

Edgar Filing: FINISHMASTER INC - Form 10-Q

FINISHMASTER INC  
Form 10-Q  
May 06, 2003

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

FOR THE QUARTER ENDED MARCH 31, 2003

Commission File Number 0-23222

FINISHMASTER, INC.  
(Exact Name of Registrant as Specified in its Charter)

Indiana  
(State or other Jurisdiction of  
Incorporation or Organization)

38-2252096  
(I.R.S. Employer  
Identification Number)

54 Monument Circle, Suite 800, Indianapolis, IN  
(Address of principal executive offices)

46204  
(Zip Code)

Registrant's Telephone Number, including area code: (317) 237-3678

Indicate by check mark whether the registrant (1) has filed all annual,  
quarterly and other reports required to be filed by Section 13 or 15(d) of the  
Securities Exchange Act of 1934 during the preceding twelve months and (2) has  
been subject to the filing requirements for at least the past 90 days.

Yes  No   
-----

Indicate by check mark whether the registrant is an accelerated filer  
(as defined in Rule 12b-2 of the Act). Yes  No

-----

The aggregate market value of the voting stock held by non-affiliates of the  
Registrant as of June 30, 2002 (the last business day of the Registrant's most  
recently completed second fiscal quarter) was \$26,500,000.

On March 31, 2003, there were 7,790,671 shares of the Registrant's common stock  
outstanding.

FINISHMASTER, INC.  
FORM 10-Q  
FOR THE QUARTER ENDED MARCH 31, 2003

TABLE OF CONTENTS

## Edgar Filing: FINISHMASTER INC - Form 10-Q

### Part I. Financial Information

#### Item 1. Financial Statements

Condensed Consolidated Balance Sheets (unaudited)

Condensed Consolidated Statements of Operations (unaudited)

Condensed Consolidated Statements of Cash Flows (unaudited)

Condensed Consolidated Statements of Shareholders' Equity (unaudited)

Notes to Condensed Consolidated Financial Statements (unaudited)

#### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

#### Item 3. Controls and Procedures

### Part II. Other Information

#### Item 6. Exhibits and Reports on Form 8-K

Signatures

Certifications

2

### PART I. FINANCIAL INFORMATION

#### ITEM 1. FINANCIAL STATEMENTS

##### FINISHMASTER, INC.

##### CONDENSED CONSOLIDATED BALANCE SHEETS (in thousands, except per share data)

|   | MARCH 31,<br>2003 | DECEMBER 31,<br>2002 (1) |
|---|-------------------|--------------------------|
|   | -----             | -----                    |
| ASSETS  | (unaudited)       |                          |
| CURRENT ASSETS  |                   |                          |
| Cash  | \$ 3,364          | \$ 2,070                 |
| Accounts receivable, net of allowance for doubtful<br>accounts of \$1,663 and \$1,517, respectively | 29,809            | 30,023                   |
| Inventory   | 47,098            | 55,566                   |
| Refundable income taxes   | -                 | 731                      |
| Deferred income taxes   | 4,164             | 4,221                    |
| Prepaid expenses and other current assets   | 2,306             | 2,972                    |
|   | -----             | -----                    |
| Total Current Assets  | 86,741            | 95,583                   |
| PROPERTY AND EQUIPMENT, NET   | 5,809             | 6,278                    |
| OTHER ASSETS  |                   |                          |

