

COAST DISTRIBUTION SYSTEM INC
Form 10-Q
August 14, 2007
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended **June 30, 2007**

OR

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

For the transition period from _____ to _____
Commission File Number 1-9511

THE COAST DISTRIBUTION SYSTEM, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE
(State or other jurisdiction
of incorporation or organization)

94-2490990
(I.R.S. Employer
Identification Number)

350 Woodview Avenue, Morgan Hill, California
(Address of principal executive offices)

95037
(Zip Code)

(408) 782-6686

(Registrant's telephone number, including area code)

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Not Applicable

(Former name, former address and former fiscal year, if changed, since last year)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports); and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.)

(Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

4,430,802 shares of Common Stock as of August 1, 2007

Table of Contents

THE COAST DISTRIBUTION SYSTEM, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2007

TABLE OF CONTENTS

	Page No.
Part I. Financial Information	
Item 1.	
Financial Statements	
<u>Condensed Consolidated Interim Balance Sheets June 30, 2007 (unaudited) and December 31, 2006</u>	1
<u>Condensed Consolidated Interim Statements of Earnings for the three and six months ended June 30, 2007 and 2006 (unaudited)</u>	2
<u>Condensed Consolidated Interim Statements of Cash Flows for the six months ended June 30, 2007 and 2006 (unaudited)</u>	3
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	4
Item 2.	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	9
<u>Management Overview</u>	9
<u>Accounting Policies and Estimates</u>	10
<u>Results of Operations</u>	12
<u>Financial Condition, Liquidity and Capital Resources</u>	13
<u>Seasonality and Inflation</u>	15
<u>Forward Looking Information and Factors that Could Affect Our Future Financial Performance</u>	15
Item 3.	
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	17
Item 4.	
<u>Controls and Procedures</u>	17
Part II. Other Information	
Item 1A.	
<u>Risk Factors</u>	18
Item 2.	
<u>Unregistered Sales of Securities and Use of Proceeds</u>	18
Item 6.	
<u>Exhibits</u>	18
<u>SIGNATURES</u>	
	S-1
<u>EXHIBITS</u>	
	E-1
Exhibit 31.1	<u>Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002</u>
Exhibit 31.2	<u>Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002</u>
Exhibit 32.1	<u>Certification of Chief Executive Officer under Section 906 of the Sarbanes-Oxley Act of 2002</u>
Exhibit 32.2	<u>Certification of Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002</u>

Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****THE COAST DISTRIBUTION SYSTEM, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED INTERIM BALANCE SHEETS**

(Dollars in Thousands)

	June 30, 2007 (unaudited)	December 31, 2006
ASSETS		
CURRENT ASSETS		
Cash	\$ 1,056	\$ 721
Accounts receivable net of allowances of \$1,412 and \$1,376 as of June 30, 2007 and December 31, 2006, respectively	27,145	14,193
Inventories	46,652	46,642
Other current assets	2,364	4,233
Total current assets	77,217	65,789
PROPERTY, PLANT, AND EQUIPMENT, NET	3,143	2,461
OTHER ASSETS	1,340	1,244
	\$ 81,700	\$ 69,494
LIABILITIES		
CURRENT LIABILITIES		
Current maturities of long-term obligations	\$ 122	\$ 137
Accounts payable	9,455	9,231
Accrued liabilities	3,529	3,717
Total current liabilities	13,106	13,085
LONG-TERM OBLIGATIONS	35,615	24,562
STOCKHOLDERS EQUITY		
Preferred stock, \$.001 par value: 2,000,000 shares authorized: none issued or outstanding:		
Common stock, \$.001 par value: 10,000,000 shares authorized; 4,430,802 and 4,414,547 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively	15,840	15,702
Accumulated other comprehensive income	1,392	650
Retained earnings	15,747	15,495
	32,979	31,847
	\$ 81,700	\$ 69,494

The accompanying notes are an integral part of these statements.

Table of Contents

THE COAST DISTRIBUTION SYSTEM, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF EARNINGS

(Dollars in thousands, except per share data)

Three and Six Months Ended June 30,

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net sales	\$ 50,827	\$ 56,777	\$ 94,465	\$ 108,313
Cost of sales, including distribution costs	41,077	44,663	76,548	85,591
Gross profit	9,750	12,114	17,917	22,722
Selling, general and administrative expenses	6,884	6,744	15,227	15,095
Operating income	2,866	5,370	2,690	7,627
Other income (expense)				
Interest	(699)	(540)	(1,238)	(921)
Other	11	6	(97)	(52)
	(688)	(534)	(1,335)	(973)
Earnings before income taxes	2,178	4,836	1,355	6,654
Income tax provision	663	1,827	482	2,536
Net earnings	\$ 1,515	\$ 3,009	\$ 873	\$ 4,118
Basic earnings per share	\$ 0.34	\$ 0.68	\$ 0.20	\$ 0.93
Diluted earnings per share	\$ 0.33	\$ 0.66	\$ 0.19	\$ 0.90

The accompanying notes are an integral part of these statements.

