

Edgar Filing: FINISHMASTER INC - Form 10-K

FINISHMASTER INC
Form 10-K
March 29, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(X) ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2001

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 600, Indianapolis, IN
(Address of principal executive offices)

46204
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

| Title of each class ----- | Name of each exchange on which registered ----- |
|----------------------------------|---|
| Common Stock - without par value | Nasdaq Stock Market |

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. []

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of March 1, 2002 was \$20,421,335.

On March 1, 2002, 7,648,363 shares of Registrant's common stock were outstanding.

Documents Incorporated By Reference

Portions of the annual proxy statement for the year ended December 31, 2001 are incorporated by reference into Part III.

Edgar Filing: FINISHMASTER INC - Form 10-K

FINISHMASTER, INC. ANNUAL REPORT ON FORM 10-K TABLE OF CONTENTS

| ITEM | | PAGE |
|------|---|------|
| 1 | Business..... | 3 |
| 2 | Properties..... | 7 |
| 3 | Legal Proceedings..... | 8 |
| 4 | Submission of Matters to a Vote of Security Holders..... | 8 |
| 5 | Market for Registrant's Common Equity and Related Shareholder Matters..... | 9 |
| 6 | Selected Consolidated Financial Data..... | 10 |
| 7 | Management's Discussion and Analysis of Financial Condition and Results of Operations..... | 11 |
| 8 | Financial Statements and Supplemental Data..... | 17 |
| 9 | Changes in, and Disagreements with Accountants on Accounting and Financial Disclosure..... | 34 |
| 10 | Directors and Executive Officers of the Registrant..... | 34 |
| 11 | Executive Compensation..... | 34 |
| 12 | Security Ownership of Certain Beneficial Owners and Management..... | 34 |
| 13 | Certain Relationships and Related Transactions..... | 34 |
| 14 | Exhibits, Financial Statement Schedules, and Reports on Form 8-K..... | 34 |
| | Signatures..... | 35 |

PART I

ITEM 1 - BUSINESS

General

We are the leading national independent distributor of automotive paints, coatings and paint-related accessories primarily to the automotive collision repair industry. As of March 1, 2002, we serve our customers through a 350 person direct sales force in 159 sales outlets and three major distribution centers located in 23 states, making us the only national independent distributor in the industry. We have approximately 15,000 customer charge accounts consisting principally of collision repair shops and automobile dealers, to which we provide a comprehensive selection of brand name products.

Edgar Filing: FINISHMASTER INC - Form 10-K

Our product offering consists of over 32,000 stock keeping units ("SKUs"), including leading brands of automotive paints, coatings, thinners and reducers manufactured by BASF, DuPont, and PPG and the leading brands of paint-related accessories manufactured principally by 3M, such as masking materials, body fillers and cleaners. For the year ended December 31, 2001, net sales were \$333.5 million and net income was \$6.2 million.

Our vision is to expand our leadership position in the distribution of products, services and technology that are recognized by customers as key factors in their success. We provide our customers with "local" value-added services such as rapid delivery, technical support, product training, management seminars, computerized color matching, inventory management, personnel placement and environmental compliance reporting. These value-added services are backed by "national" expertise in the systems and technology of warehouse distribution and supply chain management, and strategic partnering with the manufacturers of paint and paint-related accessories. Our local focus helps us respond to the unique customer needs in various geographic markets. Our national network allows us to provide better, consistent service at a lower cost than our competition. In addition, we are able to provide certain multi-site customers, such as "collision repair shop" chains and mega-dealerships, with efficient and consistent product distribution throughout their national or regional networks at competitive prices.

We estimate the U.S. automotive paint and paint-related accessories distribution after-market ("distribution after-market") to be approximately \$2.5 billion, with automotive collision repair shops being the primary customers for automotive paint and paint-related accessories. In addition to independent collision repair shops and automobile dealers, we supply products to organizations that maintain their own automobile fleet, van conversion companies and other commercial/industrial customers. The distribution after-market is supplied by a small number of manufacturers of paint and paint-related accessories and serves a highly fragmented customer base, consisting of approximately 40,000 collision repair shops alone. Our competitors tend to be family-owned, with one to three distribution sites and typically serve a highly localized customer base.

We are an Indiana based corporation. Our principal executive offices are leased from LDI, Ltd. ("LDI"), an Indiana limited partnership, which indirectly owns 73.1% of our outstanding shares. We believe that the terms of the lease are at least as favorable to us as those that could be obtained by arms-length negotiations with an unaffiliated third party. Our principal executive offices are located at 54 Monument Circle, Suite 600, Indianapolis, Indiana 46204, and our telephone number is (317) 237-3678.

Industry Overview

We estimate the distribution after-market to be approximately \$2.5 billion. The end users of the products distributed by us are principally independent collision repair shops and automobile dealers. Additionally, organizations that maintain their own automobile fleet, van conversion companies and other commercial/industrial customers make up a smaller percentage of our customer base. Automotive paint and related supplies, in contrast to labor and parts, represent only a small portion (approximately 7-10%) of the total cost of a typical collision repair job. However, while paint is a relatively minor component of the total repair cost, we play a critical role in the customer's level of satisfaction.

The distribution after-market for automotive paint and related supplies is characterized by a small number of manufacturers of paint and paint-related accessories. The five predominant manufacturers of automotive paint distributed in the United States are Akzo Nobel, BASF, DuPont, PPG and The Sherwin-Williams Company. In addition, several other large foreign manufacturers have recently

Edgar Filing: FINISHMASTER INC - Form 10-K

taken steps to expand the distribution of their paint products in the United States. 3M is the predominant manufacturer of paint-related accessories which include refinishing materials, supplies, accessories and tools such as sand paper, masking tape and paint masks.

The paint manufacturers market is continuing to consolidate. Specifically, in July 1999, PPG acquired Imperial Chemical Industries' global automotive refinish and industrial coatings business and its automotive solvents and thinners business in North America. In March 1999, DuPont acquired Herberts GmbH, the coatings company of Hoechst. The Herberts acquisition created the world's third largest coatings company and the leading automotive coatings supplier.

While automotive paint manufacturing is highly concentrated, automotive paint distribution and the end users of automotive paint are highly fragmented. We believe that a large number of independent distributors of automotive paint serve an aggregate of approximately 40,000 collision repair shops nationwide. Distributors, which tend to be family-owned with one to three distribution sites, typically serve a highly localized customer base with each distribution site serving customers located within 20 miles of the site depending upon demographics, road access and geography.

Due to the large number of end users and their increasing demands for personalized services, such as multiple daily deliveries, assistance with color-mixing and matching, and assistance with paint application techniques and environmental compliance reporting, manufacturers typically service end users through distributors like us. Nevertheless, some of the paint manufacturers have elected to operate company-owned distribution facilities in selected markets, including markets in which we operate. We believe, however, that the largest automotive paint manufacturers have generally avoided the cost of operating their own distribution network due to their inability to offer multiple lines of paint which prevents them from spreading distribution expenses across the market's entire potential customer base. Consequently, we believe that independent distributors like us, which can sell the products of several paint manufacturers, are better situated to service the end users' needs than the company owned distribution facilities of automotive paint manufacturers.

The market for paints and supplies for automotive collision repairs has changed significantly in recent years. Key factors affecting this market have been:

- o a decline in the number of vehicles repaired annually;
- o improvements in paint application technology and advances in paint system productivity;
- o environmental regulations which have required the reformulation of paints and the use of more advanced equipment and facilities;
- o automobile manufacturers' use of more complex and expensive automotive finishes; and
- o an increase in the number of vehicles repaired by insurance companies' designated "direct repair providers".

Collision repair shops have been forced to invest in new equipment and additional training of their workers, while there has been a decline in the number of repair jobs. Accordingly, there has been some consolidation in the highly fragmented collision repair industry among end users of automotive paints and accessories. In addition, collision repair shops and car dealerships are seeking to improve their financial performance and competitive position by developing relationships with distributors that can support their businesses with value-added services. This demand for higher levels of service from distributors, combined with lower unit sales volume of paint and supplies, has

Edgar Filing: FINISHMASTER INC - Form 10-K

resulted in a consolidation among after-market distributors. We have led the consolidation among distributors in recent years, having completed 39 acquisitions over the past ten years.

Although the automotive collision repair industry is experiencing a trend toward consolidation, we believe that our size and current position as a market leader will enable us to continue to grow and remain profitable. We have been able to offset the decline in unit volume by material price increases that we have been able to pass on to our customers due to the technological advancements in paints and coatings. In addition, we believe we will continue to attract new customers due to our value-added services, such as our experience in helping customers comply with environmental regulations. This service, which we currently provide in California and Colorado, will be applicable in other geographic areas as the U.S. Environmental Protection Agency enacts volatile organic compound ("VOC") regulations nationwide.

Products and Suppliers

We offer our customers a comprehensive selection of prominent brand name products and our own PrivateBrand products. The product line consists of over 32,000 SKUs, including the three leading brands of automotive paints and coatings and a leading brand of related accessories. Our PrivateBrand products include some of the most frequently used refinishing accessories such as masking materials, body fillers, thinners, reducers and cleaners.

We rely on four leading suppliers for the majority of our product requirements. BASF, DuPont, and PPG supply virtually all of our paint products, and 3M is our largest supplier of paint-related accessories. Products supplied by BASF, DuPont, 3M and PPG accounted for approximately 85% of purchases in 2001. Although each of these suppliers generally competes with the others along product lines, we do not believe the products are completely interchangeable because of high brand loyalty among customers and their brand-specific color matching computer systems. We continuously seek opportunities with new and existing suppliers to supply the highest quality products.