Edgar Filing: FINISHMASTER INC - Form 10-Q

|   |            |            |
|---|------------|------------|
| Intangible assets, net  | 101,911    | 102,137    |
| Other   | 1,909      | 1,629      |
|   | -----      | -----      |
|   | 109,629    | 103,766    |
|   | -----      | -----      |
|   | \$ 196,370 | \$ 205,627 |
|   | =====      | =====      |
| LIABILITIES AND SHAREHOLDERS' EQUITY  |            |            |
| CURRENT LIABILITIES   |            |            |
| Accounts payable  | \$ 21,944  | \$ 15,744  |
| Amounts due to LDI  | 1,212      | 1,131      |
| Accrued compensation and benefits   | 5,909      | 7,971      |
| Accrued expenses and other current liabilities  | 2,775      | 1,895      |
| Current maturities of long-term debt  | 8,023      | 7,571      |
|   | -----      | -----      |
| Total Current Liabilities   | 39,863     | 34,312     |
| LONG-TERM DEBT, LESS CURRENT MATURITIES   | 70,222     | 88,726     |
| OTHER LONG-TERM LIABILITIES   | 7,001      | 6,209      |
| SHAREHOLDERS' EQUITY  |            |            |
| 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; 7,790,671 and 7,783,261 shares issued and outstanding | 7,791      | 7,783      |
| Additional paid-in capital  | 28,928     | 28,879     |
| Accumulated other comprehensive loss  | (1,212)    | (1,286)    |
| Retained earnings   | 43,777     | 41,004     |
|   | -----      | -----      |
|   | 79,284     | 76,380     |
|   | -----      | -----      |
|   | \$ 196,370 | \$ 205,627 |
|   | =====      | =====      |

(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  
MARCH 31,

-----  
2003

-----  
200

Edgar Filing: FINISHMASTER INC - Form 10-Q

|  |    |        |       |
|--|----|--------|-------|
| NET SALES                                      | \$ | 83,495 | \$    |
| COST OF SALES                                  |    | 56,788 |       |
|  |    | -----  | ----- |
| GROSS MARGIN                                   |    | 26,707 |       |
|  |    | -----  | ----- |
| EXPENSES                                       |    |        |       |
| Operating                                      |    | 9,186  |       |
| Selling, general and administrative            |    | 10,837 |       |
| Amortization of intangible assets              |    | 307    |       |
|  |    | -----  | ----- |
|  |    | 20,330 |       |
|  |    | -----  | ----- |
| INCOME FROM OPERATIONS                         |    | 6,377  |       |
| INTEREST EXPENSE, NET                          |    | 1,718  |       |
|  |    | -----  | ----- |
| INCOME BEFORE INCOME TAXES                     |    | 4,659  |       |
| INCOME TAX EXPENSE                             |    | 1,886  |       |
|  |    | -----  | ----- |
| NET INCOME                                     | \$ | 2,773  | \$    |
|  |    | =====  | ===== |
| NET INCOME PER SHARE -- BASIC                  | \$ | 0.36   | \$    |
|  |    | =====  | ===== |
| NET INCOME PER SHARE -- DILUTED                | \$ | 0.35   | \$    |
|  |    | =====  | ===== |
| WEIGHTED AVERAGE SHARES OUTSTANDING -- BASIC   |    | 7,791  |       |
|  |    | =====  | ===== |
| WEIGHTED AVERAGE SHARES OUTSTANDING -- DILUTED |    | 7,907  |       |
|  |    | =====  | ===== |

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

FINISHMASTER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)  
(unaudited)

Edgar Filing: FINISHMASTER INC - Form 10-Q

|  | MARCH    |
|--|----------|
|  | -----    |
| OPERATING ACTIVITIES   | 2003     |
|  | -----    |
| Net income   | \$ 2,773 |
| Adjustments to reconcile net income to net cash provided by operating activities:            |          |
| Depreciation and amortization  | 1,382    |
| Changes in operating assets and liabilities (excluding the impact of acquisitions):          |          |
| Accounts receivable, net   | 163      |
| Inventories  | 8,487    |
| Prepaid expenses and other assets  | (522)    |
| Accounts payable and other liabilities   | 7,168    |
|  | -----    |
| NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES   | 19,451   |
| INVESTING ACTIVITIES   |          |
| Business acquisitions and payments under earn-out provisions of prior acquisition agreements | (36)     |
| Purchases of property and equipment  | (127)    |
|  | -----    |
| NET CASH USED IN INVESTING ACTIVITIES  | (163)    |
| FINANCING ACTIVITIES   |          |
| Proceeds from exercise of stock options  | 58       |
| Proceeds from debt   | 13,430   |
| Repayment of debt  | (31,482) |
|  | -----    |
| NET CASH PROVIDED (USED) IN FINANCING ACTIVITIES   | (17,994) |
|  | -----    |
| INCREASE IN CASH   | 1,294    |
| CASH AT BEGINNING OF PERIOD  | 2,070    |
|  | -----    |
| CASH AT END OF PERIOD  | \$ 3,364 |
|  | =====    |

