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FINISHMASTER INC
Form 10-Q
November 14, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTER ENDED SEPTEMBER 30, 2002

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

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

On October 1, 2002, there were 7,767,569 shares of the Registrant's common stock outstanding.

FINISHMASTER, INC.
FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2002

TABLE OF CONTENTS

	PAGE
Part I. Financial Information	3

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Item 1. Financial Statements (unaudited)	
Condensed Consolidated Balance Sheets	3
Condensed Consolidated Statements of Operations	4
Condensed Consolidated Statements of Cash Flows	5
Condensed Consolidated Statements of Shareholders' Equity	6
Notes to Condensed Consolidated Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	11
Item 4. Controls and Procedures	15
Part II. Other Information	16
Item 6. Exhibits and Reports on Form 8-K	16
Signatures	17
Certifications	18

2

PART I. FINANCIAL INFORMATION

FINISHMASTER, INC.

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

	SEPTEMBER 30, 2002	DECEMBER 31, 2001 (1)
	-----	-----
ASSETS		
CURRENT ASSETS		
Cash	\$ 3,070	\$ 2,977
Accounts receivable, net of allowance for doubtful accounts of \$1,829 and \$1,434 respectively	32,151	28,401
Inventory	44,179	50,096
Refundable income taxes	556	543
Deferred income taxes	3,898	3,947
Prepaid expenses and other current assets	2,637	3,627
Total Current Assets	86,491	89,591
PROPERTY AND EQUIPMENT, NET	6,756	7,831
OTHER ASSETS		
Intangible assets, net	102,298	102,273
Deferred income taxes	1,372	1,770

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Other	1,279	571
	-----	-----
	104,949	104,614
	-----	-----
	\$ 198,196	\$ 202,036
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 26,322	\$ 37,383
Amounts due LDI	1,166	812
Accrued compensation and benefits	6,564	8,578
Accrued expenses and other		
current liabilities	2,448	2,124
Current maturities on long-term debt	7,592	7,607
	-----	-----
Total Current Liabilities	44,092	56,504
LONG-TERM DEBT, LESS CURRENT MATURITIES	74,274	77,868
OTHER LONG-TERM LIABILITIES	6,453	5,129
SHAREHOLDERS' EQUITY		
Preferred stock, no par value, 1,000,000 shares authorized; no shares issued or outstanding	-	-
Common stock, \$1 stated value, 25,000,000 shares authorized; 7,767,569 and 7,638,863 shares issued and outstanding	7,768	7,638
Additional paid-in capital	28,788	27,936
Accumulated comprehensive loss	(1,218)	(1,146)
Retained earnings	38,039	28,107
	-----	-----
	73,377	62,535
	-----	-----
	\$ 198,196	\$ 202,036
	=====	=====

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

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

FINISHMASTER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

THREE MONTHS ENDED		NINE MONTHS ENDED	
SEPTEMBER 30,		SEPTEMBER 30,	
-----		-----	
2002	2001	2002	2001

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NET SALES	\$ 88,122	\$ 83,434	\$259,943	\$252,228
COST OF SALES	56,059	52,175	164,360	159,638
GROSS MARGIN	32,063	31,259	95,583	92,590
EXPENSES				
Operating	13,251	12,961	38,659	39,612
Selling, general and administrative	11,630	11,257	34,017	32,487
Amortization of intangible assets	247	1,424	737	4,168
	25,128	25,642	73,413	76,267
INCOME FROM OPERATIONS	6,935	5,617	22,170	16,323
INTEREST EXPENSE	1,775	2,409	5,486	6,692
INCOME BEFORE INCOME TAXES AND EXTRAORDINARY LOSS	5,160	3,208	16,684	9,631
Income tax expense	2,016	1,589	6,752	4,696
NET INCOME BEFORE EXTRAORDINARY LOSS	3,144	1,619	9,932	4,935
Extraordinary loss on early extinguishments of debt, net of income tax benefit of \$324	-	-	-	(495)
NET INCOME	\$ 3,144	\$ 1,619	\$ 9,932	\$ 4,440
NET INCOME PER SHARE - BASIC				
Net income before extraordinary loss	\$ 0.40	\$ 0.21	\$ 1.29	\$ 0.65
Extraordinary loss, net of income taxes	-	-	-	(0.07)
Net income	\$ 0.40	\$ 0.21	\$ 1.29	\$ 0.58
NET INCOME PER SHARE - DILUTED				
Net income before extraordinary loss	\$ 0.40	\$ 0.21	\$ 1.27	\$ 0.65
Extraordinary loss, net of income taxes	-	-	-	(0.07)
Net income	\$ 0.40	\$ 0.21	\$ 1.27	\$ 0.58
WEIGHTED AVERAGE SHARES OUTSTANDING - BASIC	7,768	7,638	7,728	7,593
WEIGHTED AVERAGE SHARES OUTSTANDING - DILUTED	7,874	7,684	7,847	7,621

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

FINISHMASTER, INC.