Table of Contents**THE COAST DISTRIBUTION SYSTEM, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS****(Dollars in thousands)****Six months ended June 30,****(Unaudited)**

	2007	2006
Cash flows from operating activities:		
Net earnings	\$ 873	\$ 4,118
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	410	366
Stock based compensation expense	98	43
Changes in assets and liabilities:		
Accounts receivable	(12,952)	(10,881)
Inventories	(10)	(5,013)
Other current assets	1,869	1,727
Accounts payable	224	2,552
Accrued liabilities	(188)	(260)
Net cash used in operating activities	(9,676)	(7,348)
Cash flows from investing activities:		
Capital expenditures	(852)	(130)
Increase in other assets	(131)	(2)
Net cash used in investing activities	(983)	(132)
Cash flows from financing activities:		
Net borrowings of long-term debt	10,569	6,805
Issuance of common stock pursuant to employee stock option and purchase plans	148	431
Dividends paid	(621)	(442)
Retirement of common stock	(108)	(599)
Net cash provided by financing activities	9,988	6,195
Effect of exchange rate changes on cash	1,006	252
NET INCREASE (DECREASE) IN CASH	335	(1,033)
Cash beginning of period	721	1,744
Cash end of period	\$ 1,056	\$ 711

The accompanying notes are an integral part of these statements.

Table of Contents**THE COAST DISTRIBUTION SYSTEM, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

- The accompanying condensed consolidated interim financial statements have been prepared in accordance with accounting principles and Securities and Exchange Commission (SEC) rules applicable to interim financial statements. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, these unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments and accruals) necessary for a fair presentation of the Company's financial position as of June 30, 2007 and the results of its operations and cash flows for the three and six month periods ended June 30, 2007 and 2006. The accounting policies followed by the Company are set forth in Note A to the Company's consolidated financial statements for the year ended December 31, 2006 contained in its Annual Report on Form 10-K for its fiscal year ended December 31, 2006. Therefore, these condensed consolidated financial statements should be read in conjunction with our consolidated financial statements and the notes thereto contained in that Annual Report.
- The Company's business is seasonal and its results of operations for the three and six month periods ended June 30, 2007 and 2006 are not necessarily indicative of the results to be expected in any other interim period during, or for the full year ending, December 31, 2007. See Management's Discussion and Analysis of Financial Condition and Results of Operations Seasonality and Inflation in Item 2 of Part I of this Report.
- Basic earnings per share for each period are computed using the weighted average number of common shares outstanding during such period. Diluted earnings per share are computed using the weighted average number of common and potentially dilutive securities outstanding during the period. Potentially dilutive securities consist of the incremental common shares issuable upon the exercise of stock options (using the treasury stock method). Potentially dilutive securities are excluded from the computation if their effect is anti-dilutive. For the three and six months ended June 30, 2007, 340,000 and 280,000 shares of common stock, respectively, that were issuable on exercise of stock options were excluded from the computation of diluted earnings per share because their exercise prices were greater than the average market price of the Company's common stock during these periods; whereas for the three and six months ended June 30, 2006 none of the shares of common stock issuable on exercise of stock options were excluded from the computation of diluted earnings per share.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Net earnings	\$ 1,515	\$ 3,009	\$ 873	\$ 4,118
Denominator:				
Weighted average shares outstanding	4,426	4,407	4,422	4,414
Dilutive effect of stock options	111	178	124	185
Denominator for diluted net income per share	4,537	4,585	4,546	4,599

- The Company leases its corporate offices, warehouse facilities and data processing equipment. Those leases are classified as operating leases as they do not meet the capitalization criteria of SFAS No. 13. The office and warehouse leases expire over the next ten years. Minimum future rental commitments under non-cancelable operating leases are as follows:

Year Ending December 31,	(In thousands)
2007 (remaining six months)	\$ 2,168
2008	4,177

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2009	3,564
2010	2,974
2011	2,504
Thereafter	10,475
	\$ 25,862

Table of Contents**THE COAST DISTRIBUTION SYSTEM, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)**