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

5

CONDENSED CONSOLIDATED STATEMENTS  
OF SHAREHOLDERS' EQUITY  
FINISHMASTER, INC.

| (In thousands)                | COMMON<br>STOCK | PAID-IN<br>CAPITAL | RETAINED<br>EARNINGS | ACCUMULATED<br>COMPREHENSIVE<br>INCOME |
|-------------------------------|-----------------|--------------------|----------------------|--|
|                               | -----           | -----              | -----                | -----                                  |
| BALANCES AT DECEMBER 31, 2001 | \$ 7,638        | \$ 27,936          | \$ 28,107            | \$                                     |
| Comprehensive income:         |                 |                    |                      |  |

## Edgar Filing: FINISHMASTER INC - Form 10-Q

|   |          |           |           |       |
|---|----------|-----------|-----------|-------|
| Net income for the year                   | -        | -         | 12,897    |       |
| Other comprehensive loss:                 |          |           |           |       |
| Interest rate swap                        | -        | -         | -         |       |
| Total comprehensive income                |          |           |           |       |
| Stock grants issued and options exercised | 145      | 943       | -         |       |
|   | -----    | -----     | -----     | ----- |
| BALANCES AT DECEMBER 31, 2002             | \$ 7,783 | \$ 28,879 | \$ 41,004 | \$    |
| Comprehensive income:                     |          |           |           |       |
| Net income for the quarter                | -        | -         | 2,773     |       |
| Other comprehensive -income:              |          |           |           |       |
| Interest rate swap                        | -        | -         | -         |       |
| Total comprehensive income                |          |           |           |       |
| Stock grants issued and options exercised | 8        | 49        | -         |       |
|   | -----    | -----     | -----     | ----- |
| BALANCES AT MARCH 31, 2003                | \$ 7,791 | \$ 28,928 | \$ 43,777 | \$    |

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

6

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. The condensed consolidated financial statements and notes are presented as permitted by the requirements for Form 10-Q and do not contain certain information included in our annual consolidated financial statements and notes. This Form 10-Q should be read in conjunction with our consolidated financial statements and notes included in our 2002 Annual Report on Form 10-K.

**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 March 31, 2003, we operated 157 sales outlets and three major distribution centers in 23 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, 3M and PPG, 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 inter-company accounts and

## Edgar Filing: FINISHMASTER INC - Form 10-Q

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. ("LDI"), an Indiana limited partnership, and is our majority shareholder with 5,587,516 shares of common stock, representing 71.7% of the outstanding shares at March 31, 2003. 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 swap are recorded each period in Other Long Term Liabilities and the net of tax effect is recorded in the Accumulated Other 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 quarter of 2003, we completed one acquisition, Rankin Auto Body Supplies, Inc., in New Jersey. The acquisition was completed on March 28, 2003, and was funded with cash.

During 2002, we completed four acquisitions: Innovative Refinish Supply, Inc., in Arizona during the first quarter; Gil Bezy, Inc., D/B/A Color Master, Inc. in Kentucky and Southern Automotive, Inc. in South Carolina during the third quarter; and Caywood's Paint Supply in California during the fourth quarter. These acquisitions were funded with cash and debt.