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

	NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2001
OPERATING ACTIVITIES		
Net income	\$ 9,932	\$ 4,440
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,747	7,797
Deferred income taxes	1,447	-
Loss on early extinguishments of debt, net of tax benefit of \$324	-	495
Loss on disposal of property and equipment	110	-
Changes in operating assets and liabilities: (excluding the impact of acquisitions):		
Accounts receivable	(3,322)	112
Inventories	7,453	21,207
Prepaid expenses and other current assets	(699)	803
Accounts payable and other liabilities	(12,526)	(29,185)
NET CASH PROVIDED BY OPERATING ACTIVITIES	6,142	5,669
INVESTING ACTIVITIES		
Business acquisitions and payments under earn-out provisions of prior acquisition agreements	(2,050)	(4,558)
Purchases of property and equipment	(706)	(587)
NET CASH USED IN INVESTING ACTIVITIES	(2,756)	(5,145)
FINANCING ACTIVITIES		
Proceeds from exercise of stock options	982	-
Debt issuance costs	-	(1,279)
Proceeds from debt	69,972	155,445
Repayments of debt	(74,247)	(154,799)
NET CASH USED IN FINANCING ACTIVITIES	(3,293)	(633)
INCREASE (DECREASE) IN CASH	93	(109)
CASH AT BEGINNING OF PERIOD	2,977	1,513
CASH AT END OF PERIOD	\$ 3,070	\$ 1,404

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

FINISHMASTER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(in thousands, unaudited)

	COMMON STOCK	PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED COMPREHENSIVE LOSS
	-----	-----	-----	-----
BALANCES AT DECEMBER 31, 2000	\$ 7,540	\$ 27,367	\$ 21,899	\$
Comprehensive income (loss):				
Net income for the year	-	-	6,208	
Other comprehensive income (loss):				
Interest rate swap	-	-	-	(1,)
Total comprehensive income (loss)				
Stock grants issued and options exercised	98	569	-	
	-----	-----	-----	-----
BALANCES AT DECEMBER 31, 2001	\$ 7,638	\$ 27,936	\$ 28,107	\$ (1,)
Comprehensive income (loss):				
Net income through September 30, 2002	-	-	9,932	
Other comprehensive income (loss):				
Interest rate swap	-	-	-	
Total comprehensive income (loss)				
Stock grants issued and options exercised	130	852	-	
	-----	-----	-----	-----
BALANCES AT SEPTEMBER 30, 2002	\$ 7,768	\$ 28,788	\$ 38,039	\$ (1,)
	=====	=====	=====	=====

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

FINISHMASTER, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION

BASIS OF PRESENTATION: The interim financial statements are unaudited but, in the opinion of management, reflect all adjustments necessary for a fair

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presentation of financial position, results of operations and cash flows for the periods presented. These adjustments consist of normal recurring items. The results of operations for any interim period are not necessarily indicative of results for the full year. The condensed consolidated financial statements and notes are presented as permitted by the requirements for Form 10-Q and do not contain certain information included in the Company's annual consolidated financial statements and notes. This Form 10-Q should be read in conjunction with the Company's consolidated financial statements and notes included in its 2001 Annual Report on Form 10-K.

NATURE OF BUSINESS: FinishMaster, Inc. ("FinishMaster") is the leading national distributor of automotive paints, coatings, and paint-related accessories to the automotive collision repair industry. As of September 30, 2002, we operated 161 sales outlets and three major distribution centers in 24 states and were organized into six major geographical regions - East, Midwest, Upper Midwest, West, South and Southeast. We aggregate these six geographical regions into a single reportable segment. We have approximately 15,000 customer charge accounts to which we provide a comprehensive selection of brand name products supplied by BASF, DuPont, 3M and PPG, in addition to our own FinishMaster PrivateBrand refinishing accessory products. We are highly dependent on the key suppliers outlined above, which account for approximately 85% of our purchases.

