

FINISHMASTER, INC. AND SUBSIDIARIES

Report on Audit of Financial Statements

At December 31, 2004 and 2003

and for the

Three Years Ended December 31, 2004

FINISHMASTER, INC.

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REPORT OF INDEPENDENT AUDITORS

Board of Directors and Shareholders
FinishMaster, Inc.

We have audited the accompanying consolidated balance sheet of FinishMaster, Inc. as of December 31, 2004, and the related consolidated statement of income, shareholders' equity, and cash flows for the year then ended. 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 audit. The financial statements of FinishMaster, Inc. as of December 31, 2003 and for each of the two years in the period ended December 31, 2003, were audited by other auditors whose report dated February 27, 2004, expressed an unqualified opinion on those statements.

We conducted our audit 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. An audit includes 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 audit provides a reasonable basis for our opinion.

In our opinion, the 2004 financial statements referred to above present fairly, in all material respects, the consolidated financial position of FinishMaster, Inc. at December 31, 2004, and the consolidated results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

Ernst + Young LLP

Indianapolis, Indiana
February 11, 2005

CONSOLIDATED BALANCE SHEETS

FinishMaster, Inc.

(In thousands, except share amounts)

ASSETS

Current assets

Cash	\$ 2,482	\$ 2,022
Accounts receivable, net of allowance for doubtful accounts of \$1,319 and \$1,462, respectively	33,020	30,329
Inventories	60,200	69,710
Deferred income taxes	4,156	4,857
Prepaid expenses and other current assets	6,670	4,607
Total current assets	106,528	111,525

Property and equipment

Land	368	368
Vehicles	2,203	2,204
Buildings and improvements	7,492	6,682
Machinery, equipment and fixtures	17,704	15,107
	27,767	24,361
Accumulated depreciation	(21,264)	(19,280)
	6,503	5,081

Other assets

Intangible assets, net (Note 3)	5,907	7,150
Goodwill, net (Note 3)	96,548	96,548
Other	6,347	2,712
	108,802	106,410
	\$ 221,833	\$ 223,016

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities

Accounts payable	\$ 34,210	\$ 44,119
Amounts due to LDI	1,075	796
Accrued compensation and benefits	7,840	7,114
Other accrued expenses and current liabilities	2,429	3,133
Current maturities of long-term debt	12,652	10,372
Total current liabilities	58,206	65,534

Long-term debt, less current maturities

54,462 63,600

Other long-term liabilities

7,389 5,984

Commitments and contingencies (Note 8)

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; 7,701,752 and 7,699,411 shares issued and outstanding	7,702	7,699
Additional paid-in capital	28,141	28,119
Accumulated comprehensive loss	(227)	(776)
Retained earnings	66,160	52,856
	101,776	87,898
	\$ 221,833	\$ 223,016

See accompanying notes.

CONSOLIDATED STATEMENTS OF INCOME

FinishMaster, Inc.

(In thousands, except per share data)

	Year Ended December 31, 2004	Year Ended December 31, 2003	Year Ended December 31, 2002
Net sales	\$ 386,415	\$ 347,012	\$ 342,803
Cost of sales	268,907	238,450	231,632
Gross margin	117,508	108,562	111,171
Expenses			
Operating	40,268	37,144	37,472
Selling, general and administrative	47,982	43,480	44,124
Amortization of intangible assets	1,556	1,316	1,027
	89,806	81,940	82,623
Income from operations	27,702	26,622	28,548
Interest expense	5,961	6,486	7,170
Income before income taxes	21,741	20,136	21,378
Income tax expense	8,437	8,284	8,481
Net income	\$ 13,304	\$ 11,852	\$ 12,897
Net income per share (Note 9)			
Basic	\$ 1.73	\$ 1.53	\$ 1.66
Diluted	\$ 1.71	\$ 1.52	\$ 1.64
Weighted average shares outstanding			
Basic	7,701	7,748	7,742
Diluted	7,759	7,820	7,856

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FinishMaster, Inc.