Whenever practical, we make purchases from suppliers in large volumes to maximize volume discounts. In addition, we participate in periodic, special incentive programs available from suppliers. These programs provide additional purchase discounts and extended payment terms in exchange for large volume purchases. We also benefit from supplier-provided early payment discounts and from other supplier-supported programs.

Services

We offer comprehensive value-added services designed to assist customers in operating their businesses more effectively. These services include:

Rapid Delivery

Products are delivered to customers using our delivery fleet of approximately 720 trucks. We offer multiple daily deliveries to meet our customers' just-in-time inventory needs. Customer concerns for product availability typically take priority over all other competitive considerations, including price.

Technical Support

Our technical support personnel demonstrate and recommend products. In addition, they assist customers with problems related to their particular product applications. Equipment specialists provide information to customers regarding their heavy equipment requirements, such as spray booths and frame straightening equipment.

Edgar Filing: FINISHMASTER INC - Form 10-K

Product Training

As a result of increasing regulations, manufacturers have introduced technologically advanced, lower VOC paints, which require significantly more sophisticated application techniques. We provide training to customers in order to teach them the techniques required to work with these products. Training sessions are typically conducted jointly by us and by one or more of our major suppliers at the customer's location or at an off-site location.

Management Seminars

Management seminars are conducted at convenient locations to inform our customers about environmental regulations and compliance, techniques to improve productivity, and industry trends.

Color Matching

The growing number of paint colors is a challenge for the refinishing industry. DuPont, for example, has more than 350,000 mix formulas. With sophisticated PC-based color matching equipment and specialists, we provide color-matching services to our customers.

Inventory Management

We perform monthly physical inventories for customers who request this service. We also provide customers with management information reports on product usage.

Assistance with Environmental Compliance Reporting

All states have air quality regulations that mandate paint and application methods which result in reduced atmospheric emissions of paint and other related materials. In California in particular, we arrange demonstrations of new products and application techniques designed to comply with air quality regulations. In addition, in California and Colorado, we assist our customers with environmental reporting requirements by providing special reports designed to simplify their compliance. The EPA has proposed regulations to control VOC emissions from automobile refinishing nationwide and, accordingly, we are considering an expansion of these programs.

Personnel Placement

Certain of our locations assist our customers with filling employment openings and/or persons seeking employment with collision repair shops located in the market served. Upon request from a customer to fill an opening, we may provide the names of one or more persons for the position. Similar services are available to persons seeking employment. We do not charge for this service but benefit from enhanced relationships with our customers and their employees.

Competition

The distribution after-market of the automotive refinishing industry is highly fragmented and competitive with many independent distributors competing primarily on the basis of technical assistance and expertise, price, speed of delivery and breadth of product offering. There are no other independent national distributors of automotive refinish paints and accessories. There are a number of independent regional distributors, many of which are in direct competition with us on a regional or local level. Competition in the purchase of independent distributors and sales outlets may occur between us and other automotive refinishing distributors that are also pursuing growth through acquisitions.

Edgar Filing: FINISHMASTER INC - Form 10-K

We may also encounter significant sales competition from new market entrants, automotive paint manufacturers, buying groups or other large distributors that may seek to enter such markets or may seek to compete with us for attractive acquisition candidates. Although the largest automotive paint manufacturers have generally not operated their own distributors, or have done so only on a limited basis, they may decide to expand such activity in the future. For example, Sherwin-Williams distributes its own automotive paints through its sales outlets. In addition, BASF, one of our principal suppliers, also distributes in certain markets through its own outlets in North America. While we do not believe that current direct distribution efforts by automotive paint manufacturers have significantly affected our sales, there can be no assurance that we will not encounter increased competition in the future. We may also compete with our suppliers in selling to certain large volume end users such as van converters, small manufacturers and large fleet operators.

Employees

As of March 1, 2002, we employed approximately 1,530 persons on a full and part-time basis. None of the employees are covered by a collective bargaining agreement, and we consider our relations with our employees to be good.

Governmental and Environmental Regulations

We are subject to various federal, state and local laws and regulations. These regulations impose requirements on our customers and us. Pursuant to the regulations of the U.S. Department of Transportation and certain state transportation departments, a license is required to transport our products and annual permits are required due to the classification of certain of our products as "hazardous." Various state and federal regulatory agencies, such as the Occupational Safety and Health Administration and the United States Environmental Protection Agency, have jurisdiction over the operation of our distribution centers and sales outlets. These agencies require us to comply with various governmental regulations, including worker safety laws, community and employee "right-to-know" laws and laws regarding clean air and water. In addition, state and local fire and environmental regulations extensively control the design and operation of our facilities, the sale of our products, and the application of these products by our customers. Such regulations are complex and subject to change. Regulatory or legislative changes may cause future increases in our operating costs or otherwise negatively affect operations.

ITEM 2 - PROPERTIES

The following table sets forth certain information regarding the facilities operated by us as of March 1, 2002.

| State | Number Of Offices | No. of Sales Outlets | No. of Distribution Centers |
|--------------------|-------------------------|----------------------------|-----------------------------------|
| Alabama..... | | 1 | |
| Arizona..... | | 3 | |
| California..... | 1 | 28 | 1*** |
| Colorado..... | | 4 | |
| Connecticut..... | | 3 | |
| Delaware..... | | 1 | |
| Florida..... | 1* | 39 | 1*** |
| Georgia..... | | 3 | |
| Illinois..... | | 5 | |
| Indiana..... | 1 | 3 | |
| Maryland..... | | 4 | |
| Massachusetts..... | | 5 | |
| Michigan..... | 1* | 12 | 1*** |

Edgar Filing: FINISHMASTER INC - Form 10-K

| | | | |
|--------------------------|---|-----|-----|
| Minnesota..... | 3 | | |
| New Jersey..... | 8 | | |
| North Carolina..... | 1 | 6 | 1** |
| Ohio..... | | 2 | |
| Oklahoma..... | | 1 | |
| Pennsylvania..... | | 3 | |
| South Carolina..... | | 6 | |
| Texas..... | | 12 | |
| Virginia..... | | 3 | |
| Wisconsin..... | | 4 | |
| ----- | | | |
| Total Offices, Sales | | | |
| Outlets and Distribution | | | |
| Centers | 5 | 159 | 4 |

* Locations where an office and distribution center are combined facilities; Kentwood, MI and Ft. Lauderdale, FL.

** Location where a store and distribution center are combined facilities; Greensboro, NC.

*** Denotes major distribution centers; Kentwood, MI, Ft. Lauderdale, FL and Los Angeles, CA.

Our sales outlets range in size from 1,250 square feet to 14,800 square feet. Some of the larger sales outlets are also used as "drop ship" points from which we supply other sales outlets. Sales outlets consist of inventory storage areas, mixing facilities, display and counter space and, in some instances, sales office space. Sales outlets are strategically located in major markets to maximize market penetration, transportation logistics and overall customer service. Our distribution centers range in size from 5,000 square feet to 18,000 square feet. The distribution centers are equipped with efficient material handling and storage equipment.

We own the distribution center and two sales outlets in Michigan, one sales outlet in Indiana, and one in Florida. The remainder of the sales outlets and the other distribution centers are leased with terms expiring from 2002 to 2008, with options to renew. We typically assume the lease of the former owner in acquisitions. In a number of instances, our sales outlets are leased from the former owners of businesses acquired by us. We believe that all of our leases are at fair market rates, that presently no single lease is material to our operations, and that alternative sites are presently available at market rates. We are leasing approximately 15,000 square feet of executive offices for our national headquarters located in Indianapolis, Indiana.

ITEM 3 - LEGAL PROCEEDINGS

In January 1999, we were named in an unfair business practices lawsuit by an automotive paint distributor located in the State of California. The plaintiff in such suit alleged that we offered, in a manner that injured the plaintiff, rebates and cash bonuses to businesses in the Southern California area if those businesses would buy exclusively from us and use our products. The plaintiff claimed damages in the amount of \$3.8 million, trebled to \$11.4 million. During 2000, the court granted summary judgment in our favor. The plaintiff has not appealed the judgment against it, and the decision is now final.

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. Our management believes that the ultimate liability, if any, in excess of amounts already provided or covered by insurance, is not likely to

Edgar Filing: FINISHMASTER INC - Form 10-K

have a material adverse effect on our financial condition, results of operations or cash flows.

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ADDITIONAL ITEM - EXECUTIVE OFFICERS OF THE REGISTRANT

The following sets forth certain information concerning the executive officers of the Company who are not also directors:

Thomas E. Case (age 56) serves as the Senior Vice President of Sales for our West Region. He had previously served as the Senior Vice President and general manager of our Western Division from June 1998 to January 2001. Mr. Case joined us upon completion of our acquisition of Thompson in November 1997. Formerly, Mr. Case was a Vice President of Thompson and served as the general manager of Thompson's California Division.

J. A. Lacy (age 37) serves as our Senior Vice President of Operations. He had previously served as the Senior Vice President of Planning and Marketing from January 1999 to January 2001. From January 1997 to December 1998, Mr. Lacy served as President of Tucker Rocky Distributing Canada, Inc., a leading after-market distributor of motorcycle components and accessories. Prior to this, Mr. Lacy was Vice President of J. Walter Thompson, an advertising agency.