7

### 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)

|                                  | THREE MONTHS ENDED MARCH 31, |       |
|----------------------------------|------------------------------|-------|
|                                  | 2003                         | 2002  |
| Numerator:                       |                              |       |
| Net income                       | \$ 2,773                     | \$ 3  |
|                                  | =====                        | ===== |
| Denominator:                     |                              |       |
| Basic-weighted average shares    | 7,791                        | 7     |
| Effect of dilutive stock options | 114                          |       |

## Edgar Filing: FINISHMASTER INC - Form 10-Q

|                                 |                         |                     |
|---------------------------------|-------------------------|---------------------|
| Diluted-weighted average shares | -----<br>7,905<br>===== | -----<br>7<br>===== |
| Net income per share -- basic   | \$ 0.36<br>=====        | \$<br>=====         |
| Net income per share -- diluted | \$ 0.35<br>=====        | \$<br>=====         |

#### 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. Our 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 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



Edgar Filing: FINISHMASTER INC - Form 10-Q

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 \$1.5 million per quarter in 2003. 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 first quarter of 2003, our interest rates were 2.00% over LIBOR (1.34% to 1.76%) or at 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 change in the fair value of the interest rate swap was \$0.1 million and \$0.4 million for the first quarter 2003 and 2002, respectively. The amounts net of tax were recorded in the Accumulated Other Comprehensive Loss section of the 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 for the quarter ended March 31, 2003.

Information regarding the other intangible assets is as follows:

(In thousands)

| Balance as of March 31, 2003 | GROSS CARRYING<br>AMOUNT | ACCUMULATED<br>AMORTIZATION | NET BOOK VALUE |
|------------------------------|--------------------------|-----------------------------|----------------|
| Customer Lists               | \$ 4,495                 | \$ 917                      | \$ 3,578       |
| Non Compete Agreements       | 12,756                   | 11,785                      | 971            |
| Debt Issue Costs             | 1,329                    | 515                         | 814            |
|                              | -----                    | -----                       | -----          |
| Total                        | \$18,580                 | \$13,217                    | \$ 5,363       |
|                              | =====                    | =====                       | =====          |

Amortization lives for intangible assets range from 3 to 6 years.

Total intangible amortization expenses for the three months ended March 31, 2003 and 2002 was \$307,000 and \$246,000, respectively. Estimated amortization for each of the five succeeding fiscal years based on intangible assets as of December 31, 2002 is expected to be approximately \$1,100,000 annually.

Edgar Filing: FINISHMASTER INC - Form 10-Q

9

ITEM 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

NET SALES

| (In thousands) | THREE MONTHS ENDED MARCH 31, |        |           |
|----------------|------------------------------|--------|-----------|
|                | 2003                         | CHANGE | 2002      |
| Net sales      | \$ 83,495                    | (0.9%) | \$ 84,261 |

Net sales for the first quarter decreased \$0.8 million, or 0.9%, due to a "same store" sales decline of approximately 3.5%, partially offset by the full quarter sales effect of prior year acquisitions. We experienced soft market conditions in the industry as a whole. Inclement weather during January and February in the eastern half of the United States impacted demand for automotive paint and related accessories. Many of our customer's collision repair facilities were closed and their operations disrupted. Slow overall economic conditions also impacted sales with minor collision damage repair being delayed or cancelled by many automobile owners. We also continue to be impacted by the longer-term trend of a flat to declining vehicular repair environment and productivity improvements in the use of automotive paints by our customers. Even though these industry dynamics are not expected to reverse in the near term, we continue to focus our efforts on increasing sales and gaining market share.

GROSS MARGIN

| (In thousands)          | THREE MONTHS ENDED MARCH 31, |        |           |
|-------------------------|------------------------------|--------|-----------|
|                         | 2003                         | CHANGE | 2002      |
| Gross margin            | \$ 26,707                    | (1.9%) | \$ 27,216 |
| Percentage of net sales | 32.0%                        |        | 32.3%     |

Gross margin decreased \$0.5 million, or 1.9%. Lower net sales volume negatively impacted margin by approximately \$0.2 million. Gross margin as a percentage of net sales decreased 30 basis points to 32.0%, negatively impacting margin by \$0.3 million. This decrease was due primarily to higher shipping and handling costs associated with delivering our products to the customer.