PRINCIPLES OF CONSOLIDATION: Our consolidated financial statements include the accounts of FinishMaster and its wholly owned subsidiaries from the dates of their respective acquisitions. All significant inter-company accounts and transactions have been eliminated. References to FinishMaster throughout this report relate to the consolidated entity.

MAJORITY SHAREHOLDER: Lacy Distribution, Inc. ("Distribution"), an Indiana corporation, is a wholly-owned subsidiary of LDI, Ltd. ("LDI"), an Indiana limited partnership, and is the majority shareholder of the Company with 5,587,516 shares of common stock, representing 71.9% of the outstanding shares at September 30, 2002. LDI and Distribution are collectively referred to herein as "LDI."

USE OF ESTIMATES: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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

SHIPPING AND HANDLING FEES AND COSTS: We include the cost of delivering product to our customers in the operating expense section of the condensed consolidated statements of operations. Total delivery costs primarily include wages, benefits, vehicle costs, and freight. The total delivery costs incurred for the nine months ended September 30, 2002 and 2001, are \$12.8 million and \$13.2 million, respectively.

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

2. ACQUISITIONS

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During the first quarter of 2002, we completed one acquisition, Innovative Refinish Supply, Inc., in Phoenix, Arizona. The acquisition was completed on March 29, 2002, and was funded with cash and debt.

7

During the third quarter of 2002, we completed two acquisitions, Gil Bezy, Inc., D/B/A Color Master, Inc. in Kentucky and Southern Automotives, Inc. in South Carolina. The acquisitions were completed on August 5, 2002 and August 16, 2002, respectively. Both were funded with cash and debt.

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 included 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. Finite life intangibles, consisting of customer lists and non-compete agreements, are being amortized over their estimated useful lives. Operating results of Badger have been included in our consolidated financial statements from the effective date of the acquisition. The pro forma results of operations for this acquisition have not been presented, as the impact on reported results is not material.

3. NET INCOME PER SHARE

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

(in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended
	2002	2001	2002
	-----	-----	-----
Numerator:			
Net income before extraordinary loss	\$ 3,144	\$ 1,619	\$ 9,932
Extraordinary loss on early extinguishments of debt, net of income tax benefit of \$324	-	-	-
	-----	-----	-----
Net income	\$ 3,144	\$ 1,619	\$ 9,932
	=====	=====	=====
Denominator:			
Basic-weighted average shares	7,768	7,638	7,728
Effect of dilutive stock options	106	46	119
	-----	-----	-----
Diluted-weighted average shares	7,874	7,684	7,847
	=====	=====	=====

Net income per share - basic

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Net income before extraordinary loss	\$ 0.40	\$ 0.21	\$ 1.29
Extraordinary loss, net of income taxes	-	-	-
	-----	-----	-----
Net income	\$ 0.40	\$ 0.21	\$ 1.29
	=====	=====	=====
Net income per share - diluted			
Net income before extraordinary loss	\$ 0.40	\$ 0.21	\$ 1.27
Extraordinary loss, net of income taxes	-	-	-
	-----	-----	-----
Net income	\$ 0.40	\$ 0.21	\$ 1.27
	=====	=====	=====

4. COMMITMENTS AND CONTINGENCIES

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

We are subject to various claims and contingencies arising out of the normal course of business, including those relating to commercial transactions, environmental, product liability, automobile, taxes, discrimination, employment and other matters. Management believes that the ultimate liability, if any, in excess of amounts already provided or covered by

8

insurance, is not likely to have a material adverse effect on our financial condition, results of operations or cash flows.

5. EARLY EXTINGUISHMENT OF DEBT

On March 29, 2001, we entered into a new senior secured credit facility with a syndicate of banks and a new senior subordinated term credit facility with LDI. The use of the proceeds from these facilities was used to repay our existing senior secured and senior subordinated credit facilities prior to their original expiration dates. An extraordinary loss on the early extinguishments 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 these expired facilities.