	Year Ended December 31, 2004	Year Ended December 31, 2003	Year Ended December 31, 2002
(In thousands)			
Operating activities			
Net income	\$ 13,304	\$ 11,852	\$ 12,897
Adjustments to reconcile net income to net cash provided (used) by operating activities:			
Depreciation and amortization	6,114	5,637	5,100
Deferred income taxes	3,647	(655)	2,473
Issuance of stock grants	25	20	25
Loss on disposal of property and equipment	9	24	113
Changes in operating assets and liabilities (excluding the impact of acquisitions):			
Accounts receivable, net	(2,261)	275	(1,275)
Inventories	10,449	(9,799)	(3,765)
Prepaid and other assets	(7,978)	(3,695)	(1,943)
Accounts payable and other liabilities	(7,299)	25,663	(22,880)
Net cash provided (used) by operating activities	16,010	29,322	(9,255)
Investing activities			
Business acquisitions and payments under earn-out provisions for prior acquisitions	(1,767)	(2,253)	(2,364)
Purchases of property and equipment	(3,205)	(1,002)	(893)
Proceeds from disposal of property and equipment	-	114	-
Net cash used in investing activities	(4,972)	(3,141)	(3,257)
Financing activities			
Proceeds from exercise of stock options	-	84	1,063
Repurchases of stock	-	(948)	-
Change in cash overdrafts	(3,501)	2,004	306
Proceeds from debt	100,294	76,820	110,800
Repayment of debt	(107,371)	(104,189)	(100,564)
Net cash provided (used) by financing activities	(10,578)	(26,229)	11,605
Increase (decrease) in cash	460	(48)	(907)
Cash at beginning of period	2,022	2,070	2,977
Cash at end of period	\$ 2,482	\$ 2,022	\$ 2,070
Supplemental disclosure of cash flow information			
Cash paid during the period for:			
Interest	\$ 5,726	\$ 5,699	\$ 6,684
Taxes	\$ 7,143	\$ 7,031	\$ 6,358

See accompanying notes.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

FinishMaster, Inc.

(In thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Comprehensive Loss	Totals
Balances at December 31, 2001	\$ 7,638	\$ 27,936	\$ 28,107	\$ (1,146)	\$ 62,535
Comprehensive income:					
Net income	-	-	12,897	-	12,897
Other comprehensive loss:					
Interest rate swap, net of tax of \$857	-	-	-	(140)	(140)
Total comprehensive income					12,757
Stock grants issued and options exercised	145	943	-	-	1,088
Balances at December 31, 2002	7,783	28,879	41,004	(1,286)	76,380
Comprehensive income:					
Net income	-	-	11,852	-	11,852
Other comprehensive loss:					
Interest rate swap, net of tax of \$344	-	-	-	510	510
Total comprehensive income					12,362
Repurchases of stock, at cost	(99)	(849)			(948)
Stock grants issued and options exercised	15	89	-	-	104
Balances at December 31, 2003	7,699	28,119	52,856	(776)	87,898
Comprehensive income:					
Net income	-	-	13,304	-	13,304
Other comprehensive income:					
Interest rate swap, net of tax of \$369	-	-	-	549	549
Total comprehensive income					13,853
Stock grants issued and options exercised	3	22	-	-	25
Balances at December 31, 2004	\$ 7,702	\$ 28,141	\$ 66,160	\$ (227)	\$ 101,776

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 leading national distributor of automotive paints, coatings, and paint-related accessories to the automotive collision repair industry. As of December 31, 2004, the Company operated 168 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 geographic 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 the Company’s 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 (“LDI”), an Indiana limited liability corporation, owns 5,878,561, 5,587,516, and 5,587,516 shares of the Company’s common stock, representing 76.33%, 72.57%, and 71.79% of the outstanding shares at December 31, 2004, 2003, and 2002, respectively. Throughout the remainder of these financial statements, LDI and Distribution are collectively referred to 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 \$3,682,000, \$4,260,000, and \$3,247,000, for the years ended December 31, 2004, 2003, and 2002, respectively. In addition, the Company leases from LDI its corporate office space. Lease expense and payments for repairs and maintenance to LDI totaled approximately \$259,000, \$236,000, and \$223,000, for the years ended December 31, 2004, 2003, and 2002, respectively. The Company also has subordinated debt payable to LDI (see Note 4, Long-Term Debt).