OPERATING EXPENSES

THREE MONTHS ENDED MARCH 31,

Edgar Filing: FINISHMASTER INC - Form 10-Q

| (In thousands)          | 2003     | CHANGE | 2002     |
|-------------------------|----------|--------|----------|
| Operating expenses      | \$ 9,186 | (0.6%) | \$ 9,244 |
| Percentage of net sales | 11.0%    |        | 11.0%    |

Operating expenses consist of wages, facility, and related costs for our branch and distribution locations.

Operating expenses decreased \$0.1 million, or 0.6%, and as a percentage of net sales, remained stable at 11.0%. Lower labor costs were offset by higher facility insurance and utility costs.

SELLING, GENERAL AND  
ADMINISTRATIVE EXPENSES

| THREE MONTHS ENDED MARCH 31,                    |           |        |           |
|---|-----------|--------|-----------|
| (In thousands)                                  | 2003      | CHANGE | 2002      |
| Selling, general and<br>administrative expenses | \$ 10,837 | 2.4%   | \$ 10,582 |
| Percentage of net sales                         | 13.0%     |        | 12.6%     |

10

Selling, general and administrative expenses ("SG&A") consist of costs associated with our corporate support staff, and expenses for commissions, sales, wages, and customer sales support activities.

SG&A expenses increased \$0.3 million, or 2.4% due primarily to higher selling expenses. In an effort to increase our sales and market share, we hired additional sales personnel and initiated various sales and marketing programs throughout 2002. These initiatives increased our selling expenses, principally sales labor and marketing expenses. As a percentage of net sales, SG&A expenses increased from 12.6% to 13.0%.

AMORTIZATION OF INTANGIBLE ASSETS

| THREE MONTHS ENDED MARCH 31,         |        |        |        |
|--------------------------------------|--------|--------|--------|
| (In thousands)                       | 2003   | CHANGE | 2002   |
| Amortization of intangible<br>assets | \$ 307 | 24.8%  | \$ 246 |
| Percentage of net sales              | 0.4%   |        | 0.3%   |

Higher amortization expense of \$0.1 million, or 24.8%, was due primarily to an

## Edgar Filing: FINISHMASTER INC - Form 10-Q

increase in customer list amortization associated with prior year acquisitions.

### INTEREST EXPENSE

| (In thousands)          | THREE MONTHS ENDED MARCH 31, |        |          |
|-------------------------|------------------------------|--------|----------|
|                         | 2003                         | CHANGE | 2002     |
| Interest expense, net   | \$ 1,718                     | (6.5%) | \$ 1,837 |
| Percentage of net sales | 2.1%                         |        | 2.2%     |

Interest expense decreased \$0.1 million, or 6.5%, due primarily to lower effective interest rates. Our effective interest rate was approximately 100 basis points lower in the current quarter compared to the prior year period.

### INCOME TAX EXPENSE

| (In thousands)          | THREE MONTHS ENDED MARCH 31, |         |          |
|-------------------------|------------------------------|---------|----------|
|                         | 2003                         | CHANGE  | 2002     |
| Income tax expense      | \$ 1,886                     | (13.6%) | \$ 2,183 |
| Percentage of net sales | 2.3%                         |         | 2.6%     |
| Effective tax rate      | 40.5%                        |         | 41.1%    |

Income tax expense decreased \$0.3 million, or 13.6%, as a result of lower income before income taxes and a slightly lower effective tax rate.