5. The Company has one operating segment, the distribution of replacement parts, accessories and supplies for recreational vehicles and boats. The following table sets forth the Company's net sales, by region, for the periods presented below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
USA	\$ 37,890	\$ 43,616	\$ 70,706	\$ 83,724
Canada	12,937	13,161	23,759	24,589
	\$ 50,827	\$ 56,777	\$ 94,465	\$ 108,313

6. Comprehensive Earnings.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Net earnings	\$ 1,515	\$ 3,009	\$ 873	\$ 4,118
Change in accumulated foreign currency translation adjustment:	675	290	742	265
Comprehensive earnings (loss)	\$ 2,190	\$ 3,299	\$ 1,615	\$ 4,383

7. Stock Based Compensation. Effective January 1, 2006, the Company adopted the provisions of Financial Accounting Standards Board Statement (SFAS) No. 123R, Share-Based Payment (SFAS No. 123R), which requires entities that grant stock options or other equity compensation awards to employees to recognize, for financial reporting purposes, the fair value of options and other share-based awards as compensation cost over their respective service (vesting) periods. SFAS No. 123R provides for, and the Company has elected to adopt, the modified prospective application method of recognizing such compensation costs, pursuant to which equity compensation is comprised of (i) compensation expense for all share-based awards granted prior to, but not yet vested as of January 1, 2006, based on their grant date fair values estimated in accordance with the original provisions of SFAS No. 123, and (ii) compensation cost for all share-based awards granted subsequent to December 31, 2005, based on their grant date fair values estimated in accordance with the provisions of SFAS No. 123(R). The Company's share-based compensation expense was \$51,000 and \$26,000 for the quarters ended June 30, 2007 and 2006, respectively, and \$98,000 and \$44,000 for the six months ended June 30, 2007 and 2006, respectively.

For purposes of SFAS No. 123R, the fair value of each option is estimated as of the date of grant using a binomial model. This model incorporates certain assumptions including a risk-free market interest rate, expected dividend yield of the underlying common stock, expected option life and expected volatility in the market value of the underlying common stock.

Table of Contents**THE COAST DISTRIBUTION SYSTEM, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)**

Set forth below are the weighted average assumptions that we used in estimating the fair value of the options that were granted in the six month periods ended June 30, 2007 and 2006. No options were granted in either of the three month periods ended June 30, 2007 and 2006, respectively.

	Six Months Ended June 30,	
	2007	2006
Stock Option Plans:		
Expected volatility	46%	52.0%
Risk free interest rates	4.45%	4.6%
Expected dividend yields	3.6%	2.7%
Expected lives	4 years	4 years
Stock Purchase Plan:		
Expected volatility	40%	47%
Risk free interest rates	4.90%	4.8%
Expected dividend yields	3.6%	2.7%
Expected lives	1 year	1 year

Expected volatilities are based on the historical volatility of the Company's common stock. The risk free interest rates are based upon market yields for United States Treasury debt securities. The expected dividend yields are based upon the Company's current dividend policy and the fair market value of the Company's shares at the end of each period. Expected lives are based on several factors including the average holding period and remaining terms of outstanding options and the cycle of our long range business plan.

The Company has in effect a 2005 Stock Incentive Plan (the "2005 Plan"), which authorizes the granting of options to directors, officers and other key employees, that entitle them to purchase shares of our common stock. A total of 350,000 shares were authorized for issuance under the 2005 Plan. Options to purchase a total of 230,000 shares of our common stock granted under the 2005 Plan were outstanding at June 30, 2007. We also have in effect a 1999 Stock Incentive Plan (the "1999 Plan"), which authorizes the issuance of options to purchase up to 300,000 shares of our common stock. Options to purchase a total of 196,667 shares of our common stock granted under the 1999 Plan were outstanding at June 30, 2007. The Company had in effect a 1993 Stock Option Plan which authorized the issuance of options to purchase up to 500,000 shares of common stock (the "1993 Plan"). The 1993 Plan has expired and options may not longer be granted under that Plan. However, options to purchase a total of 140,666 shares of our common stock remained outstanding under the 1993 Plan as of June 30, 2007.

In 1997 the Company adopted an Employee Stock Purchase Plan to encourage employees to purchase shares of our common stock and, thereby, become stockholders of the Company. A total of 400,000 shares of the Company's common stock were reserved for issuance under this Plan. The Plan is available to all full-time employees (other than employees that own 5% or more of our outstanding shares of common stock) and participation is voluntary. Employees who desire to participate may elect to do so at the beginning of an annual purchase period, at which time they are required to authorize payment for the shares they desire to purchase under the Plan by payroll deductions to be made ratably over the annual purchase period. The price of the shares is determined at the end of the purchase period, at which time the participating employees have the option of having their withholdings applied to purchase shares under the Plan or withdraw from the Plan, in which case their accumulated payroll deductions are refunded. The price at which shares are sold under the Plan is 85% of the market price of the Company's shares, either at the beginning of the purchase period, or at the end of the purchase period, whichever is lower. At June 30, 2007, there were a total of 179,065 shares available for future issuance under this Plan.