6. LONG TERM DEBT

On March 29, 2001, we entered into a new \$100.0 million senior secured credit facility with a syndicate of banks and a new \$20.0 million senior subordinated term credit facility with LDI. The new senior secured credit facility consisted of a \$40.0 million term credit facility and a \$60.0 million revolving credit facility. The term credit facility, which expires on June 30, 2006, requires quarterly principal payments that increase in amount over the term of the loan. Quarterly principal payments began on June 30, 2001, and are \$1.5 million per quarter in 2002. The revolving credit facility is limited to the lesser of (1) \$60.0 million less letter of credit obligations, or (2) 80 percent of eligible

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accounts receivable plus 65 percent of eligible inventory less letter of credit obligations and a reserve for three months facility rent. Principal is due on June 30, 2006. Both the revolving credit and term facilities are subject to interest rates, which fluctuate based on our Leverage Ratio, as defined in the Credit Facility. During the third quarter of 2002, our interest rates were 2.25% over LIBOR or 0.25% over prime in the case of Floating Rate Advances.

To convert our new senior term credit facility from a floating to a fixed interest rate obligation, we entered into interest rate swap agreements with notional amounts of \$40.0 million. The weighted average fixed interest rate under these agreements is 5.43%. In order to maintain effectiveness, the quarterly settlement terms of the swap agreements are established to match the interest payments on the term credit facility. The change in the fair value of the interest rate swap was (\$0.8) million and (\$1.4) million for the third quarter 2002 and 2001, respectively, and (\$1.1) million and (\$1.6) million for the nine months ending September 30, 2002 and 2001, respectively. The amounts net of tax were recorded in the Accumulated Comprehensive Loss section of the Shareholders' Equity.

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

7. GOODWILL AND OTHER INTANGIBLE ASSETS

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, "Business Combinations," and No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that the purchase method of accounting be used for all business combinations after June 30, 2001. SFAS No. 142 prohibits the amortization of goodwill and intangible assets with indefinite useful lives. SFAS No. 142 also requires that these intangible assets be reviewed for impairment at least annually. Intangible assets with finite lives continue to be amortized over their estimated useful lives.

Effective January 1, 2002, we adopted SFAS No. 142, which requires that goodwill and indefinite lived assets be tested for impairment at the reporting unit level at adoption and at least annually thereafter. An impairment charge is recognized only when the calculated fair value of a reporting unit, including goodwill, is less than its carrying amount. In accordance with SFAS No. 142, we completed the required transitional impairment tests of goodwill and indefinite lived intangible assets and determined the fair value to be in excess of the carrying value of these assets. We also completed our required annual impairment test as of June 30, 2002 and determined the fair value of goodwill and indefinite lived intangible assets to be in excess of the carrying value of these assets.

As required by SFAS No. 142, intangible assets with finite lives are amortized over their estimated useful lives. Included in intangible assets with finite lives are non-compete agreements and customer lists.

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A reconciliation of reported net income adjusted to reflect the adoption of SFAS No. 142 is provided below:

(in thousands, except per share data)

	THREE MONTHS ENDED SEPTEMBER 30,		
	2002	2001	
REPORTED NET INCOME BEFORE EXTRAORDINARY LOSS	\$ 3,144	\$ 1,619	\$
Extraordinary loss on early extinguishments of debt, net of income tax benefit of \$324	-	-	
REPORTED NET INCOME	\$ 3,144	\$ 1,619	\$
Add-back goodwill and indefinite lived intangible asset amortization, net of tax	-	918	
ADJUSTED NET INCOME	\$ 3,144	\$ 2,537	\$
REPORTED BASIC EARNINGS PER SHARE BEFORE EXTRAORDINARY LOSS	\$ 0.40	\$ 0.21	\$
Extraordinary loss on early extinguishments of debt, net of tax	-	-	
REPORTED BASIC EARNINGS PER SHARE	\$ 0.40	\$ 0.21	\$
Add-back goodwill and indefinite lived intangible asset amortization, net of tax	-	0.12	
ADJUSTED BASIC EARNINGS PER SHARE	\$ 0.40	\$ 0.33	\$
REPORTED DILUTED EARNINGS PER SHARE BEFORE EXTRAORDINARY LOSS	\$ 0.40	\$ 0.21	\$
Extraordinary loss on early extinguishments of debt, net of tax	-	-	
REPORTED DILUTED EARNINGS PER SHARE	\$ 0.40	\$ 0.21	\$
Add-back goodwill and indefinite lived intangible asset amortization, net of tax	-	0.12	
ADJUSTED DILUTED EARNINGS PER SHARE	\$ 0.40	\$ 0.33	\$

