

COAST DISTRIBUTION SYSTEM INC  
Form 10-Q  
August 14, 2007  
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**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

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**THE COAST DISTRIBUTION SYSTEM, INC.**

**QUARTERLY REPORT ON FORM 10-Q**

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

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| 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)**

|  | <b>June 30,<br/>2007<br/>(unaudited)</b> | <b>December 31,<br/>2006</b> |
|--|--|------------------------------|
| <b>ASSETS</b>  |  |                              |
| <b>CURRENT ASSETS</b>  |  |                              |
| 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                    |
| <b>LIABILITIES</b>   |  |                              |
| <b>CURRENT LIABILITIES</b>   |  |                              |
| 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                       |
| <b>STOCKHOLDERS EQUITY</b>   |  |                              |
| 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.



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**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<br>June 30, |           | Six Months Ended<br>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)**

|   | <b>2007</b> | <b>2006</b> |
|---|-------------|-------------|
| 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<br>Ended June 30, |          | Six Months Ended<br>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<br>June 30, |           | Six Months Ended<br>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<br>June 30, |          | Six Months Ended<br>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.

|                             | <b>Six Months Ended June 30,</b> |             |
|-----------------------------|----------------------------------|-------------|
|                             | <b>2007</b>                      | <b>2006</b> |
| <b>Stock Option Plans:</b>  |                                  |             |
| 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     |
| <b>Stock Purchase Plan:</b> |                                  |             |
| 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<br>Exercise Price | Weighted-Average<br>Remaining<br>Contractual Term | Aggregate<br>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<br>Exercise Price | Weighted-Average<br>Remaining<br>Contractual Term | Aggregate<br>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<br>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                         |                |   |
| <b>Nonvested at June 30, 2007</b> | <b>359,000</b> | <b>\$ 7.28</b>                                |
|                                   |                |   |
|                                   | <b>Shares</b>  | <b>Weighted Average Grant Date Fair Value</b> |
| Nonvested at December 31, 2005    | 122,000        | \$ 5.68                                       |
| Granted                           | 74,000         | 7.25  |
| Vested                            |                |   |
| Forfeited                         |                |   |
| <b>Nonvested at June 30, 2006</b> | <b>196,000</b> | <b>\$ 6.27</b>                                |

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.

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**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  |          |
|  | (Dollars in thousands, except per share amounts) |           |          |                           |            |         | 2007     |
|  |  |           |          |                           |            |         | vs. 2006 |
| 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.

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### **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.



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### *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.

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*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%     |

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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<br>June 30, |        | Six Months Ended<br>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<br>June 30, |          | Six Months Ended<br>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.



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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<br>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               |
| <b>Total</b>                                 | <b>\$ 51,258</b> | <b>\$ 4,298</b> | <b>\$ 31,577</b> | <b>\$ 5,213</b> | <b>\$ 10,170</b>     |

*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 compared to \$442,000 in the comparable period in 2006.

*Share Repurchases.* In 2005, the Board of Directors authorized the repurchase by us of up to \$2,940,000 of our shares of common stock in open market or private purchases. We repurchased approximately \$108,000 and \$599,000 of our shares in the six months ended June 30, 2007 and 2006, respectively.

*Expected Uses and Sources of Funds.* We expect our principal uses for cash in the year ending December 31, 2007 will be to fund operations and capital expenditures, cash dividends and share repurchases, and we anticipate that we will be able to fund those cash requirements in 2007 with borrowings under our revolving credit facility and internally generated funds. We do not currently anticipate any material changes in our cash requirements or the sources of funds for our operations during the remainder of 2007.

However, we will continue to explore opportunities to increase our sales and our market shares and to improve our profit margins. We plan to establish new product supply relationships, including relationships that enable us to increase the products that we source from lower cost, but high quality, overseas suppliers, including product suppliers in China and other countries in the Far East, and in Canada, Europe and the United States, and to invest in tooling needed for such products. We also may seek to take advantage of other growth opportunities if and

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when they may arise. As a result, we may have occasion in the future to use internally generated funds or bank borrowings for these purposes.

### **Seasonality and Inflation**

*Seasonality.* Sales of recreational vehicle and boating parts, supplies and accessories are seasonal. We have significantly higher sales during the six-month period from March through August than we do during the remainder of the year. Because a substantial portion of our expenses do not vary as a result of changes in our net sales, operating income declines and the Company sometimes incurs losses and must rely more heavily on borrowings to fund operating requirements in the months when sales are lower.

*Inflation.* Generally, we have been able to pass inflationary price increases on to our customers. However, inflation also may cause or may be accompanied by increases in interest rates and gasoline prices. Such increases, or even the prospect of increases in the price or shortages in the supply of gasoline, can adversely affect the purchase and usage of RVs and boats, which can result in a decline in the demand for our products.

