263
Deferred income taxes	689	561
Issuance of stock grants	10	25
Loss on disposal of property and equipment	78	4
Changes in operating assets and liabilities (excluding the impact of acquisitions):		
Accounts receivable, net	(1,550)	(4,717)
Inventories	(7,794)	(734)
Prepaid expenses and other assets	(326)	(3,387)
Accounts payable and other liabilities	(3,228)	8,059
<b>Net cash provided by operating activities</b>	<b>2,068</b>	<b>10,574</b>
<b>Investing activities</b>		
Business acquisitions	(831)	(863)
Purchases of property and equipment	(886)	(1,357)
<b>Net cash used in investing activities</b>	<b>(1,717)</b>	<b>(2,220)</b>
<b>Financing activities</b>		
Proceeds from exercise of stock options	-	880
Repurchases of stock	-	(771)
Changes in cash overdrafts	(453)	2,131
Proceeds from debt	56,624	44,810
Repayment of debt	(56,342)	(53,254)
<b>Net cash used in financing activities</b>	<b>(171)</b>	<b>(6,204)</b>
<b>Increase in cash</b>	<b>180</b>	<b>2,150</b>
<b>Cash at beginning of period</b>	<b>3,821</b>	<b>2,482</b>
<b>Cash at end of period</b>	<b>\$ 4,001</b>	<b>\$ 4,632</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	Paid-in Capital	Accumulated Comprehensive Loss	Retained Earnings	Totals
<b>Balances at December 31, 2004</b>	\$ 7,702	\$ 28,141	\$ (227)	\$ 66,160	\$ 101,776
Comprehensive income:					
Net income for the year	-	-	-	15,647	15,647
Other comprehensive income:					
Interest rate swap, net of tax of \$142	-	-	208	-	208
Total comprehensive income					\$ 15,855
Repurchases of stock	(58)	(713)	-	-	(771)
Stock grants issued and options exercised	129	949	-	-	1,078
<b>Balances at December 31, 2005</b>	\$ 7,773	\$ 28,377	\$ (19)	\$ 81,807	\$ 117,938
Comprehensive income:					
Net income for the quarter	-	-	-	9,702	9,702
Other comprehensive income:					
Interest rate swap, net of tax of \$3	-	-	19	-	19
Total comprehensive income					9,721
Stock grants issued	1	9			10
<b>Balances at June 30, 2006</b>	\$ 7,774	\$ 28,386	\$ -	\$ 91,509	\$ 127,669

The accompanying notes are an integral part of the condensed 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. (“the Company” or “FinishMaster”) is the leading national independent distributor of automotive paints, coatings, and paint-related accessories to the automotive collision repair industry. As of June 30, 2006, the Company operated 169 branch locations and three major distribution centers in 28 states, and is organized into six major geographical regions: East, Midwest, Upper Midwest, West, South and Southeast. The Company aggregates its six geographical regions into a single reportable segment. The Company has approximately 13,000 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 PrivateBrand refinishing accessory products. The Company is highly dependent on the key suppliers outlined above, which account for approximately 85% of its purchases.

**Principles of Consolidation:** The Company’s 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 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, an Indiana limited liability corporation, owns 5,878,561 shares of common stock, representing 75.6% of the outstanding shares at June 30, 2006. LDI and Distribution are collectively referred to herein as “LDI.”

**Transactions with Majority Shareholder:** The Company reimburses its majority shareholder, LDI, for the cost of insurance, management fees and certain other expenses. Those expenses amounted to \$1,815,000 and \$1,990,000 for the six months ended June 30, 2006 and 2005, respectively. In addition, the Company leases from LDI its corporate office space. Lease expense and payments for repairs and maintenance to LDI totaled approximately \$133,000 and \$127,000 for the six months ended June 30, 2006 and 2005, respectively. The Company also has subordinated debt payable to LDI in the amount of \$19,850,000 as of June 30, 2006 and December 31, 2005.