Robert R. Millard (age 44) joined us in October 1998 as the Senior Vice President of Finance, Chief Financial Officer, Secretary and Treasurer. From February 1996 until September 1998, Mr. Millard served as Vice President of Finance, Chief Financial Officer, Secretary and Treasurer of Personnel Management, Inc., a publicly held personnel staffing company based in Indianapolis, Indiana. From July 1991 until January 1996, Mr. Millard served as the Corporate Controller of Lacy Diversified Industries, Ltd., an affiliate of LDI.

Charles VanSlaars (age 52) serves as the Senior Vice President of Marketing. He had previously served as the Senior Vice President of Sales for our Eastern Division, a position held from January 2001 until November 2001, and Senior Vice President and General Manager of our Southeastern Division, a position he held from June 1998 to January 2001. From June 1996 until May 1998, Mr. VanSlaars served as an executive officer of LDI AutoPaints, Inc. From 1994 until 1996, Mr. VanSlaars served as Vice President of Parts Depot Company, L.P., a Florida-based distributor of auto paints.

PART II

ITEM 5 - MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED SHAREHOLDER MATTERS

Our common stock trades on The NASDAQ Stock Market (SmallCap Market) under the symbol FMST. The number of beneficial owners of our common stock at December 31, 2001, was approximately 350.

The range of high and low closing prices reported by NASDAQ for the last twelve quarters were:

| Year | Quarter Ended | High | Low |
|-------|---------------|------|-----|
| ----- | | | |

Edgar Filing: FINISHMASTER INC - Form 10-K

| | | | |
|------|--------------|--------|-------|
| 1999 | March 31 | 7.000 | 5.625 |
| 1999 | June 30 | 6.000 | 4.750 |
| 1999 | September 30 | 7.375 | 5.688 |
| 1999 | December 31 | 7.938 | 5.750 |
| 2000 | March 31 | 8.000 | 6.750 |
| 2000 | June 30 | 8.000 | 4.750 |
| 2000 | September 30 | 7.000 | 5.250 |
| 2000 | December 31 | 7.000 | 4.700 |
| 2001 | March 31 | 7.250 | 4.875 |
| 2001 | June 30 | 9.000 | 6.000 |
| 2001 | September 30 | 8.680 | 5.760 |
| 2001 | December 31 | 10.270 | 7.250 |

No cash dividends on common stock have been paid during any period and none are expected to be paid in the foreseeable future. We anticipate that all earnings and other cash resources will be retained by us for investment in our business.

ITEM 6 - SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data as of December 31, 2001 and 2000 and for the years ended December 31, 2001, 2000, and 1999, are derived from our audited consolidated financial statements that are included elsewhere herein. The selected consolidated financial data as of December 31, 1999, 1998 and 1997 and for the years ended December 31, 1998 and 1997 are derived from our audited consolidated financial statements, which are not included herein. The financial data should be read in conjunction with our audited consolidated financial statements and notes thereto, included elsewhere herein, and with "Management's Discussion and Analysis of Financial Condition and Results of Operations."

| | Year Decem | | |
|---|---------------|--------------|------|
| (In thousands, except per share data) | 2001 (1) (2) | 2000 (1) (2) | 199 |
| | ----- | ----- | --- |
| Per Share | | | |
| Net income before extraordinary loss | | | |
| Basic | \$ 0.88 | \$ 0.49 | \$ |
| Diluted | \$ 0.88 | \$ 0.49 | \$ |
| Extraordinary loss on early extinguishment of debt, net | | | |
| Basic | \$ 0.07 | \$ - | \$ |
| Diluted | \$ 0.07 | \$ - | \$ |
| Net income | | | |
| Basic | \$ 0.81 | \$ 0.49 | \$ |
| Diluted | \$ 0.81 | \$ 0.49 | \$ |
| Pro forma net income (loss) (3) | \$ - | \$ - | \$ |
| Statements of Operations Data | | | |
| Net sales | \$ 333,468 | \$ 337,213 | \$ 3 |
| Gross margin | \$ 124,183 | \$ 122,995 | \$ 1 |
| Income from operations | \$ 21,695 | \$ 19,572 | \$ |
| Net income before extraordinary loss | \$ 6,703 | \$ 3,727 | \$ |
| Extraordinary loss on early extinguishment of debt, net | \$ 495 | \$ - | \$ |
| Net income | \$ 6,208 | \$ 3,727 | \$ |

Edgar Filing: FINISHMASTER INC - Form 10-K

| | | | | | |
|---------------------------------|----|--------------|----|--------------|-------|
| Pro forma net income (loss) (3) | \$ | - | \$ | - | \$ |
| Weighted average shares | | | | | |
| outstanding - Diluted | | 7,648 | | 7,551 | |
| Pro forma weighted average | | | | | |
| shares outstanding - Diluted | | - | | - | |
| | | | | | Dece |
| | | ----- | | ----- | ----- |
| | | 2001 (1) (2) | | 2000 (1) (2) | 199 |
| | | ----- | | ----- | ----- |
| Balance Sheet Data | | | | | |
| Net working capital | \$ | 33,087 | \$ | 35,209 | \$ |
| Total assets | \$ | 202,036 | \$ | 218,317 | \$ |
| Long-term debt | \$ | 77,868 | \$ | 90,652 | \$ |
| Shareholders' equity | \$ | 62,535 | \$ | 56,806 | \$ |

-
- (1) The operating results for the years ended December 31, 2001, 2000, 1999, 1998 and 1997 are affected by the acquisition of Thompson on November 21, 1997. The operating results of Thompson are included in our consolidated operating results since the acquisition date.
 - (2) The operating results for the years ended December 31, 2001, 2000, 1999, and 1998 are affected by the acquisition of AutoPaints on June 30, 1998. The operating results of AutoPaints are included in our consolidated operating results since the acquisition date.
 - (3) Pro forma amounts for the years ended December 31, 1998 and 1997 have been prepared to give effect to the acquisitions of Thompson and AutoPaints as if the transactions had occurred on January 1, 1997. These amounts are unaudited and are presented for informational purposes only. No pro forma amounts are presented for other acquisitions completed by the Company in 1999, 2000 or 2001, as the impact of such acquisitions are not material.

ITEM 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis about our financial condition and results of operations should be read in conjunction with the consolidated financial statements and related notes presented in this annual report.

Overview

FinishMaster, Inc. is the leading independent distributor of automotive paints, coatings and paint-related accessories primarily to the automotive collision repair industry in the United States. As of March 1, 2002, we served our customers through 159 sales outlets and three major distribution centers located in 23 states, making us the only national independent distributor in the industry. We have approximately 15,000 customer charge accounts that 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 typically are the primary source of supply to our customers and we offer a broad range of services designed to enhance the operating efficiencies and competitive positions of our customers and suppliers. Our operations are currently organized into five geographical regions. We aggregate these five

Edgar Filing: FINISHMASTER INC - Form 10-K

regions into a single reportable segment.

We are the leading consolidator in the automotive refinish distribution industry, having successfully completed as of March 1, 2002 approximately 39 acquisitions over the past ten years, ranging from "add-on" acquisitions to the strategic acquisitions of Thompson, AutoPaints, and Badger Paint Plus, Inc. We intend to continue our strategy of expanding through acquisitions.

On May 7, 2001, we acquired the assets of Badger Paint Plus, Inc., a Wisconsin corporation, Badger Paint Plus of the Twin Cities, Inc., Badger Paint Plus of Duluth, Inc., Badger Paint Plus of St. Cloud, Inc., Lakeland Sales, Inc., each a Minnesota corporation, and Badger Paint Plus of Chicago, Inc., an Illinois corporation (collectively "Badger"). Badger, like FinishMaster, was an aftermarket distributor of automotive paints, coatings, and paint-related accessories. The purchase price, including related acquisition costs, was \$7.4 million and includes the issuance of 93,999 shares of our common stock. The acquisition has been accounted for as a purchase and accordingly, the acquired assets and liabilities have been recorded at their estimated fair values on the date of the acquisition. Goodwill associated with the acquisition is being amortized over 15 years and all other intangible assets are amortized over 5 years. Operating results of Badger have been included in our consolidated financial statements from the effective date of the acquisition.

Results of Operations

| (In thousands) | 2001 | Change | 2000 | Change | 1999 |
|----------------|------------|--------|------------|--------|------------|
| Net sales | \$ 333,468 | (1.1%) | \$ 337,213 | 3.9% | \$ 324,490 |

Continued weakness in demand for automotive paints and related accessories impacted our net sales, which decreased \$3.7 million or 1.1% from 2000 to 2001. During 2001, "same store sales" decreased approximately 2.5% due to soft market conditions throughout most of our distribution network. Factors leading to this softening in demand included slower overall economic conditions; flat to declining number of automobiles being repaired; continued productivity improvements in the use of automotive paint by our customers; and changes in vendor supported marketing programs used to attract and retain customers. These industry dynamics are not expected to reverse in the near term.

Net sales acquired through acquisitions contributed approximately \$6.5 million or 1.9% of the net sales variance between years. Two acquisitions were completed during 2001, Badger in May and Scotty's Paint Supply, Inc. in December.

Net sales increased \$12.7 million or 3.9% from 1999 to 2000 due primarily to acquisitions. During 2000, we completed six acquisitions. As a result of competitive market conditions and flat industry demand, we experienced minimal "same store sales" growth.