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ITEM 2

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

NET SALES

	THREE MONTHS ENDED SEPTEMBER 30,			NINE MONTHS ENDED SEPTEMBER 30,	
(In thousands)	2002	CHANGE	2001	2002	CHANGE
Net Sales	\$ 88,122	5.6%	\$ 83,434	\$ 259,943	3.1%

Net sales for the third quarter of 2002 increased \$4.7 million, or 5.6%, primarily due to acquisitions and "same store" sales growth. "Same store" sales growth for the quarter was 1.5%. This improvement was attributable to increased demand as a result of improved market conditions and higher purchase levels by customers prior to annual price increases on two major product lines. Demand in the prior year third quarter was impacted by the September 11th terrorist attacks.

For the nine months ended September 30, 2002, net sales increased \$7.7 million or 3.1%. Since January 1, 2001, we have completed nine acquisitions that have contributed significantly to the year-to-date increase in net sales. "Same store" sales growth on a year-to-date basis was unfavorable by 0.7%.

GROSS MARGIN

	THREE MONTHS ENDED SEPTEMBER 30,			NINE MONTHS ENDED SEPTEMBER 30,	
(In thousands)	2002	CHANGE	2001	2002	CHANGE
Gross Margin	\$ 32,063	2.6%	\$ 31,259	\$ 95,583	3.2%
Percentage of net sales	36.4%		37.5%	36.8%	

Gross margin for the third quarter of 2002 increased \$0.8 million, or 2.6%, compared to the prior year period. Higher net sales volume positively impacted margin by \$1.8 million for the quarter. Gross margin as a percentage of net sales decreased 110 basis points to 36.4%, negatively impacting margin by \$1.0 million for the quarter. Less favorable purchasing opportunities from our vendors were the primary contributors to the decrease in gross margins as a percentage of net sales.

Gross margin for the nine months ended September 30, 2002 increased \$3.0 million, or 3.2%, compared to the prior year period. Higher net sales volume positively impacted margin on a year-to-date basis by \$2.8 million. Gross margin as a percentage of net sales increased 10 basis points to 36.8% from 36.7%.

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OPERATING EXPENSES

	THREE MONTHS ENDED SEPTEMBER 30,			NINE MONTHS ENDED SEPTEMBER 30,	
(In thousands)	2002	CHANGE	2001	2002	CHANGE
Operating Expenses	\$ 13,251	2.2%	\$ 12,961	\$ 38,659	(2.4%)
Percentage of net sales	15.0%		15.5%	14.9%	

Operating expenses consist of wages, facility, vehicle and related costs for our branch and distribution locations. Operating expenses increased \$0.3 million for the third quarter and decreased \$1.0 million for the nine months ended September 30, 2002, compared to prior year periods. The third quarter increase was a result of higher wages and insurance related costs, partially offset by higher finance charge income. For the nine months ended September 30, 2002, the decreases in operating expenses were a result of lower utilities, fuel, and freight expenses, and higher finance charge income. Partially offsetting these decreases were increased expenses associated with acquired operations in 2001 and higher insurance costs. As a percentage of net sales, operating expenses compared to the prior year period decreased 50 basis points to 15.0% in the third quarter, and 80 basis points to 14.9% for the nine months ended September 30, 2002.

11

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

	THREE MONTHS ENDED SEPTEMBER 30,			NINE MONTHS ENDED SEPTEMBER 30,	
(In thousands)	2002	CHANGE	2001	2002	CHANGE
Selling, General and Administrative Expenses	\$ 11,630	3.3%	\$ 11,257	\$ 34,000	13.5%
Percentage of net sales	13.2%		13.5%	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. Compared to the prior year period, SG&A expenses for the third quarter of 2002 increased \$0.4 million, or 3.3%, and for the nine months ended September 30, 2002, \$1.5 million, or 4.7%. The third quarter increase was due primarily to an increase in insurance costs. For the nine months ended September 30, 2002, the increase was due primarily to higher wages, insurance, communication, and travel expenses. As a percentage of net sales, SG&A expenses compared to the prior year period decreased 30 basis points to 13.2% in the third quarter, and increased 20 basis points to 13.1% for the nine months ended September 30, 2002.