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: The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. At December 31, 2004 and 2003, checks drawn on future deposits and borrowings of \$2,672,000 and \$6,173,000, respectively, were classified as accounts payable. These amounts represent 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, 2004 and 2003. 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 first-in, first-out 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 amounted to \$5,988,000 and \$6,028,000, net of reserves, at December 31, 2004 and 2003, 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 \$562,000 and \$464,000, net of accumulated depreciation and reserves, at December 31, 2004 and 2003, 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 2004, 2003, and 2002 was \$2,031,000, \$2,365,000, and \$2,453,000, 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 investments with its customers which consist of cash in lieu of discounts. In consideration for these investments, customers make multi-year purchase commitments that include liquidated damages in the event that the customer breaches the commitment. These investments are capitalized and amortized over the commitment period or four years, whichever is shorter. 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 in 2004, 2003, and 2002 were \$2,213,000, \$1,325,000, and \$982,000, 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 \$2,579,000 and \$1,900,000 at December 31, 2004 and 2003, respectively. The non-current portion of deferred charges is classified within Other Long-Term Assets and amounted to \$4,559,000 and \$1,011,000 at December 31, 2004 and 2003, 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.

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 accordingly 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 \$21,106,000, \$18,270,000, \$16,500,000, in 2004, 2003, and 2002, respectively.

Stock-based Compensation: The Company recognizes compensation expense related to its stock option plan in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees." Options are granted at a price equal to the fair market value of the Company's common stock on the date of grant, therefore no compensation expense is recognized. Had compensation expense been determined at the date of grant based on the fair value of the awards consistent with Statement of Financial Accounting Standards No. 123, "Accounting for Stock Based Compensation," the Company's net income and net income per share would have been reduced to the pro forma amounts indicated in the following table:

	Year Ended December 31, 2004	Year Ended December 31, 2003	Year Ended December 31, 2002
(In thousands, except per share data)			
Net income			
As reported	\$ 13,304	\$ 11,852	\$ 12,897
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effect	(65)	(90)	(261)
Pro forma	\$ 13,239	\$ 11,762	\$ 12,636
Net income per share			
As reported, Basic	\$ 1.73	\$ 1.53	\$ 1.66
As reported, Diluted	\$ 1.71	\$ 1.52	\$ 1.64
Pro forma, Basic	\$ 1.72	\$ 1.52	\$ 1.63
Pro forma, Diluted	\$ 1.71	\$ 1.50	\$ 1.61

The fair value of each option granted was estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions for the years ended December 31, 2004, 2003, and 2002, respectively: risk free interest rate of 4.15%, 4.00%, and 4.70%; no dividend yield; expected option lives of nine years; and stock price volatility of 68.71%, 36.31%, and 41.90%.

The weighted-average fair value of options granted during the years ended December 31, 2004, 2003, and 2002, was \$6.91, \$5.32, and \$7.06, per option, respectively, where the exercise price of the options equaled the market price on the date of grant. Certain options were granted during 2002 where the exercise price of the options exceeded the market value of the stock on the date of grant. The weighted-average fair value of these options was \$6.58 per option at December 31, 2002.

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.

New Accounting Pronouncements: In December 2004, the Financial Accounting Standards Board issued revised Statement No. 123(R), "Share-Based Payment." This Statement establishes accounting and reporting standards for various types of equity-based awards (stock grants, options, etc.). This Statement generally requires recognition over the required service period of expense related to equity-based awards determined by measurement of fair values and is effective for the Company's financial statements beginning in 2006. The Company is currently studying the future effects of adopting this Statement. At this time, adoption of Statement No. 123(R) is not expected to have a significant effect on the Company's results of operations, financial position or cash flows.

Reclassifications: Certain amounts in the 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 periods presented. All acquisitions have been accounted for as purchases and, accordingly, the acquired assets and liabilities have been recorded at their estimated fair values at the dates of acquisition. Intangible assets such as goodwill, exclusive fulfillment contracts, agreements not to compete, and customer lists were recorded with each acquisition, if appropriate. Operating results of acquired entities have been included in the Company's consolidated financial statements from the respective date of purchase.