Approximately 70% of our net sales consisted of automotive paint products while the remaining portion was paint-related accessories.

| (In thousands) | 2001 | Change | 2000 | Change | 1999 |
|----------------------------|------------|--------|------------|--------|------------|
| Gross margin | \$ 124,183 | 1.0% | \$ 122,995 | 5.1% | \$ 117,002 |
| Percentage of net sales | 37.2% | | 36.5% | | 36.1% |

Gross margin dollars in 2001 increased \$1.2 million, or 1.0% over the prior year

Edgar Filing: FINISHMASTER INC - Form 10-K

period. Strong gross margin as a percentage of net sales more than offset the negative impact of lower net sales volume. Gross margin as a percentage of net sales increased 70 basis points to 37.2%, positively impacting margin by \$2.5 million for the year. Lower net sales volume negatively impacted margin by \$1.3 million. The improvement in margin as a percentage of net sales was primarily the result of improved inventory management procedures, supplier purchasing incentive programs, and large inventory purchases in late 2000 made prior to manufacturers' price increases. Margin is affected by purchasing opportunities presented to us by our vendors. We do not anticipate being able to maintain our 2001 margin levels in 2002 as a result of less favorable purchasing opportunities from our vendors which reduced the level of inventory purchased by us in late 2001 prior to manufacturers' price increases.

Gross margin in 2000 increased \$6.0 million or 5.1% over 1999 due to higher sales volume and improved margins. Higher net sales volume positively impacted margin by \$4.6 million. Gross margin as a percentage of net sales increased 40 basis points to 36.5%, positively impacting margins by \$1.4 million. The improvement in margin as a percentage of net sales was primarily the result of supplier incentive programs and the optimization of early payment discounts.

| (In thousands) | 2001 | Change | 2000 | Change | 1999 |
|-------------------------|-----------|--------|-----------|--------|-----------|
| Operating expenses | \$ 52,485 | 0.6% | \$ 52,195 | 6.5% | \$ 49,029 |
| Percentage of net sales | 15.7% | | 15.5% | | 15.1% |

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

Operating expenses increased \$0.3 million or 0.6% from 2000 to 2001. As a percentage of net sales, operating expenses increased from 15.5% in 2000 to 15.7% in 2001. Excluding the operating expenses associated with acquired operations in 2001, operating expenses decreased \$0.5 million between years due primarily to reduced labor costs.

Operating expenses as a percentage of net sales increased from 15.1% in 1999 to 15.5% in 2000 due primarily to higher vehicle fuel costs and increased depreciation expense associated with the new point-of-sale computer system implemented during 2000.

| (In thousands) | 2001 | Change | 2000 | Change | 1999 |
|--|-----------|--------|-----------|--------|-----------|
| Selling, general and administrative expenses | \$ 44,111 | (1.8%) | \$ 44,928 | 5.9% | \$ 42,436 |
| Percentage of net sales | 13.2% | | 13.3% | | 13.1% |

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

SG&A expenses decreased \$0.8 million or 1.8% from 2000 to 2001. As a percentage of net sales, SG&A expenses decreased from 13.3% in 2000 to 13.2% in 2001. Excluding the expenses associated with the acquired operations in 2001, SG&A expenses decreased \$1.4 million due primarily to lower communication costs,

Edgar Filing: FINISHMASTER INC - Form 10-K

supply expense, bad debt expense and professional fees associated with the implementation of our new computer systems in 2000. Partially offsetting these decreases was higher costs associated with wages and benefits.

SG&A expenses as a percentage of net sales increased from 13.1% to 13.3% from 1999 to 2000 as a result of increased wages and benefit costs, higher bad debt expenses and increased costs associated with attracting and retaining customers.

| (In thousands) | 2001 | Change | 2000 | Change | 1999 |
|-----------------------------------|----------|--------|----------|--------|----------|
| Amortization of intangible assets | \$ 5,892 | (6.5%) | \$ 6,300 | (7.2%) | \$ 6,792 |
| Percentage of net sales | 1.8% | | 1.9% | | 2.1% |

The decrease in amortization expense among 1999, 2000 and 2001, was a result of certain intangible assets, principally non-compete agreements, becoming fully amortized in those years.

| (In thousands) | 2001 | Change | 2000 | Change | 1999 |
|-------------------------|----------|---------|-----------|--------|-----------|
| Interest expense, net | \$ 8,547 | (26.3%) | \$ 11,604 | 7.4% | \$ 10,802 |
| Percentage of net sales | 2.6% | | 3.4% | | 3.3% |

Interest expense in 2001 decreased \$3.1 million or 26.3% compared to the prior year. Lower average outstanding borrowings in 2001 of approximately \$23.3 million were the primary contributor to this favorable decrease in interest expense. Lower effective interest rates of approximately 25 basis points also contributed to the decrease.

Interest expense in 2000 increased \$0.8 million or 7.4 % compared to the prior year due to higher effective interest rates of approximately 110 basis points, partially offset by lower average outstanding borrowings. Average outstanding borrowings decreased \$13.7 million during 2000.

| (In thousands) | 2001 | Change | 2000 | Change | 1999 |
|-------------------------|----------|--------|----------|--------|----------|
| Income tax expense | \$ 6,445 | 52.0% | \$ 4,241 | 0.2% | \$ 4,232 |
| Percentage of net sales | 1.9% | | 1.3% | | 1.3% |
| Effective tax rate | 49.0% | | 53.2% | | 53.3% |

Higher income before income taxes was responsible for the increased income tax expense among 1999, 2000, and 2001. The effective tax rate varied from the federal statutory rate as a result of certain expenses, principally nondeductible intangible amortization. The decrease in the effective tax rate between 2000 and 2001 was due to these nondeductible expenses remaining stable in relation to the higher income before income taxes.

Edgar Filing: FINISHMASTER INC - Form 10-K

| (In thousands) | 2001 | Change | 2000 | Change | 1999 |
|--|--------|--------|------|--------|------|
| Extraordinary loss on early extinguishment of debt, net of tax | \$ 495 | - | \$ - | - | \$ - |
| Percentage of net sales | 0.1% | | | | |

An extraordinary loss on the early extinguishment of debt of \$0.5 million, net of \$0.3 million in income tax benefit, resulted from the write-off of the unamortized debt issuance costs related to the early extinguishment of our senior secured and senior subordinated credit facilities in March 2001.

| (In thousands, except per share data) | 2001 | Change | 2000 | Change | 1999 |
|---------------------------------------|----------|--------|----------|--------|----------|
| Net income | \$ 6,208 | 66.6% | \$ 3,727 | 0.4% | \$ 3,711 |
| Percentage of net sales | 1.9% | | 1.1% | | 1.1% |
| Net income per share | \$ 0.81 | 65.3% | \$ 0.49 | 0.0% | \$ 0.49 |

Factors contributing to the changes in net income and the related per share amounts are discussed in the detail above.

Inflation and Other Economic Factors

Inflation affects our cost of materials sold, salaries and other related costs of distribution. To the extent permitted by competition, we offset these higher costs of materials through selective price increases.

Our business may be negatively affected by cyclical economic downturns in the markets in which we operate. Our financial performance is also dependent on our ability to acquire businesses and profitably integrate them into our operations.

Quantitative and Qualitative Disclosure about Market Risk

A review of our financial instruments and risk exposures indicates we have exposure to interest rate risk. To reduce this exposure, we entered into interest rate swap agreements in March 2001 with notional amounts of \$40.0 million. These agreements intend to convert our senior term credit facility from a floating to a fixed interest rate obligation. 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. Based upon the Company's outstanding debt at December 31, 2001 and the term for which current interest rates are fixed, a 10% increase in interest rates would increase interest expense for 2002 by an estimated \$0.1 million.

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

Edgar Filing: FINISHMASTER INC - Form 10-K

days during the holiday season. As a result, our financial performance is generally lower during the December and March quarters compared to the June and September quarters. In addition, the timing of acquisitions may cause substantial fluctuations of operating results from quarter to quarter. We also take advantage of periodic special incentive programs available from our suppliers that extend the due date of inventory purchases beyond terms normally available with large volume purchases. The timing of these programs can contribute to fluctuations in our quarterly cash flows and operating results. 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) | 2001 | 2000 | 1999 |
|---------------------------------------|-------------|-------------|------------|
| Net working capital | \$ 33,087 | \$ 35,209 | \$ 48,147 |
| Long-term debt | \$ 77,868 | \$ 90,652 | \$ 111,603 |
| Cash provided by operating activities | \$ 27,865 | \$ 29,646 | \$ 8,781 |
| Cash used in investing activities | \$ (5,853) | \$ (5,059) | \$ (2,371) |
| Cash used in financing activities | \$ (20,548) | \$ (23,693) | \$ (6,800) |

Our primary sources of funds over the past three years were from operating activities and borrowings under our credit facilities. Our principal uses of cash were to fund capital expenditures, acquisitions, and the repayment of outstanding borrowings.

Net cash generated from operating activities was \$27.9 million in 2001, compared with \$29.6 million in 2000. This decrease was the result of a negative change in operating assets and liabilities, primarily accounts payable and other liabilities. This change in accounts payable and other liabilities resulted from differences in payment terms between years on large "year end" inventory purchases. Partially offsetting this use of cash for accounts payable and other liabilities was lower investments in inventory and prepaid and other assets. The year-end inventory balance decreased as a result of lower inventory purchases in late 2001 made prior to manufacturers' price increases compared to the prior year period.