**Cash:** At June 30, 2006 and December 31, 2005, checks drawn on future deposits and borrowings of \$2,367,000 and \$2,820,000, respectively, were classified as accounts payable. These amounts represent outstanding checks in excess of funds on deposit.

**Receivables:** Trade accounts receivable represent amounts due from customers. Trade receivables are typically not collateralized. No single customer exceeds 10% of the Company’s receivables at June 30, 2006 and December 31, 2005. 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.

**Consigned Inventories:** Inventories consigned with customers are stated at net realizable value and consist primarily of purchased paint and refinishing supplies. Consigned inventory is classified within other long-term assets in the accompanying consolidated balance sheets and amounted to \$4,806,000 and \$5,235,000, net of reserves, at June 30, 2006 and December 31, 2005, respectively.

**Consigned Equipment:** Equipment consigned with customers is stated at cost and is depreciated over a four-year period with no residual value. Consigned equipment is classified within other long-term assets in the accompanying consolidated balance sheets and amounted to \$214,000 and \$322,000, net of accumulated depreciation and reserves, at June 30, 2006 and December 31, 2005, respectively.

**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 combination of straight-line and accelerated methods over the following range of estimated useful lives:

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

Depreciation expense for the six months ended June 30, 2006 and 2005 was \$986,000 and \$980,000, 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 No. 144 (SFAS 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.

**Deferred Charges:** The Company makes cash payments 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 over the period in which these customers earn rebates on their cumulative levels of purchases. The amortization is reflected as a reduction of revenue in accordance with 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 for the six months ended June 30, 2006 and 2005 were \$3,109,000 and \$2,754,000, respectively. The current portion of deferred charges is classified within prepaid expenses and other current assets in the accompanying consolidated balance sheets and amounted to \$5,366,000 and \$4,784,000 at June 30, 2006 and December 31, 2005, respectively. The non-current portion of deferred charges is classified within other long-term assets and amounted to \$8,055,000 and \$7,548,000 at June 30, 2006 and December 31, 2005, 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. All of the Company's interest rate swap agreements have expired as of June 30, 2006.

**Revenue Recognition:** Revenues from product sales are recognized at the time of delivery (FOB destination) to the 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 projected 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 the product 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 inventory 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 \$12,348,000 and \$10,982,000 for the six months ended June 30, 2006 and 2005, respectively.

**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 Statement of Financial Accounting Standards 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.

**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.

**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 2006, the Company completed two acquisitions: the Raleigh, North Carolina automotive paint operations of Barnes Motor & Parts Company, Inc. and the Conway, South Carolina location of Spectrum Auto Paint and Supply, Inc. The acquisitions were funded with cash and debt.

During 2005, the Company completed five acquisitions: Vallet Paint Service Company, Inc. with two locations in Ohio; California Car Color, LLC with four locations in California; the Las Vegas, Nevada automotive paint operations of Single Source, Inc.; the Sheboygan, Wisconsin automotive paint operations of Fasse Paint Company, Inc.; and the Muskegon, Michigan automotive paint operations of American Auto Color, Inc. These acquisitions were funded with cash and debt.

### 3. LITIGATION

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 two superfund site investigations 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.

### 4. 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>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Numerator:				
Net income	<u>\$ 5,371</u>	<u>\$ 4,255</u>	<u>\$ 9,702</u>	<u>\$ 7,500</u>
Denominator:				
Basic-weighted average shares	7,773	7,770	7,773	7,744
Effect of dilutive stock options	49	38	46	37
Diluted-weighted average shares	<u>7,822</u>	<u>7,808</u>	<u>7,819</u>	<u>7,781</u>
Net income per share				
Basic	<u>\$ 0.69</u>	<u>\$ 0.55</u>	<u>\$ 1.25</u>	<u>\$ 0.97</u>
Diluted	<u>\$ 0.69</u>	<u>\$ 0.54</u>	<u>\$ 1.24</u>	<u>\$ 0.96</u>