(In thousands)	Year Ended December 31, 2004	Year Ended December 31, 2003	Year Ended December 31, 2002
Accounts receivable	\$ 430	\$ 581	\$ 347
Inventory	939	4,346	1,705
Equipment and other	257	304	138
Intangible assets	560	3,125	1,140
	<u>2,186</u>	<u>8,356</u>	<u>3,330</u>
Less liabilities assumed	-	1,058	380
Acquisition price	2,186	7,298	2,950
Acquisition debt	219	5,044	586
Net assets of businesses acquired, net of acquisition debt	<u>\$ 1,967</u>	<u>\$ 2,254</u>	<u>\$ 2,364</u>
Number of acquisitions	2	3	4

Intangibles recorded as a result of these acquisitions are as follows:

(In thousands)	Year Ended December 31, 2004	Year Ended December 31, 2003	Year Ended December 31, 2002
Goodwill and Other Intangible Assets Purchased			
Goodwill	\$ -	\$ -	\$ 178
Exclusive fulfillment contract	-	1,601	-
Agreements not to compete	130	384	304
Customer lists	430	1,140	658
Total purchased goodwill and other intangible assets	<u>\$ 560</u>	<u>\$ 3,125</u>	<u>\$ 1,140</u>

During 2004, the Company completed two acquisitions: Hutchins Auto Supply Company, Inc. in North Carolina and Virginia Paint Company, Inc. in Richmond, Virginia. These acquisitions were funded with cash and debt.

During 2003, the Company completed three acquisitions: Rankin Auto Body Supplies, Inc. in New Jersey; Advance Paint, LLC in Denver, and Automotive Refinish Technologies in ten geographic locations. All these acquisitions were funded with cash and debt.

During 2002, the Company completed four acquisitions: Innovative Refinish Supply, Inc. in Arizona; Gil Bezy, Inc., D/B/A Color Master, Inc. in Kentucky; Southern Automotives, Inc., in South Carolina; and Caywood's Paint Supply in California. All these acquisitions were funded with cash and debt.

3. GOODWILL AND OTHER INTANGIBLE ASSETS

The Company follows the provisions of Statement of Financial Accounting Standards No. 142 (SFAS 142), "Goodwill and Other Intangible Assets," which requires that goodwill and indefinite lived assets be 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 142, the Company completed its required annual impairment test as of June 30, 2004 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, 2004			
Customer lists	\$ 5,949	\$ 2,546	\$ 3,403
Exclusive fulfillment contract	1,601	200	1,401
Agreements not to compete	13,244	12,521	723
Debt issue costs	1,328	948	380
Total	\$ 22,122	\$ 16,215	\$ 5,907

(In thousands)

	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Balance as of December 31, 2003			
Customer lists	\$ 5,519	\$ 1,575	\$ 3,944
Exclusive fulfillment contract	1,601	40	1,561
Agreements not to compete	13,114	12,097	1,017
Debt issue costs	1,328	700	628
Total	\$ 21,562	\$ 14,412	\$ 7,150

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 2004, 2003, and 2002 was \$1,556,000, \$1,316,000, and \$1,027,000, respectively. Estimated amortization expense for each of the five succeeding fiscal years based on intangible assets as of December 31, 2004 is expected to be as follows:

(In thousands)

2005	\$	1,725
2006		1,494
2007		1,186
2008		532
2009		354

Debt issuance cost amortization expense is included in interest expense, and in 2004, 2003, and 2002 was \$248,000 each year.