Net cash used in investing activities was \$5.9 million in 2001, compared with \$5.1 million in 2000 due to increased spending for acquisition activity. During 2001, we completed two acquisitions that utilized \$5.0 million of cash compared to six acquisitions and \$1.9 million of cash in the prior year. Partially offsetting this increase was lower capital spending in 2001. With the implementation of a new "point-of-sale" computer system and a consolidated general ledger system in 2000, our capital spending requirements were less in the current year period. We estimate that capital expenditures for 2002, principally for information technology equipment, will approximate \$1.5 million.

Net cash used in financing activities was \$20.5 million in 2001, compared with \$23.7 million in 2000. Lower debt repayments of \$4.3 million, partially offset by higher debt issuance costs of \$1.1 million were the primary factors contributing to the decrease in net cash used in financing activities. The decrease in debt repayments was a result of lower net cash provided by operating activities and increased spending on acquisitions. The use of cash for debt issuance costs was related to the refinancing of our credit facilities in March

Edgar Filing: FINISHMASTER INC - Form 10-K

2001.

Total capitalization at December 31, 2001, was \$148.0 million, comprised of \$85.5 million of debt and \$62.5 million of equity. Debt as a percentage of total capitalization was 57.8% compared to 64.1% in the prior year. This improvement was attributable to the increase in equity resulting from current year net income, along with the decrease in debt resulting from repayments.

At December 31, 2001, we had term credit and revolving credit facilities totaling \$58.9 million and senior subordinated debt of \$19.9 million. We were in compliance with the covenants underlying these credit facilities, and had availability under our revolving credit facility of \$25.0 million as of year-end.

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.

Other Matters

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, ("FAS 141"), "Business Combinations" and Statement of Financial Accounting Standard No. 142, ("FAS 142"), "Goodwill and Other Intangible Assets". Under FAS 142, goodwill and intangible assets with indefinite lives are no longer amortized but are reviewed annually (or more frequently if impairment indicators arise) for impairment. Separable intangible assets that are not deemed to have indefinite lives will continue to be amortized over their useful lives (but with no maximum life). The amortization provisions of FAS 142 apply to goodwill and intangible assets acquired after June 30, 2001. With respect to goodwill and intangible assets acquired prior to July 1, 2001, we are required to adopt FAS 142 effective January 1, 2002. We are currently evaluating the effect that adoption of the provisions of FAS 142 that are effective January 1, 2002 will have on our results of operations and financial position.

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 143, ("FAS 143"), "Accounting for Asset Retirement Obligations". FAS 143 addresses the financial accounting and reporting obligations associated with the retirement of tangible assets and the associated asset retirement costs. It requires companies to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred, which is adjusted to its present value each period. In addition, companies must capitalize a corresponding amount by increasing the carrying amount of the related long-lived asset, which is depreciated over the useful life of the related asset. We will adopt FAS 143 on January 1, 2002, and we do not expect that this Standard will have a material effect on our consolidated financial statements or results of operations.

In October 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("FAS 144"). FAS 144 modifies and expands the financial accounting and reporting for the impairment or disposal of long-lived assets other than goodwill, which is specifically addressed by FAS 142. FAS 144 maintains the requirement that an impairment loss be recognized for a long-lived asset to be held and used if its carrying value is not recoverable from its undiscounted cash flows, with the recognized impairment being the difference between the carrying amount and fair value of the asset. With respect to long-lived assets to be disposed of other than by sale, FAS 144 requires that the asset be considered held and used until it is actually disposed of, but requires that its depreciable life be revised in accordance with APB Opinion No. 20. FAS 144 will be effective for us in the first quarter of 2002, and it is not

Edgar Filing: FINISHMASTER INC - Form 10-K

expected to have a material effect on our consolidated financial statements or results of operations.

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, 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.

ITEM 8 - FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

| Financial Statements: | Page |
|---|------|
| Report of Independent Accountants | 18 |
| Consolidated Balance Sheets | 19 |
| Consolidated Statements of Operations | 20 |
| Consolidated Statements of Cash Flows | 21 |
| Consolidated Statements of Shareholders' Equity | 22 |
| Notes to Consolidated Financial Statements | 23 |
| Financial Statement Schedule: | |
| Schedule II - Valuation and Qualifying Accounts | 37 |

All other schedules are omitted because they are not applicable or the required information is shown in the financial statements or the notes thereto.

Report of Independent Accountants

To the Board of Directors and
Shareholders of FinishMaster, Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of FinishMaster, Inc. and its subsidiaries at December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in

Edgar Filing: FINISHMASTER INC - Form 10-K

conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Indianapolis, Indiana
February 19, 2002

CONSOLIDATED
BALANCE SHEETS
FinishMaster, Inc.

| | December 31, 2001 | Dec |
|---|----------------------|-----|
| (In thousands, except share amounts) | | |
| ASSETS | | |
| Current assets | | |
| Cash | \$ 2,977 | \$ |
| Accounts receivable, net of allowance for doubtful accounts of \$1,434 and \$1,337, respectively | 28,401 | |
| Inventory | 50,096 | |
| Refundable income taxes | 543 | |
| Deferred income taxes | 3,947 | |
| Prepaid expenses and other current assets | 3,627 | |
| Total current assets | 89,591 | |
| Property and equipment | | |
| Land | 368 | |
| Vehicles | 1,205 | |
| Buildings and improvements | 6,291 | |
| Machinery, equipment and fixtures | 12,682 | |
| | 20,546 | |
| Accumulated depreciation | (12,715) | |
| | 7,831 | |
| Other assets | | |
| Intangible assets, net | 102,273 | |
| Deferred income taxes | 1,770 | |
| Other | 571 | |
| | 104,614 | |
| | | |

Edgar Filing: FINISHMASTER INC - Form 10-K

| | | | |
|--|----|---------|----|
| | \$ | 202,036 | \$ |
| ===== | | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| Current liabilities | | | |
| Accounts payable | \$ | 37,383 | \$ |
| Amounts due to LDI | | 812 | |
| Accrued compensation and benefits | | 8,578 | |
| Other accrued expenses and current liabilities | | 2,124 | |
| Current maturities of long-term debt | | 7,607 | |
| | | ----- | |
| Total current liabilities | | 56,504 | |
| Long-term debt, less current maturities | | 77,868 | |
| Other long-term liabilities | | 5,129 | |
| 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; 7,638,863 and 7,540,804 shares issued and outstanding | | 7,638 | |
| Additional paid-in capital | | 27,936 | |
| Accumulated comprehensive loss | | (1,146) | |
| Retained earnings | | 28,107 | |
| | | ----- | |
| | | 62,535 | |
| | | ----- | |
| | \$ | 202,036 | \$ |
| ===== | | | |

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

CONSOLIDATED STATEMENTS
OF OPERATIONS
FinishMaster, Inc.

| | | | |
|---------------------------------------|----|---------------|--------|
| | | Year Ended | |
| | | December 31, | Decemb |
| | | 2001 | |
| (In thousands, except per share data) | | | |
| Net sales | \$ | 333,468 | \$ 3 |
| Cost of sales | | 209,285 | 2 |
| | | ----- | |
| Gross margin | | 124,183 | 1 |
| Expenses | | | |
| Operating | | 52,485 | |
| Selling, general and administrative | | 44,111 | |
| Amortization of intangible assets | | 5,892 | |
| | | ----- | |
| | | 102,488 | 1 |
| | | ----- | |
| Income from operations | | 21,695 | |

Edgar Filing: FINISHMASTER INC - Form 10-K

| | | |
|---|----------|----|
| Interest expense, net | 8,547 | |
| ----- | | |
| Income before income taxes | 13,148 | |
| Income tax expense | 6,445 | |
| ----- | | |
| Net income before extraordinary loss | \$ 6,703 | \$ |
| Extraordinary loss on early extinguishment of debt, net of tax benefit of \$324 | 495 | |
| ===== | | |
| Net income | \$ 6,208 | \$ |
| ===== | | |
| Net income per share - Basic and Diluted | | |
| Net income before extraordinary loss | \$ 0.88 | \$ |
| Extraordinary loss, net of income taxes | \$ 0.07 | \$ |
| ----- | | |
| Net income per share (Note 10): | | |
| Basic | \$ 0.81 | \$ |
| ===== | | |
| Diluted | \$ 0.81 | \$ |
| ===== | | |
| Weighted average shares outstanding - Basic | 7,638 | |
| ===== | | |
| Weighted average shares outstanding - Diluted | 7,648 | |
| ===== | | |

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

CONSOLIDATED STATEMENTS
OF CASH FLOWS
FinishMaster, Inc.

| | Year Ended December 31, 2001 | Decem |
|---|---------------------------------------|-------|
| (In thousands) | | |
| Operating activities | | |
| Net income | \$ 6,208 | \$ |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 10,418 | |
| Deferred income taxes | (388) | |
| Loss on extinguishment of debt | 495 | |
| Other | (97) | |
| Gain on disposal of property and equipment | (18) | |
| Changes in operating assets and liabilities (excluding the impact of acquisitions): | | |
| Accounts receivable, net | 2,182 | |
| Inventories | 15,976 | |