Table of Contents**THE COAST DISTRIBUTION SYSTEM, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)**

The following table summarizes stock option activity during the six month periods ended June 30, 2007 and 2006:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2006	437,333	\$ 5.16		
Granted	150,000	8.30		
Exercised	(20,000)	3.19		
Forfeited				
Outstanding at June 30, 2007	567,333	\$ 6.06	5.9 years	\$ 868,157
Exercisable at June 30, 2007	208,833	\$ 3.97	3.3 years	\$ 688,157
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2005	453,066	\$ 3.92		
Granted	74,000	7.25		
Exercised	(77,833)	3.41		
Forfeited				
Outstanding at June 30, 2006	449,233	\$ 4.55	4.5 years	\$ 1,863,621
Exercisable at June 30, 2006	253,233	\$ 3.22	2.8 years	\$ 1,387,281

The aggregate intrinsic values of the options that were outstanding and those that were exercisable at June 30, 2007 and 2006, as set forth in each of the tables above, represent the total pre-tax intrinsic value (the aggregate difference between the closing stock price of the Company's common stock on June 30, 2007 or 2006, respectively, and the exercise prices for in-the-money options) that would have been received by the option holders if all in-the-money options had been exercised on June 30, 2007 or 2006, respectively. The total pre-tax intrinsic values of the options exercised during the six months ended June 30, 2007 and 2006 were \$85,770 and \$327,069, respectively.

The weighted average grant-date values of options granted during the six month periods ended June 30, 2007 and 2006 were \$2.58 and \$2.65 respectively.

A summary of the status of the Company's nonvested options as of June 30, 2007 and 2006, and of the changes during the six month periods ended June 30, 2007 and 2006, is presented below:

	Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2006	248,000	\$ 6.74
Granted	150,000	8.30

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Vested	(39,000)		7.78
Forfeited			
Nonvested at June 30, 2007	359,000	\$	7.28
	Shares	Weighted Average Grant Date Fair Value	
Nonvested at December 31, 2005	122,000	\$	5.68
Granted	74,000		7.25
Vested			
Forfeited			
Nonvested at June 30, 2006	196,000	\$	6.27

As of June 30, 2007 and 2006, there was \$609,383 and \$252,346, respectively, of total unrecognized compensation cost related to nonvested options granted under both of the Company's option plans. That cost is expected to be recognized over a weighted average period of 2.71 years.

Table of Contents

THE COAST DISTRIBUTION SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

8. **Recent Accounting Pronouncements**

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets (SFAS No. 156). This statement amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 became effective for us on January 1, 2006. The adoption of SFAS No. 156 did not have a material impact on our consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 provides a new single authoritative definition of fair value and provides enhanced guidance for measuring the fair value of assets and liabilities and requires additional disclosures related to the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS No. 157 will be effective for us as of January 1, 2008. We are currently assessing the impact that the adoption of SFAS No. 157 may have on our consolidated financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option of Financial Assets and Liabilities (SFAS No. 159). SFAS No. 159 provides entities with the option to report selected financial assets and liabilities at fair value. Business entities adopting SFAS No. 159 will report unrealized gains and losses in earnings at each subsequent reporting date for assets and liabilities for which the fair value option has been elected. SFAS No. 159 established presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 requires additional information that will help investors and other financial statements users to understand the effect of an entity's choice to report the fair value of assets and liabilities on its earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted. We are currently assessing the impact that the adoption of SFAS No. 159 may have on our consolidated financial position, results of operation and cash flows.

In June 2006, the FASB issued interpretation No. 48, Accounting for Uncertainty in Income Taxes (Fin 48). Fin 48 clarifies the accounting for uncertainty in income taxes recognized in enterprises' financial statements in accordance with SFAS No. 109, Accounting for Income Taxes . This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Fin 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted Fin 48 effective January 1, 2007. As a result of the implementation of Fin 48, the Company recognized no material adjustment in the liability for unrecognized tax benefits. At the date of our adoption of Fin 48, we had \$159,000 of unrecognized tax benefits. To the extent these unrecognized tax benefits are ultimately recognized, they will impact the Company's effective tax rate. In accordance with Fin 48, the Company also has decided to classify interest and penalties as a component of tax expense. As of June 30, 2007, interest and penalties were \$51,000.