4. LONG-TERM DEBT

Long-term debt consisted of the following:

(In thousands)

	December 31, 2004	December 31, 2003
Revolving credit facility	\$ 22,260	\$ 19,910
Term credit facility	17,000	25,000
Senior subordinated debt	19,850	19,850
Notes payable to former owners of acquired businesses with interest at various rates up to 10%, due at various dates through 2008	5,667	7,938
Other long-term financing at various rates, due at various dates through 2010	2,337	1,274
	<u>67,114</u>	<u>73,972</u>
Less current maturities	12,652	10,372
	<u>\$ 54,462</u>	<u>\$ 63,600</u>

Revolving Credit Facility: The Company has a \$100 million senior secured credit facility with a syndicate of banks. The senior secured credit facility consists of a \$40 million term credit facility and a \$60 million revolving credit facility. The revolving credit facility is limited to the lesser of (1) \$60 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. 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, 2004 and 2003 was 2.00% over LIBOR or prime in the case of Floating Rate Advances. Interest rates and payment dates are variable based upon interest rates and term options selected by management. Interest rates at December 31, 2004 and 2003 on outstanding revolving credit borrowings varied from 3.09% to 5.25% in 2004 and 3.10% to 4.50% in 2003. The Company is charged an annual administrative fee of \$35,000, and an annual commitment fee, payable quarterly, that ranges between 0.38% and 0.50% of the unused portion of the revolving line of credit. At December 31, 2004 and 2003, the Company had \$33.6 million and \$36.3 million, respectively, of available borrowings under its revolving credit facility. The credit facility also allows the Company to borrow up to \$10 million on an unsecured basis.

Term Credit Facility: The term credit facility, which expires on June 30, 2006, requires quarterly principal payments that began on June 30, 2001. Quarterly principal payments in 2004 and 2003 were \$2.0 million and \$1.5 million, respectively, and increase in amount each year over the remaining term of the loan. Term 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, 2004 was 2.00% over LIBOR or prime in the case of Floating Rate Advances. Interest rates and payment dates are variable based upon interest rates and term options selected by management. Interest rates at December 31, 2004 and 2003 were 4.56% and 3.41%, respectively, on outstanding term borrowings.

To convert the Company's senior term credit facility from a floating to a fixed interest rate obligation, the Company entered into interest rate swap agreements in March 2001 with notional amounts of \$40 million. The notional amounts under the swap agreements are reduced according to the senior term credit facility's amortization schedule. 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 fair value of the interest rate swap liability at December 31, 2004 and 2003 was \$0.4 million and \$1.3 million, respectively. The change in the fair market value is recorded in the Accumulated Comprehensive Loss section of Shareholders' Equity, net of tax.

Combined Facilities: Substantially all of the Company's assets serve as collateral for the revolving credit facility and term credit facility. These credit agreements contain various quarterly and annual covenants pertaining to, among other things, achieving a minimum fixed charge coverage ratio, a maximum leverage ratio, a maximum senior debt leverage ratio, a minimum interest expense coverage ratio and a minimum consolidated net worth level. The covenants also limit purchases and sales of assets and restrict payment of dividends. If any default as described in the credit facilities occurs with respect to the Company, the obligations of the lenders to make additional loans automatically terminates and the outstanding obligations become immediately due and payable.

As of December 31, 2004 and 2003, the Company was in compliance with its covenants.

Senior Subordinated Debt: The Company has a \$19.9 million senior subordinated term credit facility with LDI. All outstanding principal is due on March 29, 2007, and interest is paid quarterly at a rate of 12.00% per annum.

The aggregate principal payments on long-term debt for the next five years subsequent to December 31, 2004, are as follows:

(In thousands)

2005	\$	12,652
2006		31,276
2007		21,051
2008		1,005
2009		56

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 two letters of credit outstanding for a total of \$3,836,000 and \$3,801,000 at December 31, 2004 and 2003, respectively.

5. EMPLOYEE SAVINGS PLAN

The Company has an Employee Savings Plan ("Plan"), which covers substantially all employees who have met certain requirements as to date of service. The Company currently contributes on a graduated scale 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 \$766,000, \$733,000, and \$657,000, for the years ended December 31, 2004, 2003, and 2002, respectively. In addition, the Company may contribute to the Plan, at the discretion of the Board of Directors, an additional amount up to 4% of employees' annual compensation. No discretionary contributions were made in 2004, 2003, and 2002.