Edgar Filing: FINISHMASTER INC - Form 10-K

| | | |
|--|-----------|-----|
| Prepaid and other assets | 552 | |
| Accounts payable and other liabilities | (7,463) | |
| Net cash provided by operating activities | 27,865 | |
| Investing activities | | |
| Business acquisitions and payments under earn-out provisions for prior acquisitions | (5,001) | |
| Purchases of property and equipment | (703) | |
| Proceeds from disposal of property and equipment | 39 | |
| Other | (188) | |
| Net cash used in investing activities | (5,853) | |
| Financing activities | | |
| Proceeds from the exercise of stock options | 7 | |
| Debt issuance costs | (1,284) | |
| Proceeds from debt | 167,448 | |
| Repayment of debt | (186,719) | (1) |
| Net cash used in financing activities | (20,548) | (|
| Increase(decrease) in cash | 1,464 | |
| Cash at beginning of period | 1,513 | |
| Cash at end of period | \$ 2,977 | \$ |
| Supplemental disclosure of cash flow information | | |
| Cash paid during the period for: | | |
| Interest | \$ 9,464 | \$ |
| Taxes | \$ 6,009 | \$ |

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

CONSOLIDATED STATEMENTS
OF SHAREHOLDERS' EQUITY
FinishMaster, Inc.

| (In thousands) | Common Stock | Paid-in Capital | Retained Earnings | |
|-------------------------------|-----------------|--------------------|----------------------|----|
| Balances at December 31, 1998 | \$ 7,536 | \$ 27,351 | \$ 14,461 | \$ |
| Stock grants issued | 2 | 8 | - | |
| Net income for the year | - | - | 3,711 | |
| Balances at December 31, 1999 | \$ 7,538 | \$ 27,359 | \$ 18,172 | \$ |
| Stock grants issued | 2 | 8 | - | |
| Net income for the year | - | - | 3,727 | |
| Balances at December 31, 2000 | \$ 7,540 | \$ 27,367 | \$ 21,899 | \$ |

Edgar Filing: FINISHMASTER INC - Form 10-K

| | | | |
|---|----------|-----------|-----------|
| Comprehensive income (loss): | | | |
| Net income for the year | - | - | 6,208 |
| Other comprehensive income (loss): | | | |
| Interest rate swap | - | - | - |
| Total comprehensive income (loss) | | | |
| Stock grants issued and options exercised | 98 | 569 | - |
| | | | |
| Balances at December 31, 2001 | \$ 7,638 | \$ 27,936 | \$ 28,107 |
| | | | |

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

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 February 15, 2002, the Company operated 159 sales outlets and three major distribution centers in 23 states and is organized into five major geographical regions - North East, Florida/Texas, Mid-Atlantic, Central, and Western. The Company aggregates its five geographic regions into a single reportable segment. The Company has approximately 15,000 customer charge accounts to which it provides a comprehensive selection of brand name products supplied by BASF, DuPont, 3M and PPG, 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 an indirect wholly-owned subsidiary of LDI, Ltd., ("LDI"), an Indiana limited partnership, owns 5,587,516 shares of the Company's common stock, representing 73.1% of the outstanding shares at December 31, 2001, and 74.1% of the outstanding shares at December 31, 2000, and 1999. 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 and certain other expenses. Those expenses amounted to \$782,000, \$183,000, and \$158,000 for the years ended December 31, 2001, 2000, and 1999, respectively. In addition, the Company leases from LDI its corporate office space. Lease expense and payments for repairs and maintenance to LDI totaled approximately \$206,000, \$202,000, and \$214,000 for the years ended December 31, 2001, 2000 and 1999, respectively. The Company also has subordinated debt payable to LDI (see Note 4, Long-Term Debt).

Edgar Filing: FINISHMASTER INC - Form 10-K

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, 2001, and 2000, checks drawn on future deposits and borrowings of \$3,863,000 and \$10,622,000, respectively, were classified as accounts payable. These amounts represent outstanding checks in excess of funds on deposit.

Receivables: Trade accounts receivable represents amounts due primarily from automotive collision repair shops and dealerships. Trade receivables are typically not collateralized. No single customer exceeds 10% of the Company's receivables at December 31, 2001.

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.

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 2001, 2000 and 1999 was \$2,287,000, \$2,215,000 and \$2,427,000, respectively.

Revenue Recognition: Revenues from product sales are recognized at the time of shipment or delivery to the customer. The company has reviewed the accounting and disclosure requirements of Staff Accounting Bulletin (SAB) No. 101 "Revenue Recognition in Financial Statements" and has determined that it is in compliance.

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 ("SFAS") 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.

Intangibles: Intangibles consist primarily of the excess of cost over the fair market value of net assets of acquired businesses ("goodwill"). Intangible assets, including goodwill and non-compete agreements, are amortized on a straight-line basis over periods ranging from 5 to 30 years. The majority of the Company's goodwill relates to its November 1997 acquisition of Thompson and is being amortized over 30 years. The carrying value of goodwill is periodically reviewed to determine if an impairment has occurred. The Company measures for potential impairment of recorded goodwill based on the estimated undiscounted cash flows of acquired entities over the remaining amortization period. If the estimated future undiscounted cash flows are less than the carrying amount of

Edgar Filing: FINISHMASTER INC - Form 10-K

such goodwill, an impairment would be deemed to have occurred and a loss would be recognized. Such loss would be determined based upon expected discounted cash flows or market prices. Debt issuance costs are amortized over the term of the related debt agreements.

Internal Use Software: Costs incurred to develop or obtain software for internal use within the business are capitalized in accordance with the provisions of Accounting Standards Executive Committee Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." During 2001 and 2000, the Company capitalized approximately \$0 and \$2,223,000, respectively, of costs related to efforts to migrate to a single information technology platform. Once placed in service, software costs incurred are depreciated over their estimated useful life that range from 3 to 5 years.

Derivative Instruments and Hedging Activities: The Company utilizes derivative financial instruments, principally 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 are recorded each period in the Accumulated Comprehensive Loss section of Shareholders' Equity.

Shipping and Handling Fees and Costs: The Company includes the cost of delivering the product to the customer in the operating expense section of the consolidated statements of operations. The total delivery costs incurred for 2001, 2000, and 1999 are estimated at \$16,974,000, \$17,564,000, and \$17,035,000, respectively.

Reclassification: 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 FinishMaster 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 related to goodwill and covenants not to compete were recorded with each acquisition, if appropriate. Operating results of acquired entities have been included in FinishMaster's consolidated financial statements from the respective date of purchase.

| (In thousands) | Year Ended December 31, 2001 | Year Ended December 31, 2000 |
|--|---------------------------------------|---------------------------------------|
| Accounts receivable | \$ 1,520 | \$ 78 |
| Inventory | 2,670 | 1,98 |
| Equipment and other | 506 | 37 |
| Intangible assets | 5,076 | 1,27 |
| | 9,772 | 4,41 |
| Less liabilities assumed | 1,075 | 51 |
| Acquisition price | 8,697 | 3,90 |
| Acquisition debt | 3,046 | 2,04 |
| Stock grants | 650 | |
| Net assets of businesses acquired, net of acquisition debt | \$ 5,001 | \$ 1,85 |

Edgar Filing: FINISHMASTER INC - Form 10-K

Number of acquisitions

2

During 2001, the Company completed two acquisitions: Badger and Scotty's Paint Supply, Inc. The acquisitions involved operations in Minnesota, Illinois, Wisconsin, and Florida, and were funded with cash, debt and common stock.

During 2000, the Company completed six acquisitions. The acquisitions occurred in California, South Carolina, Washington DC, Ohio and Texas, and were funded with cash and debt.

During 1999, the Company completed six acquisitions. The acquisitions occurred in Illinois, New Jersey and Texas, and were funded with cash and debt.

3. INTANGIBLE ASSETS

Intangible assets consisted of the following:

| (In thousands) | December 31, 2001 | December 31, 2000 |
|-------------------------------|----------------------|----------------------|
| Goodwill | \$ 125,121 | \$ 121,018 |
| Non-compete agreements | 12,426 | 12,262 |
| Other intangible | 573 | - |
| Debt issuance costs | 1,329 | 2,179 |
| | ----- | ----- |
| | 139,449 | 135,459 |
| Less accumulated amortization | 37,176 | 32,601 |
| | ----- | ----- |
| Intangible assets, net | \$ 102,273 | \$ 102,858 |
| | ===== | ===== |

4. LONG-TERM DEBT

Long-term debt consisted of the following:

| (In thousands) | December 31, 2001 | December 31, 2000 |
|---|----------------------|----------------------|
| Revolving Credit Facility | \$ 21,590 | \$ 35,100 |
| Acquisition Revolving Credit Facility | - | 1,797 |
| Term Credit Facility | 37,000 | 28,495 |
| Senior Subordinated Debt | 19,850 | 30,000 |
| Notes payable to former owners of acquired businesses with interest at various rates up to 10%, due at various dates through 2007 | 5,578 | 4,624 |
| Other long-term financing at various rates, due at various dates through 2010 | 1,457 | 1,626 |
| | ----- | ----- |
| | 85,475 | 101,642 |
| Less current maturities | 7,607 | 10,990 |
| | ----- | ----- |
| | \$ 77,868 | \$ 90,652 |
| | ===== | ===== |

Edgar Filing: FINISHMASTER INC - Form 10-K

Revolving Credit Facility: On March 29, 2001, the Company entered into a new \$100.0 million senior secured credit facility with a syndicate of banks. The new senior secured credit facility consists of \$40.0 million term credit facility and a \$60.0 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. Interest rates and payment dates are variable based upon interest rate and term options selected by management. Interest rates at December 31, 2001 on outstanding revolving credit borrowings varied from 4.17% to 5.00%. Revolving credit borrowings are subject to interest rates, which fluctuate based on the Company's Leverage Ratio, as defined in the Credit Facility, which in 2001 was 2.25% over LIBOR or 0.25% over prime in the case of Floating Rate Advances. For a period of six months after the close of the transaction, the interest rate was fixed at LIBOR plus 3.00%. The Company is charged an annual administrative fee of \$35,000, and an annual commitment fee, payable monthly, that ranges between 0.375% and 0.5% of the unused portion of the revolving line of credit. At December 31, 2001, the Company had \$25.0 million of available borrowings under its revolving credit facility.