The Company's federal income tax returns for 2003-2006 are open tax years. The Company files tax returns in numerous state and foreign jurisdictions with varying statutes of limitations. The Company's state income tax returns are open for years ranging from 2002-to-2006, depending on the duration of each of such statutes of limitation.

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Management Overview**

We believe that we are one of the largest wholesale distributors of replacement parts, accessories and supplies for recreational vehicles (RVs), and boats in North America. We supply more than 14,000 products and serve more than 12,000 customers throughout the United States and Canada, from 13 regional distribution centers in the United States and 4 regional distribution centers in Canada. Our sales are made primarily to retail parts and supplies stores, service and repair establishments and new and used RV and boat dealers (After-Market Customers). Our sales are affected primarily by (i) usage of RVs and boats by the consumers to whom After-Market Customers sell our products, because such usage affects the consumers' needs for and purchases of replacement parts, repair services and supplies, and (ii) sales of new RVs and boats, because consumers often accessorize their RVs and boats at the time of purchase.

Factors Generally Affecting Sales of RV and Boating Products

The usage and the purchase, by consumers, of RVs and boats depend, in large measure, upon the extent of discretionary income available to consumers and their confidence about economic conditions, including the availability and prices of gasoline and prevailing interest rates. As a result, recessionary conditions and increases in gasoline prices or in interest rates often lead to declines in the purchase and, to a lesser extent, in the usage, of RVs and boats, because these conditions increase the consumers' costs of purchasing, and the costs and difficulties of using, their RVs and boats. Weather conditions also can affect our operating results, because unusually severe or extended winter weather conditions can reduce the usage of RVs and boats for periods extending beyond the ordinary winter months or to regions that ordinarily encounter milder winter weather conditions and can cause period-to-period fluctuations in our sales and financial performance. As a result, our sales and operating results can be, and in the past have been, affected by recessionary economic conditions, shortages in the supply and increases in the prices of gasoline, increases in interest rates and unusually adverse weather conditions.

Overview of Operating Results Three and Six Months Ended June 30, 2007 vs. Three and Six Months Ended June 30, 2006

	Three Months Ended June 30,			Six Months Ended June 30,		
	Amounts	Amounts	%	Amounts	Amounts	%
	2007	2006	vs. 2006	2007	2006	Change 2007 vs. 2006
	(Dollars in thousands, except per share amounts)					
Net Sales	\$ 50,827	\$ 56,777	(10.5)%	\$ 94,465	\$ 108,313	(12.8)%
Gross Profit	9,750	12,114	(19.5)%	17,917	22,722	(21.1)%
Selling, general and administrative exp.	6,884	6,744	2.1%	15,227	15,095	0.9%
Operating income	2,866	5,370	(46.6)%	2,690	7,627	(64.7)%
Earnings before income taxes	2,178	4,836	(55.0)%	1,355	6,654	(79.6)%
Net earnings	1,515	3,009	(49.7)%	873	4,118	(78.8)%
Earnings per common share - diluted	\$ 0.33	\$ 0.66	(50.0)%	\$ 0.19	\$ 0.90	(78.9)%

As indicated in the table above, in the three months ended June 30, 2007, net sales and gross profits declined by 10.5% and 19.5%, as compared to the same period in 2006. In the six months ended June 30, 2007, sales declined by 12.8% and gross margin declined by 21.1%. We believe that those declines were primarily attributable to higher interest rates and increased gasoline prices, which made purchases and the usage of RVs more expensive. As a result, net income declined by approximately \$1.5 million or 50% in the three months, and by approximately \$3.2 million or 79% in the six months, ended June 30, 2007.

Table of Contents

Accounting Policies and Estimates

General

In accordance with accounting principles generally accepted in the United States of America (GAAP), we record most of our assets at the lower of cost or fair value. In the case of some of our assets, principally accounts receivable, inventories and deferred income taxes, we make adjustments to their cost or fair values to arrive at what we expect to be able to collect on outstanding accounts receivables, the amounts for which we expect to be able to sell our inventories and the amounts of available tax deductions that we will be able to use to reduce our future income tax liability. Those adjustments are made on the basis of a number of different factors, including judgments or assumptions we make regarding economic and market conditions and trends and their impact on our financial performance, and those judgments and assumptions are, in turn, based on current information available to us. If those trends or conditions were to change in ways that we did not expect, then based on our assessment of how those changes will affect the prospects for realizing the values at which we have recorded these assets, we may be required, pursuant to GAAP, to further adjust the carrying values at which we record these assets for financial reporting purposes. Any resulting downward adjustments are commonly referred to as write-downs of the assets affected by the changed conditions.