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, 2004 were fully vested. Stock option activity for the three years ended December 31, 2004 is summarized as follows:

	December 31, 2004		December 31, 2003		December 31, 2002	
	Options	Weighted - Average Exercise Price	Options	Weighted - Average Exercise Price	Options	Weighted - Average Exercise Price
Outstanding-beginning of year	355,312	\$ 8.66	477,136	\$ 8.60	593,180	\$ 8.14
Granted	6,186	\$ 9.22	7,304	\$ 10.41	52,348	\$ 11.75
Exercised	-	\$ -	10,400	\$ 6.72	142,842	\$ 7.44
Cancelled	31,400	\$ 5.70	67,303	\$ 7.61	-	\$ -
Forfeited	53,400	\$ 11.40	51,425	\$ 10.15	25,550	\$ 10.75
Outstanding-end of year	276,698	\$ 8.48	355,312	\$ 8.66	477,136	\$ 8.60
Exercisable-end of year	276,698	\$ 8.48	347,312	\$ 8.59	461,136	\$ 8.50

	Exercise Price Range		
	\$5.34-\$8.25	\$9.22-\$12.15	Total
Options outstanding and exercisable	154,860	121,838	276,698
Weighted average exercise price	\$ 6.49	\$ 11.02	\$ 8.48
Average remaining contractual life	4.2 years	5.4 years	4.8 years

7. INCOME TAXES

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

	Year Ended December 31, 2004	Year Ended December 31, 2003	Year Ended December 31, 2002
(In thousands)			
Current:			
Federal	\$ 3,951	\$ 7,340	\$ 4,901
State	839	1,599	1,107
	4,790	8,939	6,008
Deferred:			
Federal	3,132	(561)	2,123
State	515	(94)	350
	3,647	(655)	2,473
	\$ 8,437	\$ 8,284	\$ 8,481

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

	Year Ended December 31, 2004	Year Ended December 31, 2003	Year Ended December 31, 2002
Federal statutory tax rate	34.0%	34.0%	34.0%
State tax provision, net of federal benefit	5.6%	5.6%	5.6%
Other	(0.8%)	1.5 %	0.1%
Effective tax rate	<u>38.8%</u>	<u>41.1%</u>	<u>39.7%</u>

The significant components of the Company's deferred tax assets as of December 31, 2004, and 2003 are as follows:

(In thousands)	December 31, 2004	December 31, 2003
Deferred tax assets:		
Depreciation	\$ 279	\$ 1,848
Allowances	1,356	1,893
Inventory	2,310	1,978
Accrued expenses and other	636	1,411
Total deferred tax assets	<u>4,581</u>	<u>7,130</u>
Deferred tax liabilities:		
Amortization of intangibles	(4,186)	(2,719)
Total deferred tax liabilities	<u>(4,186)</u>	<u>(2,719)</u>
Net tax effect of temporary differences	<u>\$ 395</u>	<u>\$ 4,411</u>

8. 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, 2004:

(In thousands)	
2005	\$ 7,151
2006	4,955
2007	3,531
2008	2,319
2009	1,234
Thereafter	<u>1,425</u>
	<u>\$ 20,615</u>

Rent expense charged to operations, including short-term leases, totaled approximately \$8,800,000, \$8,500,000, and \$8,600,000, for the years ended December 31, 2004, 2003, and 2002, 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 three superfund site investigations, two in Florida and one in Georgia. 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.

9. NET INCOME PER SHARE

The Company follows the provisions of Statement of Financial Accounting Standards No. 128 (SFAS 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 this Statement.

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

	Year Ended December 31, 2004	Year Ended December 31, 2003	Year Ended December 31, 2002
<small>(In thousands, except per share data)</small>			
Numerator:			
Net income	\$ 13,304	\$ 11,852	\$ 12,897
Denominator:			
Basic-weighted average shares	7,701	7,748	7,742
Effect of dilutive stock options	58	72	114
Diluted-weighted average shares	7,759	7,820	7,856
Net income per share:			
Basic	\$ 1.73	\$ 1.53	\$ 1.66
Diluted	\$ 1.71	\$ 1.52	\$ 1.64

For all years presented, antidilutive stock options were excluded in the determination of diluted earnings per share.