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AMORTIZATION OF INTANGIBLE ASSETS

	THREE MONTHS ENDED SEPTEMBER 30,				NINE
(In thousands)	2002	CHANGE	2001		2002
Amortization of					
Intangible Assets	\$ 247	(82.7%)	\$ 1,424	\$	7
Percentage of net sales	0.3%		1.7%		0

Lower amortization expense of \$1.2 million, or 82.7%, for the third quarter of 2002, and \$3.4 million, or 82.3%, for the nine months ended September 30, 2002, was due primarily to the adoption of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," which eliminates the amortization of goodwill and intangible assets with indefinite useful lives. Intangible assets with finite lives, principally non-compete agreements and customer lists, continue to be amortized over their estimated useful lives.

INTEREST EXPENSE

	THREE MONTHS ENDED SEPTEMBER 30,				NINE
(In thousands)	2002	CHANGE	2001		2002
Interest Expense	\$ 1,775	(26.3%)	\$ 2,409	\$	5,4
Percentage of net sales	2.0%		2.9%		2

Interest expense for the third quarter decreased \$0.6 million, or 26.3%, and for the nine months ended September 30, 2002, \$1.2 million, or 18.0%, primarily due to lower average outstanding borrowings. Average outstanding borrowings were lower by \$17.7 million and \$9.8 million compared to the prior year for the three and nine months ended September 30, 2002, respectively. Lower effective interest rates in the current year periods also contributed to the favorable decreases in interest expense.

INCOME TAX EXPENSE

	THREE MONTHS ENDED SEPTEMBER 30,				NINE
(In thousands)	2002	CHANGE	2001		2002
Income Tax Expense	\$ 2,016	26.9%	\$ 1,589	\$	6,7
Percentage of net sales	2.3%		1.9%		2
Effective tax rate	39.1%		49.5%		40

Income tax expense increased \$0.4 million, or 26.9%, for the third quarter, and for the nine months ended September 30, 2002, \$2.1 million, or 43.8%, due to higher income before income taxes. The adoption of SFAS No. 142 reduced our

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effective tax rate in the current year due to the elimination of certain goodwill amortization, including non-deductible goodwill amortization. On a SFAS No. 142 comparable basis, the effective tax rate would have been 41.5% and 41.0% for the third quarter and the nine months ended September 30, 2001, respectively.

12

EXTRAORDINARY LOSS

	THREE MONTHS ENDED SEPTEMBER 30,			NINE	
(In thousands)	2002	CHANGE	2001	2002	
Extraordinary loss, net	\$ -	N/A	\$ -	\$ -	
Percentage of net sales	0.0%		0.0%	0	

In 2001, an extraordinary loss on the early extinguishments 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 extinguishments of our senior secured and senior subordinated credit facilities. See Note 5 within Condensed Financial Statements in Item 1.

NET INCOME AND INCOME PER SHARE

	THREE MONTHS ENDED SEPTEMBER 30,			NINE	
(In thousands)	2002	CHANGE	2001	2002	
Net Income	\$ 3,144	94.2%	\$ 1.619	\$ 9,9	
Percentage of net sales	3.6%		1.9%	3	
Net income per share - Diluted	\$ 0.40		\$ 0.21	\$ 1.	

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

SEASONALITY AND QUARTERLY FLUCTUATIONS

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

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contribute to fluctuations in our quarterly cash flows. Although we continue to investigate strategies to smooth the seasonal pattern of our quarterly results of operations, there can be no assurance that our net sales, results of operations and cash flows will not continue to display seasonal patterns.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

(In thousands)	SEPTEMBER 30, 2002	DECEMBER 31, 2001
Working capital	\$ 42,399	\$ 33,087
Long-term debt	\$ 81,866	\$ 85,475

NINE MONTHS ENDED SEPTEMBER 30,		
(In thousands)	2002	2001
Cash provided by operating activities	\$ 6,142	\$ 5,669
Cash used in investing activities	\$ (2,756)	\$ (5,145)
Cash used in financing activities	\$ (3,293)	\$ (633)

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

Operating activities for the nine months ended September 30, 2002 provided \$6.1 million of net cash compared with \$5.7 million of net cash in the prior year period. This increase was the result of higher net income and non-cash items in the current year period partially offset by a negative change in operating assets and liabilities, primarily inventories and accounts receivable. Lower inventory purchases in late 2001 made prior to manufacturers' price increases compared to the same period in 2000 decreased the cash flows provided by inventories in 2002 compared to the prior year period. Differences in payment terms between years on the large year-end inventory purchases also impacted cash used by

13

accounts payable and other liabilities in the comparable periods. Higher sales levels in the current year period resulted in decreased cash flows from accounts receivable.