It is our practice to establish reserves or allowances against which we are able to charge any downward adjustments or write-downs to those assets. Examples include an allowance established for uncollectible accounts receivable (sometimes referred to as bad debt reserves) and an allowance for inventory obsolescence. The amounts at which those allowances are established and maintained are based on our historical experience and also on our assumptions and judgments about economic or market conditions or trends or any other factors that could affect the values at which we had recorded such assets. Those allowances are periodically increased to replenish the allowances following write-downs of uncollectible accounts or to take account of increased risks due to changes in economic or market conditions or trends. Increases in the allowances are effectuated by charges to income or increases in expense in our statements of operations in the periods when those allowances are increased. As a result, our judgments or assumptions about market or economic conditions or trends and about their effects on our financial performance can and will affect not only the amounts at which we record these assets on our balance sheet, but also our results of operations.

The decisions as to the timing of (i) adjustments or write-downs of this nature and (ii) the increases we make to our reserves, also require subjective evaluations or assessments about the effects and duration of changes in economic or market conditions or trends. For example, it is difficult to predict whether events or changes in economic or market conditions, such as increasing gasoline prices or interest rates or economic slowdowns, will be of short or long-term duration, and it is not uncommon for it to take some time after the onset of such changes for their full effects on our business to be recognized. Therefore, management makes such estimates based upon the information available at that time and reevaluates and adjusts its reserves and allowances for potential write-downs on a quarterly basis.

Under GAAP, most businesses also must make estimates or judgments regarding the periods during which sales are recorded and also the amounts at which they are recorded. Those estimates and judgments will depend on such factors as the steps or actions that a business must take to complete a sale of products or to perform services for a customer and the circumstances under which a customer would be entitled to return the products or reject or adjust the payment for services rendered to it. Additionally, in the case of a business that grants its customers contractual rights to return products sold to them, GAAP requires that a reserve or allowance be established for product returns by means of a reduction in the amount at which its sales are recorded, based primarily on the nature, extensiveness and duration of those rights and its historical return experience.

In making our estimates and assumptions we follow GAAP and accounting practices applicable to our business that we believe will enable us to make fair and consistent estimates of the carrying values of those assets and to establish adequate reserves or allowances for downward adjustments in those values that we may have to make in future periods.

Table of Contents

Critical Accounting Policies

Set forth below is a summary of the accounting policies that we believe are material to an understanding of our financial condition and the results of operations that are discussed below.

Revenue Recognition and the Allowance for Product Returns. We recognize revenue from the sale of a product upon its shipment to the customer. We provide our customers with limited rights to return products that we sell to them. We establish an allowance for potential returns which reduces the amounts of our reported sales. We estimate the allowance based on historical experience with returns of like products and current economic and market conditions and trends, which can affect the level at which customers submit product returns.

Accounts Receivable and the Allowance for Doubtful Accounts. In the normal course of business we extend 30 day payment terms to our customers and, due to the seasonality of our business, during late fall and winter we grant payment terms of longer duration to those of our customers that have good credit records. We regularly review our customers' accounts and estimate the amount of, and establish an allowance for, uncollectible accounts receivables in each reporting period. The amount of the allowance is based on several factors, including the age of unpaid amounts, a review of significant past due accounts, and current economic and market trends that can affect the ability of our customers to keep their accounts current. Estimates of uncollectible amounts are reviewed periodically to determine if the allowance should be increased, and any increases are recorded in the accounting period in which the events or circumstances that require such increases become known. For example, if the financial condition of customers or economic or market conditions were to deteriorate, adversely affecting their ability to make payments to us on a timely basis, increases in the allowance may be required. Since the allowance is increased or replenished by recording a charge which is included in, and has the effect of increasing, selling, general and administrative expenses, an increase in the allowance will reduce income in the period when the increase is recorded.

Reserve for Excess and Obsolete Inventory. Inventories are valued at the lower of cost (first-in, first-out) or net realizable value and that value is reduced by an allowance for excess and slowing-moving or obsolete inventories. The amount of the allowance is determined on the basis of historical experience with different product lines, estimates or assumptions concerning future economic and market conditions and estimates of future sales. If there is an economic downturn or a decline in sales, causing inventories of some product lines to accumulate, it may become necessary to increase the allowance. Other factors that can require increases in the allowance or inventory write downs are reductions in pricing or introduction of new or competitive products by manufacturers; however, due to the relative maturity of the markets in which the company operates, usually these are not significant factors. Increases in this allowance also will cause a decline in operating results as such increases are effectuated by charges against income.