### NET INCOME AND INCOME PER SHARE

| (In thousands, except per share data) | THREE MONTHS ENDED MARCH 31, |         |          |
|---------------------------------------|------------------------------|---------|----------|
|                                       | 2003                         | CHANGE  | 2002     |
| Net income                            | \$ 2,773                     | (11.2%) | \$ 3,124 |
| Percentage of net sales               | 3.3%                         |         | 3.7%     |
| Net income per share - Diluted        | \$ 0.35                      |         | \$ 0.40  |

### SEASONALITY AND QUARTERLY FLUCTUATIONS

Our sales and operating results have varied from quarter to quarter due to various factors and we expect these fluctuations to continue. Among these factors are seasonal buying patterns of our customers and the timing of acquisitions. Historically, sales have slowed in the late fall and winter of each year largely due to inclement weather and the reduced number of business days during the holiday season. In addition, the timing of acquisitions may cause substantial fluctuations in operating results from quarter to quarter. We

## Edgar Filing: FINISHMASTER INC - Form 10-Q

also take advantage of periodic special incentive programs available from our suppliers that extend the due date of inventory purchases beyond terms

11

normally available with large volume purchases. The timing of these programs can contribute to fluctuations in our quarterly cash flows. Although we continue to investigate strategies to smooth the seasonal pattern of our quarterly results of operations, there can be no assurance that our net sales, results of operations and cash flows will not continue to display seasonal patterns.

### FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

| (In thousands)                                  | MARCH 31,<br>2003 | ----- |
|---|-------------------|-------|
| Working capital                                 | \$ 46,878         | \$    |
| Long-term debt                                  | \$ 70,222         | \$    |
|   | -----             | ----- |
|   | THREE MONTHS ENDE | ----- |
|   | 2003              | ----- |
| Cash provided (used) by operating activities    | \$ 19,451         | \$    |
| Cash used in investing activities               | \$ (163)          | \$    |
| Cash provided by (used in) financing activities | \$ (17,994)       | \$    |
|   | -----             | ----- |

Our primary sources of funds are from operations and borrowings under our credit facilities. Our principal uses of cash are to fund working capital, capital expenditures, acquisitions, and the repayment of outstanding borrowings.

Operating activities in the first quarter of 2003 generated \$19.5 million of net cash compared with \$2.2 million of net cash used in the prior year period. This increase was the result of a positive change in operating assets and liabilities, primarily inventories and accounts payable and other liabilities. For the comparable first quarter periods, differences in payment terms between years on large year-end inventory purchases impacted cash used by accounts payable and other liabilities. Reductions in inventories purchased under the year-end purchase programs led to the cash generated from decreased inventory levels.

Net cash used in investing activities was \$0.2 million in the first quarter of 2003, compared to \$0.5 million in the prior year period due to decreased expenditures for the purchase of fixed assets and acquisitions. We estimate that capital expenditures for 2003, principally for information technology equipment, will approximate \$2.1 million.

Cash generated by operating activities, principally working capital, allowed us to repay approximately \$18.0 million of debt during the first quarter of 2003. In the prior year period, proceeds from borrowings were used to fund operating and investing activities.

## Edgar Filing: FINISHMASTER INC - Form 10-Q

Total capitalization at March 31, 2003, was \$157.5 million, comprised of \$78.2 million of debt and \$79.3 million of equity. Debt as a percentage of total capitalization was 49.7% at March 31, 2003 compared to 55.8% at December 31, 2002.

At March 31, 2003, we had outstanding term credit and revolving credit facilities totaling \$52.9 million and senior subordinated debt of \$19.9 million. We were in compliance with the covenants underlying these credit facilities, and had estimated availability under our revolving credit facilities of \$27.2 million, based upon the March 31, 2003 borrowing base calculation.

Based on current and projected operating results and giving effect to total indebtedness, we believe that cash flow from operations and funds available from lenders and other creditors will provide adequate funds for ongoing operations, debt service and planned capital expenditures.

### CRITICAL ACCOUNTING POLICIES

The accounting policies described below require us to make significant estimates and assumptions using information available at the time the estimates are made. Such estimates and assumptions significantly affect various reported amounts of assets and liabilities. If our future experience differs materially from these estimates and assumptions, our results of operations and financial condition could be affected.