Term Credit Facility: The term loan, which expires on June 30, 2006, requires quarterly principal payments that began on June 30, 2001. Quarterly principal payments in 2001 were \$1.0 million and increase in amount each year over the remaining term of the loan. Interest rates and payment dates are variable based upon interest rate and term options selected by management. Interest rates at December 31, 2001 were at 4.84% on outstanding term borrowings. Term borrowings are subject to interest rates, which fluctuate based on the Company's Leverage Ratio, as defined in the Credit Facility, of 2.25% over LIBOR. To convert the Company's new 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 \$40.0 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 decrease in the fair value of the interest rate swap from the date of inception was \$1.1 million, which was recorded in the Accumulated Comprehensive Loss section of the Shareholders' Equity.

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, 2001 and 2000, the Company was in compliance with its covenants.

Senior Subordinated Debt: Concurrent with funding the senior secured credit facility, the Company repaid its \$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 paid quarterly at a rate of 12.0% per annum.

Edgar Filing: FINISHMASTER INC - Form 10-K

Early Extinguishment of Debt: An extraordinary loss on the early extinguishment of debt of \$0.5 million, net of \$0.3 million in income tax benefit, resulted from the write-off of the unamortized debt issuance costs related to the early extinguishment of our senior secured and senior subordinated credit facilities in March 2001.

Prior Credit Facilities: Prior to March 29, 2001, the Company had a revolving credit facility with a syndicate of banks, 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 plus \$7.5 million less letter of credit obligations and a reserve for three months facility rent. Interest rates and payment dates were variable based upon interest rate and term options selected by management. Interest rates at December 31, 2000 on outstanding revolving credit borrowings varied from 8.91% to 10.25%. Revolving credit borrowings were subject to interest rates, which fluctuated based on the Company's Leverage Ratio, as defined in the Credit Facility, which in 2000 was 2.25% over LIBOR or 0.75% over prime in the case of Floating Rate Advances. Effective January 1, 2001, the interest rates were 2.00% over LIBOR or 0.50% over prime based upon the Company's Leverage Ratio as of September 30, 2000. The Company was charged an annual administrative fee of \$50,000, and an annual commitment fee, payable monthly, that ranged between 0.2% and 0.5% of the unused portion of the revolving line of credit. At December 31, 2000, the Company had \$24.9 million of available borrowings under its revolving credit facility.

The Company also had a revolving credit facility with a syndicate of banks to finance future business acquisitions. Interest rates and payments were based upon one of two options selected by management: LIBOR plus 3.0% or an alternative base rate that was prime plus 1%. The Company was charged a commitment fee of 0.5% on the average daily unused portion of the facility, due quarterly. This facility was cancelled on March 29, 2001.

The Company also had a term credit facility that required quarterly principal payments beginning on March 31, 1999. Quarterly principal payments in 2000 were \$1.5 million. Interest rates and payment dates were variable based upon interest rate and term options selected by management. Interest rates at December 31, 2000 were at 8.98% on outstanding term borrowings. Term borrowings were subject to interest rates, which fluctuated based on the Company's Leverage Ratio, as defined in the Credit Facility, of 2.25% over LIBOR. Effective January 1, 2001, the interest rate was 2.00% over LIBOR based upon the Company's Leverage Ratio as of September 30, 2000. This facility was refinanced on March 29, 2001.

The aggregate principal payments for the next five years subsequent to December 31, 2001 are as follows:

(In thousands)

| | |
|------------|-----------|
| 2002 | 7,607 |
| 2003 | 7,449 |
| 2004 | 9,312 |
| 2005 | 10,966 |
| 2006 | 29,102 |
| Thereafter | 21,039 |
| | ----- |
| | \$ 85,475 |
| | ===== |

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.

Edgar Filing: FINISHMASTER INC - Form 10-K

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 25% of each \$1.00 contributed by employees up to 6% of their annual compensation. Effective January 1, 2002, the Company doubled the graduated scale up to 50% of each \$1.00 contributed by employees up to 6% of their annual compensation. Company contributions charged to operations under the Plan were approximately \$316,000, \$279,000, and \$213,000 for the years ended December 31, 2001, 2000 and 1999, 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. In 2001, a discretionary contribution of 2% of employees' annual compensation was awarded in the amount of \$895,000; no discretionary contribution was made in 2000.

6. STOCK OPTIONS

The Company has a stock option plan that was amended on April 29, 1999, under which officers, key employees, and directors may be granted options to purchase stock. The amendments included increasing the number of shares of common stock reserved for issuance under the plan from 600,000 to 750,000 and changing the method for determining the exercise price of the options on the date of grant. 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. Certain stock options granted in 2001, 2000, and 1999 were also fully vested at the date of issue, while others vest over periods ranging from one to four years.

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 not less than 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 SFAS 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, | |
|---|-------------------------------|--------|
| (In thousands, except per share data) | 2001 | Decemb |
| Net income before extraordinary loss | | |
| As reported | \$ 6,703 | \$ |
| Pro forma | \$ 6,538 | \$ |
| Extraordinary loss on early extinguishment of debt, net | | |
| As reported | \$ 495 | \$ |
| Pro forma | \$ 495 | \$ |
| Net income | | |
| As reported | \$ 6,208 | \$ |
| Pro forma | \$ 6,043 | \$ |
| Net income per share before extraordinary loss | | |
| As reported, Basic | \$ 0.88 | \$ |
| As reported, Diluted | \$ 0.88 | \$ |

Edgar Filing: FINISHMASTER INC - Form 10-K

| | | | |
|---|----|------|----|
| Pro forma, Basic | \$ | 0.86 | \$ |
| Pro forma, Diluted | \$ | 0.86 | \$ |
| Extraordinary loss on early extinguishment of debt, net | | | |
| As reported | \$ | 0.07 | \$ |
| Pro forma | \$ | 0.07 | \$ |
| Net income per share | | | |
| As reported, Basic | \$ | 0.81 | \$ |
| As reported, Diluted | \$ | 0.81 | \$ |
| Pro forma, Basic | \$ | 0.79 | \$ |
| Pro forma, Diluted | \$ | 0.79 | \$ |

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, 2001, 2000, and 1999 respectively: risk free interest rate of 5.0%, 6.4%, and 5.6%; no dividend yield; expected option lives of nine years; and stock price volatility of 42.9%, 48.5%, and 50.4%.

| | December 31, 2001 ---- | | December 31, 2000 ---- | | |
|-------------------------------|------------------------------|---|------------------------------|---|--|
| | Options | Weighted- Average Exercise Price | Options | Weighted- Average Exercise Price | |
| Outstanding-beginning of year | 612,334 | \$ 8.13 | 524,034 | \$ 8.35 | |
| Granted | 15,936 | \$ 7.74 | 92,200 | \$ 7.28 | |
| Exercised | 1,000 | \$ 6.59 | - | \$ - | |
| Forfeited | 34,090 | \$ 7.87 | 3,900 | \$ 8.50 | |
| Outstanding-end of year | 593,180 | \$ 8.14 | 612,334 | \$ 8.13 | |
| Exercisable-end of year | 578,780 | \$ 8.06 | 563,534 | \$ 8.06 | |

| | Exercise Price Range | | | |
|------------------------------------|---------------------------------|-----------------|-------|-------|
| | ----- \$5.34-\$8.25 ----- | \$10.25-\$11.55 | ----- | Total |
| Options outstanding | 396,060 | 197,120 | | 5 |
| Weighted average exercise price | \$ 6.80 | \$ 10.83 | \$ | |
| Average remaining contractual life | 7.5 years | 4.5 years | | 6.6 |
| Options exercisable | 396,060 | 182,720 | | 5 |
| Weighted average exercise price | \$ 6.80 | \$ 10.81 | \$ | |

The weighted-average fair value of options granted during the years ended

Edgar Filing: FINISHMASTER INC - Form 10-K

December 31, 2001, 2000, and 1999 were \$4.66, \$4.75, and \$3.84, per option, respectively, where the exercise price of the options equaled the market price on the date of grant. Certain options were granted during 2000 and 1999 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 \$4.61 and \$3.67 per option at December 31, 2000 and 1999, respectively. The remaining contractual life of options outstanding at December 31, 2001 is 6.6 years.