Allowance for Deferred Income Taxes. We record as a deferred tax asset on our balance sheet the tax loss carryforwards and tax deductions that can be applied in future periods to offset or reduce our future income tax liability. At June 30, 2007, the aggregate amount of that deferred tax asset was approximately \$2.0 million. Under applicable federal and state income tax laws and regulations, tax deductions will expire if not used within specified periods of time. Accordingly, the ability to use this deferred tax asset depends on the taxable income that we are able to generate during those time periods. We have made a judgment, based on historical experience and current and anticipated market and economic conditions and trends, that it is more likely than not that we will be able to generate taxable income in future years sufficient to fully use the deferred tax asset that is recorded in our financial statements. However, if due to future events or circumstances, such as an economic downturn that might adversely affect our operating results, we subsequently come to a different conclusion regarding our ability to fully utilize this asset, it may become necessary to create a valuation allowance in order to reduce the amount at which we record the deferred tax asset. The creation of such an allowance would be effectuated by an increase in the provision (or a reduction in the credit) for income taxes in our statement of income, which would have the effect of reducing our income in the fiscal period in which such provision is recorded.

Long-lived Assets and Goodwill. Long-lived assets, such as property and equipment and goodwill and certain types of intangible assets, are reviewed for possible impairment at least annually or if and when events or changes in circumstances indicate that the carrying value of those assets may not be recoverable in full, based on standards established by SFAS No. 142, by comparing the fair value of the long-lived asset to its carrying amount.

Table of Contents

Foreign Currency Translation. The financial position and results of operations of our foreign subsidiaries are measured using local currency as the functional currency. Assets and liabilities of each foreign subsidiary are translated into U.S. dollars at the rate of exchange in effect at the end of each reporting period. Revenues and expenses are translated into U.S. dollars at the average exchange rate for the reporting period. Foreign currency translation gains and losses not impacting cash flows are credited to or charged against other comprehensive earnings. Foreign currency translation gains and losses arising from cash transactions are credited to or charged against current earnings.

Results of Operations*Net Sales*

Three Months Ended June 30,			Six Months Ended June 30,		
Amounts		% Change	Amounts		% Change
2007	2006	2007 vs. 2006	2007	2006	2007 vs. 2006
(Unaudited)					
\$50,827	\$ 56,777	(10.5)%	\$ 94,465	\$ 108,313	(12.8)%

The declines in net sales during the three and six months ended June 30, 2007 were due primarily to an industry-wide slowdown in purchases and the usage of RVs and boats. That slowdown, we believe, was primarily attributable to increases in gasoline prices and increases in interest rates. Those conditions made the purchase and usage of RVs and boats less affordable, which led consumers to reduce their purchases and usage of RVs and boats, thereby adversely affecting consumer demand for the products we sell.

Gross Margin

Gross profit is calculated by subtracting the cost of products sold from net sales. Cost of products sold consists primarily of the amounts paid to manufacturers and suppliers for the products that we purchase for resale, and warehouse and distribution costs, including freight charges. Gross margin is gross profits stated as a percentage of net sales.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
(In thousands)				
Gross Profit	\$ 9,750	\$ 12,114	\$ 17,917	\$ 22,722
Gross Margin	19.2%	21.3%	19.0%	21.0%

The decrease in our gross margin in the three and six month periods ended June 30, 2007, as compared to the same periods in 2006, was primarily due to the effect of fixed warehouse costs on reduced sales levels and increased costs associated with our proprietary products including freight, product testing, reserves and warranty expense.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses include selling, marketing and advertising expenses, compensation paid to management and administrative personnel, insurance premiums, professional fees, and rent for administrative offices.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
(In thousands)				
Selling, general and administrative expenses	\$ 6,884	\$ 6,744	\$ 15,227	\$ 15,095
As a percentage of net sales	13.5%	11.9%	16.1%	13.9%

Table of Contents

Our SG&A expenses increased by \$140,000, or 2.1%, in the three months ended June 30, 2007 and by \$132,000, or 0.9%, in the six months ended June 30, 2007 as compared to their respective corresponding periods of 2006. Despite those modest increases in the dollar amounts of SG&A expenses, as a percentage of net sales those expenses increased to 13.5% in the three months ended June 30, 2007, from 11.9% in the same three months of 2006, and to 16.1% in the six months ended June 30, 2007 from 13.9% in the same six months of 2006. Those increases were primarily the result of the decline in net sales in the three and six months ended June 30, 2007.