Net cash used in investing activities was \$2.8 million for the nine months ended September 30, 2002, compared to \$5.1 million in the prior year period due to decreased expenditures for acquisitions. During 2001, we completed the Badger acquisition. This acquisition was significantly larger than those completed in the current year period. See Note 2 within Condensed Financial Statements in Item 1. We estimate that capital expenditures for 2002, principally for information technology equipment, will approximate \$1.0 million.

Net cash used by financing activities, primarily the repayment of borrowings, was \$3.3 million for the nine months ended September 30, 2002, compared to \$0.6 million in the prior year period. The increase in net debt repayments was a

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result of higher cash flows generated from operating activities in the current year and lower cash used in investing activities.

Total capitalization at September 30, 2002, was \$155.3 million, comprised of \$81.9 million of debt and \$73.4 million of equity. Debt as a percentage of total capitalization was 52.7% at September 30, 2002 compared to 57.7% at December 31, 2001.

At September 30, 2002, we had outstanding term credit and revolving credit facilities totaling \$55.7 million and senior subordinated debt of \$19.9 million. We were in compliance with the covenants underlying these credit facilities, and had estimated availability under our revolving credit facilities of \$24.2 million as of October 31, 2002, based upon the September 30, 2002 borrowing base calculation.

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

CRITICAL ACCOUNTING POLICIES

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

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

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

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

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

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Reserve for Obsolete Inventory - Our estimate of the reserve for obsolete inventory is based on historical product usage information. Changes in the rate of introduction of new products by our manufacturers, our ability to return excess inventory to vendors, and our ability to sell excess inventory could materially change these estimates.

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 generally, 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 4

CONTROLS AND PROCEDURES

We maintain a system of internal controls and procedures designed to provide reasonable assurance as to the reliability of our consolidated financial statements and other disclosures included in this report. Our Board of Directors, operating through its audit committee, which is composed entirely of independent outside directors, provides oversight to our financial reporting process.

Within the 90-day period prior to the date of this report, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-14 of the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective in alerting them in a timely manner to material information relating to FinishMaster, Inc. required to be included in this quarterly report on Form 10-Q.

There have been no significant changes in our internal controls or in other factors which could significantly affect internal controls subsequent to the date that we carried out our evaluation.

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Item 6. Exhibits and Reports on Form 8-K

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

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

- (b) Reports on Form 8-K. A Form 8-K was filed on July 23, 2002 announcing management changes at the Company.

SIGNATURES

Pursuant to the requirements 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: November 14, 2002

FINISHMASTER, INC.

By: /s/ Andre B.Lacy

Andre B. Lacy
Chief Executive Officer

By: /s/ Robert R. Millard

Robert R. Millard
Senior Vice President and
Chief Financial Officer

CERTIFICATION

By signing below, each of the undersigned officers hereby certifies that, to his knowledge, (i) this report fully complies with the requirements of Section 13(a) or 15 (d) of the Securities Exchange Act of 1934 and (ii) the information contained in this report fairly presents, in all material respects, the financial condition and results of operations of FinishMaster, Inc.

Date: November 14, 2002

By: /s/ Andre B.Lacy

Andre B. Lacy
Chief Executive Officer

By: /s/ Robert R. Millard

Robert R. Millard
Senior Vice President and
Chief Financial Officer

CERTIFICATION

I, Andre B. Lacy, Chairman and Chief Executive Officer of FinishMaster, Inc., (FinishMaster) certify that:

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

Date: November 14, 2002

By: /s/ Andre B. Lacy

Andre B. Lacy

Title: Chairman and Chief Executive Officer

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(Principal Executive Officer)

18

CERTIFICATION

I, Robert R. Millard, Senior Vice President and Chief Financial Officer of FinishMaster, Inc. (FinishMaster), certify that:

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

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6. FinishMaster's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

By: /s/ Robert R. Millard

Robert R. Millard

Title: Senior Vice President and Chief Financial Officer
(Principal Financial Officer)