12

**Allowance for Consigned Inventory** - We routinely consign inventory with our customers to attract and retain their business. The consigned inventory is an asset on our balance sheet. Upon termination of the customer relationship, the inventory is either returned to us or paid for by the customer. We periodically review the realizable value of the consigned inventory by following a detailed process that entails verifying that the customer's business relationship exists at a level to justify the consigned inventory balance. A reserve has been established to reduce the consigned inventory balance to its estimated net realizable value.

**Provision for Income Taxes** - We determine our provision for income taxes using the balance sheet method. Under this method, deferred tax assets and liabilities are recognized for the future tax effects of temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Changes in future tax provisions may be affected by the passage of new tax laws, changes in taxable income and the resolution of the tax audit issues.

**Allowance for Doubtful Accounts Receivable** - Our estimate of the allowance for doubtful accounts receivable is based on historical customer payment experience and reflects our best estimate of collectibility. Future events and circumstances related to the financial condition of our customers could materially change these estimates.

**Allowance for Vendor Credits Due** - Our estimate of the allowance for vendor credits due is based on historical collection experience and reflects our best estimate of collectibility. Future events and circumstances related to continued vendor support could materially change these estimates.

**Reserve for Obsolete Inventory** - Our estimate of the reserve for obsolete inventory is based on historical product usage information. Changes in the rate of introduction of new products by our suppliers, our ability to return excess

## Edgar Filing: FINISHMASTER INC - Form 10-Q

inventory to vendors, and our ability to sell excess inventory could materially change these estimates.

Deferred Charges - To attract and retain business, we will occasionally provide paint related equipment and/or make upfront cash investments in lieu of discounts with our customers. In consideration for these investments, our 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 thirty-six months, whichever is shorter. The amortization is reflected as a reduction of the selling price of the product and is reported as an offset to revenue.

### FORWARD-LOOKING STATEMENTS

This Report contains certain forward-looking statements pertaining to, among other things, our future results of operations, cash flow needs and liquidity, acquisitions, and other aspects of our business. We may make similar forward-looking statements from time to time. These statements are based largely on our current expectations and are subject to a number of risks and uncertainties. Actual results could differ materially from these forward-looking statements. Important factors to consider in evaluating such forward-looking statements include changes in external market factors, changes in our business strategy or an inability to execute this strategy due to changes in our industry or the economy in general, difficulties associated with assimilating acquisitions, the emergence of new or growing competitors, seasonal and quarterly fluctuations, governmental regulations, the potential loss of key suppliers, the realization of tax benefits from deferred tax assets, limitations on access to capital due to covenant restrictions, and various other competitive factors. In light of these risks and uncertainties, there can be no assurance that the future developments described in the forward-looking statements contained in this Report will in fact occur.

### SECURITIES AND EXCHANGE COMMISSION FILINGS

All reports filed electronically by us with the United States Securities and Exchange Commission (SEC), including the annual report on Form 10-K, quarterly reports on Form 10-Q, and current events reports on Form 8-K, as well as any amendments to those reports, are accessible on the SEC's website at <http://www.sec.gov>.

For additional information on FinishMaster, visit our website at <http://www.finishmaster.com/> or Corporate News on the Net at <http://www.businesswire.com/companyspecific>

13

### ITEM 3

#### CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-14 promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), within 90 days of the filing date of this report. Based on their evaluation, our chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures are effective.

There have been no significant changes (including corrective actions with regard

## Edgar Filing: FINISHMASTER INC - Form 10-Q

to significant deficiencies or material weaknesses) in our internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation referenced above.

### PART II -- OTHER INFORMATION

#### Item 6. Exhibits and Reports on Form 8-K

- (a) Exhibits. The following exhibits, unless otherwise indicated, have been filed as exhibits to documents otherwise filed by the Registrant, and are hereby incorporated by reference.