Other Expense

Other Expense consists almost entirely of the interest we pay on our outstanding borrowings under our revolving bank credit facility.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Other Expense				
Interest expense	\$ 699	\$ 540	\$ 1,238	\$ 921
Other	(11)	(6)	97	52
Total	\$ 688	\$ 534	\$ 1,335	\$ 973
As a percentage of net sales	1.4%	0.9%	1.4%	0.9%

The increase in other expense in the three months and six months ended June 30, 2007, as compared to the same periods of 2006, was primarily the result of increases in the amount of the average borrowings outstanding under that credit facility.

Income Taxes

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Income tax provision	\$ 663	\$ 1,827	\$ 482	\$ 2,536
Effective tax rate	30.4%	37.8%	35.6%	38.1%

Our effective tax rate is affected by the amount of our expenses that are not deductible for income tax purposes and by varying tax rates on income generated by our foreign subsidiaries. The decreases in our effective tax rates in the three and six months ended June 30, 2007, as compared to the same respective periods of 2006, were due in large part to the fact that our subsidiary in Canada, where the effective tax rate is lower, accounted for a higher proportion of our consolidated pre-tax earnings in those periods, as compared to the same respective periods of 2006.

Financial Condition, Liquidity and Capital Resources

We finance our working capital requirements for our operations primarily with borrowings under a long-term revolving bank credit facility and internally generated funds. Under the terms of that revolving credit facility, which expires in May 2010, we may borrow up to the lesser of (i) \$50,000,000 during the period from March through July, and from \$40,000,000 during the period from August through February, of each year, or (ii) an amount equal to 80% of eligible accounts receivable and between 50% to 55% of eligible inventory. Interest on the revolving credit facility is payable at the bank's prime rate or, at the Company's option but subject to certain limitations, at the bank's LIBOR rate, plus 1.25 percent.

Borrowings under our credit facility increased by \$10,569,000 in the six months ended June 30, 2007 and \$6,805,000 in the six months ended June 30, 2006.

At August 1, 2007, outstanding bank borrowings totaled \$25,910,000. Our bank borrowings are secured by substantially all of our assets, and rank senior in priority to other indebtedness of the Company.

Table of Contents

We generally use cash for, rather than generate cash from, operations in the first half of the year, because we build inventories, and accounts receivables increase, as our customers begin increasing their product purchases for the spring and summer months when product sales increase due to seasonal increases in the usage and purchases of RVs and boats. See *Seasonality and Inflation* below.

During the six months ended June 30, 2007, our accounts receivable increased by \$12,952,000 as compared to an increase of \$10,881,000 in the same period of 2006. These increases are due primarily to the seasonality of our business as customers make most of their purchases from us in the first five months of the year in preparation for the summer selling months.

We increased our inventories significantly at the end of December 31, 2006 in anticipation of purchase orders from After-Market customers in the first half of 2007. As a result, we did not have to increase our inventories during the first six months of 2007. By comparison, we increased inventories by \$5,013,000 in the six months ended June 30, 2006.

We made capital expenditures of \$852,000 in the six months ended June 30, 2007 and \$130,000 in the comparable period in 2006. These expenditures in 2007 were primarily for testing equipment for our new testing and design facility in Elkhart, Indiana and for the planned expansion of our St. Bruno, Quebec distribution center. In 2006, we made capital expenditures primarily for computer enhancements and purchases of telephone and warehouse equipment.

We lease the majority of our facilities and certain of our equipment under non-cancelable operating leases. Our future lease commitments are described in Note 4 of Notes to the Company's Interim Condensed Consolidated Financial Statements included elsewhere in this report. The following table sets forth the total and the maturities of our contractual obligations, in thousands of dollars, at December 31, 2006:

Contractual Obligations at December 31, 2006	Total	Less Than			More than 5 years
		1 Year	1-3 Years	4-5 Years	
(In thousands)					
Contractual Obligations:					
Long-Term debt obligations	\$ 23,979	\$	\$ 23,979	\$	\$
Capital lease obligations	\$ 508	137	260	111	
Operating lease obligations	\$ 26,771	4,161	7,338	5,102	10,170
Total	\$ 51,258	\$ 4,298	\$ 31,577	\$ 5,213	\$ 10,170

Dividends. In the third quarter of 2006, the Company's Board of Directors increased the quarterly cash dividend to \$0.07 per share from \$0.05 per share. As a result, the Company paid cash dividends of \$621,000 in the six months ended June 30, 2007, as c