7. INCOME TAXES

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

| (In thousands) | Year Ended December 31, 2001 | Year Ended December 31, 2000 | Year Ended December 31, 1999 |
|------------------|---------------------------------------|---------------------------------------|---------------------------------------|
| Current: | | | |
| Federal | \$ 5,562 | \$ 3,202 | \$ 2,383 |
| State | 1,272 | 817 | 724 |
| | 6,834 | 4,019 | 3,107 |
| Deferred: | | | |
| Federal | (334) | 193 | 952 |
| State | (55) | 29 | 173 |
| | (389) | 222 | 1,125 |
| | \$ 6,445 | \$ 4,241 | \$ 4,232 |

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

| (In thousands) | Year Ended December 31, 2001 | December 31, 2000 |
|--|---------------------------------------|----------------------|
| Provision / (Benefit) from continuing operations | \$ 6,445 | \$ |
| Provision / (Benefit) from extraordinary charge | (324) | (324) |
| | \$ 6,121 | \$ |

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, 2001 | Year Ended December 31, 2000 |
|---------------------------------------|---------------------------------------|---------------------------------------|
| Federal statutory tax rate | 34.0% | 34.0% |
| State tax provision | 7.0% | 7.0% |
| Nondeductible intangible amortization | 6.3% | 8.4% |

Edgar Filing: FINISHMASTER INC - Form 10-K

| | | |
|--------------------|-------|-------|
| Other | 1.7% | 3.8% |
| Effective tax rate | 49.0% | 53.2% |

Significant components of the Company's deferred tax assets as of December 31, 2001, and 2000 are as follows:

| (In thousands) | December 31, 2001 | December 31, 2000 |
|-----------------------------|----------------------|----------------------|
| Deferred tax assets: | | |
| Depreciation | \$ 1,038 | \$ 553 |
| Amortization of intangibles | 634 | 1,167 |
| Allowances | 1,264 | 856 |
| Inventory | 1,398 | 1,065 |
| Accrued expenses and other | 1,383 | 1,688 |
| | ----- | ----- |
| | \$ 5,717 | \$ 5,329 |
| | ===== | ===== |

8. COMMITMENTS AND CONTINGENCIES

FinishMaster 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, 2001:

| (In thousands) | |
|----------------|-----------|
| 2002 | \$ 7,928 |
| 2003 | 6,621 |
| 2004 | 4,577 |
| 2005 | 2,928 |
| 2006 | 1,295 |
| Thereafter | 670 |
| | ----- |
| | \$ 24,019 |
| | ===== |

Rent expense charged to operations, including short-term leases, totaled approximately \$8.5 million, \$8.4 million, and \$8.5 million for the years ended December 31, 2001, 2000, and 1999, 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 the 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.

In January 1999, the Company was named in an unfair business practices lawsuit by an automotive paint distributor located in the State of California. The plaintiff in such suit alleged that we offered, in a manner that injured the plaintiff, rebates and cash bonuses to businesses in the Southern California area if those businesses would buy exclusively from us and use our products. The plaintiff claimed damages in the amount of \$3.8 million, trebled to \$11.4 million. During 2000, the court granted summary judgment in our favor. The plaintiff has not appealed the judgment against it, and the decision is now final.

Edgar Filing: FINISHMASTER INC - Form 10-K

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. 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.

9. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following table presents the quarterly results of operations for each period presented.

| (In thousands, except per share data) | Three Months ended | | |
|--|--------------------|------------------|--------|
| | March 31, 2001 | June 30, 2001 | Septem |
| Net sales | \$ 83,235 | \$ 86,241 | \$ 8 |
| Gross margin | 30,353 | 31,660 | 3 |
| Income from operations | 4,795 | 5,911 | |
| Income before income taxes | 2,487 | 3,936 | |
| Net income before extraordinary loss | 1,334 | 1,982 | |
| Net income | \$ 839 | \$ 1,982 | \$ |
| Net income before extraordinary loss - Diluted | \$ 0.18 | \$ 0.26 | \$ |
| Extraordinary loss, net of tax - Diluted | 0.07 | - | |
| Net income per share - Diluted | \$ 0.11 | \$ 0.26 | \$ |

| (In thousands, except per share data) | Three Months ended | | |
|---------------------------------------|--------------------|------------------|--------|
| | March 31, 2000 | June 30, 2000 | Septem |
| Net sales | \$ 84,670 | \$ 87,343 | \$ 8 |
| Gross margin | 29,933 | 31,359 | 3 |
| Income from operations | 4,643 | 5,457 | |
| Income before income taxes | 1,755 | 2,407 | |
| Net income | \$ 904 | \$ 1,061 | \$ |
| Net income per share - Diluted | \$ 0.12 | \$ 0.14 | \$ |

10. NET INCOME PER SHARE

In 1997, the Company adopted the provisions of SFAS No. 128, "Earnings Per Share." SFAS No. 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

Edgar Filing: FINISHMASTER INC - Form 10-K

| (In thousands, except per share data) | Ended December 31, 2001 | Dec |
|---|-------------------------------|-----|
| Numerator: | | |
| Net income before extraordinary loss | \$ 6,703 | \$ |
| Extraordinary loss on early extinguishment of debt, net of tax benefit of \$324 | 495 | |
| Net income | \$ 6,208 | \$ |
| Denominator: | | |
| Basic-weighted average shares | 7,638 | |
| Effect of dilutive stock options | 10 | |
| Diluted-weighted average shares | 7,648 | |
| Net income per share - Basic and Diluted | | |
| Net income before extraordinary loss | \$ 0.88 | \$ |
| Extraordinary loss, net of tax benefit | 0.07 | |
| Basic net income per share | \$ 0.81 | \$ |
| Diluted net income per share | \$ 0.81 | \$ |

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

ITEM 9 - CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10 - DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Item 10 is incorporated by reference from the Registrant's definitive proxy statement to be filed within 120 days of December 31, 2001.

ITEM 11 - EXECUTIVE COMPENSATION

Item 11 is incorporated by reference from the Registrant's definitive proxy statement to be filed within 120 days of December 31, 2001.

ITEM 12 - SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Item 12 is incorporated by reference from the Registrant's definitive proxy statement to be filed within 120 days of December 31, 2001.

ITEM 13 - CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Item 13 is incorporated by reference from the Registrant's definitive proxy statement to be filed within 120 days of December 31, 2001.

PART IV

Edgar Filing: FINISHMASTER INC - Form 10-K

ITEM 14 - EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) The following documents have been filed as a part of this report, or where noted, incorporated by reference:

- (1) Financial Statements: The Consolidated Financial Statements of the Company are included in Item 8 of this report.
- (2) Financial Statement Schedule: The financial statement schedule filed in response to Item 8 and Item 14(d) of Form 10-K is listed in the Index to Consolidated Financial Statements included in Item 8 of this report.
- (3) The Exhibits filed herewith or incorporated herein by reference are set forth in the Exhibit Index on page 35.

(b) Reports on Form 8-K: None

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 March 28, 2002

FINISHMASTER, INC.

By: /s/ Robert R. Millard

Robert R. Millard

Senior Vice President, Finance
And Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature | Date | Title |
|--|----------------|--|
| ----- | | |
| (1) Principal Executive Officer | | |
| /s/ Andre B. Lacy | | |
| ----- | | |
| Andre B. Lacy | March 28, 2002 | Chairman of the Board and Chief Executive Officer |
| (2) Principal Financial and Accounting Officer: | | |
| /s/ Robert R. Millard | | |
| ----- | | |
| Robert R. Millard | March 28, 2002 | Senior Vice President, Finance and Chief Financial Officer |
| (3) A Majority of the Board of Directors: | | |
| /s/ Andre B. Lacy | | |

Edgar Filing: FINISHMASTER INC - Form 10-K

| | | |
|---------------------------------|----------------|----------|
| ----- Andre B. Lacy | March 28, 2002 | Director |
| /s/ Thomas U. Young ----- | | |
| Thomas U. Young | March 28, 2002 | Director |
| /s/ David N. Shane ----- | | |
| David Shane | March 28, 2002 | Director |
| /s/ Margot L. Eccles ----- | | |
| Margot L. Eccles | March 28, 2002 | Director |
| /s/ Wes N. Dearbaugh ----- | | |
| Wes N. Dearbaugh | March 28, 2002 | Director |
| /s/ Peter L. Frechette ----- | | |
| Peter L. Frechette | March 28, 2002 | Director |
| /s/ David W. Knall ----- | | |
| David W. Knall | March 28, 2002 | Director |
| /s/ Michael L. Smith ----- | | |
| Michael L. Smith | March 28, 2002 | Director |
| /s/ Walter S. Wiseman ----- | | |
| Walter S. Wiseman | March 28, 2002 | Director |

FINISHMASTER, INC. AND SUBSIDIARIES
ANNUAL REPORT ON FORM 10-K

EXHIBITS

| 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 |

Edgar Filing: FINISHMASTER INC - Form 10-K

- 10.1 FinishMaster, Inc. Stock Option Plan (Amended and Restated as of April 29, 1999) (previously filed with Registrant's proxy statement on Schedule 14/A dated April 9, 1999)
- 10.2 FinishMaster, Inc. Deferred Compensation Plan dated as of November 1, 2000 (previously filed with form 10-K dated March 29, 2001)
- 21* Subsidiaries of the Registrant
- 23* Consent of Independent Accountants
- 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 City Bank of Indiana, as Agent (previously filed with 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
- 99(c) 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)

*filed herein

Schedule II - Valuation and Qualifying Accounts (In thousands)

| Description | Balance at Beginning of Period | Charged to Costs and Expenses | Deductions | Bala at E of Peri |
|---------------------------------|--------------------------------------|--|--------------|----------------------------|
| Year ended December 31, 2001: | | | | |
| Allowance for doubtful accounts | \$ 1,337 | \$ 723 | \$ 626 (A) | \$ 1, |
| Year ended December 31, 2000: | | | | |
| Allowance for doubtful accounts | \$ 1,419 | \$ 1,011 | \$ 1,093 (A) | \$ 1, |
| Year ended December 31, 1999: | | | | |
| Allowance for doubtful accounts | \$ 1,680 | \$ 433 | \$ 694 (A) | \$ 1, |

(A) Represents uncollectible accounts written off, less recoveries.