| Exhibit No. | Description of Document   |
|-------------|---|
| -----       | -----   |
| 2.1         | Agreement and Plan of Merger, dated as of October 14, 1997, by and among FinishMaster, Inc., FMST Acquisition Corporation and Thompson PBE, Inc. (incorporated by reference to Exhibit (c)(2) of Schedule 14D-1 previously filed by FMST Acquisition Corporation on October 21, 1997) |
| 2.2         | Agreement and Plan of Merger, dated February 16, 1998, by and among FinishMaster, Inc., LDI AutoPaints, Inc. and Lacy Distribution, Inc. (previously filed with Form 10-K dated March 31, 1998)   |
| 3.1         | Articles of Incorporation of FinishMaster, Inc., an Indiana corporation, as amended June 30, 1998 (previously filed with Form 10-Q dated August 14, 1998)   |
| 3.2         | Amended and Restated Code of Bylaws of FinishMaster, Inc., an Indiana corporation (previously filed with Form 10-K dated March 28, 2002)  |
| 10.1        | FinishMaster, Inc. Stock Option Plan (Amended and Restated as of April 29, 1999) (previously filed with Registrant's proxy statement on Schedule 14A dated April 9, 1999)   |
| 10.2        | FinishMaster, Inc. Deferred Compensation Plan dated as of November 1, 2000 (previously filed with Registrant's proxy statement on Schedule 14A dated April 9, 2001)   |
| 10.3        | First Amendment to the FinishMaster, Inc. Deferred Compensation Plan dated January 1, 2002 (previously filed with Form 10-K dated March 28, 2002)   |
| 21          | Subsidiaries of the Registrant (previously filed with Form 10-K dated March 28, 2002)   |
| 99(a)       | Credit Agreement, dated as of March 29, 2001, among FinishMaster, Inc., the Institutions from Time to Time Parties Thereto as Lenders and National  |



## Edgar Filing: FINISHMASTER INC - Form 10-Q

dated May 14, 2001)

- 99 (b) First Amendment to Credit Agreement, dated as of December 14, 2001, among FinishMaster, Inc., the Institutions from Time to Time Parties Thereto as Lenders and National City Bank of Indiana, as Agent (previously filed with Form 10-K dated March 28, 2002)
- 99 (c) Second Amendment to Credit Agreement dated as of December 23, 2002, among FinishMaster, Inc., the Institutions from Time to Time Parties Thereto as Lenders and National City Bank of Indiana, as Agent (previously filed with Form 10-K dated March 28, 2002)
- 99 (d) Subordinated Note Agreement, dated as of March 29, 2001, by and between FinishMaster, Inc. and LDI, Ltd. (previously filed with Form 10-Q dated May 14, 2001)
- 99.1 Certification

- (b) Reports on Form 8-K. There were no reports on Form 8-K filed in the quarter ended March 31, 2003.

\*filed herein

15

### SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: May 6, 2003

FINISHMASTER, INC.

By: /s/ Andre B. Lacy

-----  
Andre B. Lacy  
Chief Executive Officer

By: /s/ Robert R. Millard

-----  
Robert R. Millard  
Senior Vice President and  
Chief Financial Officer

16

[GRAPHIC: This graphic shows where each of the funds in the Ultra Series Fund, in addition to other types of investments, fall on a curve that depicts the risk taken for the gain potential. The x-axis is labelled "Long-Term Potential for Gains;" the y-axis is labelled "Short-Term Risk (Volatility of Returns)."]

CERTIFICATION

## Edgar Filing: FINISHMASTER INC - Form 10-Q

I, Andre B. Lacy, certify that:

1. I have reviewed this quarterly report on Form 10-Q of FinishMaster, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

## Edgar Filing: FINISHMASTER INC - Form 10-Q

Date: May 6, 2003

/s/ Andre B. Lacy  
-----

Andre B. Lacy  
Chairman and Chief Executive Officer

17

### CERTIFICATION

I, Robert R. Millard, certify that:

1. I have reviewed this quarterly report on Form 10-Q of FinishMaster, Inc.:
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flow of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal control; and

Edgar Filing: FINISHMASTER INC - Form 10-Q

- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
- 6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses

Date: May 6, 2003

/s/ Robert R. Millard

-----  
Robert R. Millard  
Senior Vice President and Chief  
Financial Officer