### **Forward Looking Information and Factors that Could Affect Our Future Financial Performance**

Statements contained in this Report that are not historical facts or that discuss our expectations, beliefs or views regarding our future operations or future financial performance or trends in our business constitute forward-looking statements. Forward-looking statements often include the words believe, expect, anticipate, intend, plan, estimate, project, or words of similar meaning, or future or conditional verbs such as should, could, or may. Forward-looking statements usually consist of estimates or predictions of our future financial performance or financial condition, or are statements about our assessment of financial or market trends that may affect our future results of operations. Those estimates and predictions are based upon current information and are subject to a number of risks and uncertainties that could cause our actual operating results or our financial performance or condition in future periods to differ significantly from those expected at the current time. Those risks and uncertainties include, although they are not limited to, the following:

*Our Business is Seasonal and is Subject to Various Economic and Climatic Influences.* Our sales are affected directly by the purchase and usage levels of RVs and boats. The purchase and usage of RVs and boats are affected by consumers' level of discretionary income and their confidence about economic conditions; weather conditions; prevailing interest rates; and the availability and prices of gasoline. As a result, our future sales and earnings can be, and in the past have been, adversely affected by the following:

Loss of confidence among consumers regarding economic conditions and the onset of economic recessions, which cause consumers to reduce their purchases and usage of RVs and boats;

Increases in interest rates which affect the availability and affordability of financing for RVs and boats and accessories for RVs and boats;

Increases in the price and shortages in the supply of gasoline, which increase the costs of using, and the willingness of consumers to purchase and use, RVs and boats; and

Unusually severe or extended winter weather conditions, which 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 which can cause period-to-period fluctuations in our sales and financial performance.

These conditions also often lead to increased price competition in our markets which could force us to reduce our prices, thereby reducing our sales revenue and our gross profit margins and earnings.

*We rely heavily on bank borrowings in the operation of our business.* We rely heavily on bank borrowings to fund our working capital requirements and capital expenditures. Our outstanding borrowings create additional risks for our business. Among other things, we may find it more difficult to obtain additional financing to fund expansion or take advantage of other business opportunities, and we use a substantial portion of our cash flow from



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operations to pay the principal and interest on our debt. Our existing debt also makes us more vulnerable to general economic downturns and competitive pressures, which could cause us to fail to meet financial covenants in our bank loan agreement and, the interest we have to pay on such debt impacts our operating results.

*Reliance on Sole Sources of Supply for Certain of our Products.* We sometimes choose to carry only a single manufacturer's products for certain of the brand-name product lines that we sell. In addition, we obtain each of our proprietary products from a single source manufacturer, although in many instances we own the tooling required for their manufacture. Dependence on a single manufacturer for any product or line of related products, however, presents some risks, including the risk that we will be unable to readily obtain alternative product supply sources in the event that a single source supplier (i) encounters quality or other production problems, or (ii) decides to enter into an exclusive supply arrangement or alliance with a competing distributor, or to vertically integrate its operations to include not only manufacturing, but also distribution, of its products. If any of our single source suppliers were to encounter any manufacturing problems or disruptions or terminate our supply relationship, our sales and earnings could decline, possibly to a significant extent.

*The Effects of Possible Changes in Supply Relationships in Our Markets.* As is the customary practice in our markets, in most instances we do not have long term supply contracts with our product suppliers. As a result, product suppliers are free to change the terms on which they will sell us product or to discontinue supplying us with products altogether, because they may choose to distribute their products directly to after-market dealers or because they might choose to establish exclusive supply relationships with other distributors. Additionally, manufacturers of new RVs and boats may choose to incorporate optional equipment on the RVs and boats at the time of manufacture that, historically, were sold to their dealers by distributors such as the Company. Any of these occurrences could result in increased competition in our markets or reduce the number of products we are able to offer our customers, which could cause our sales to decline and could result in lower margins and reduced earnings.

*Risks Related to New Proprietary Products Strategy.* We have begun sourcing and buying from overseas manufacturers and marketing and selling new products into new markets. We do not have experience in marketing and selling products in some of those markets and there is no assurance that these products will gain acceptance among customers in those markets. We also expect to encounter stiff competition from companies that manufacture or market competing products. We expect that many of those companies will be larger and will have greater financial and marketing resources than we have. Also, we will have greater responsibilities in marketing and providing warranty protection and service for these products. There is no assurance that we will be successful in marketing and selling these products, and the costs we incur in doing so may reduce our earnings or possibly even cause us to incur losses and we could encounter liabilities for possible warranty claims relating to these products.

*Product liability Risks.* Although we do not manufacture any of the products we sell, it is not uncommon for us to be named as an additional defendant in product liability lawsuits brought against the product manufacturers. To protect ourselves from liability, in many instances we have been able to obtain indemnification agreements from these manufacturers or to be named as additional insureds under their product liability insurance policies. Nevertheless, we also maintain our own product liability insurance. Although we have never incurred any material product liabilities in excess of the insurance coverages that we have obtained under policies of insurance maintained by product manufacturers or by us, there is no assurance that we will not incur, in the future, product liabilities in amounts that materially exceed the insurance coverage and indemnification protections that we have.

*No Assurance that We Will Be Able to Fund Cash Dividends Pursuant to our Dividend Policy.* Although the Board of Directors has adopted a cash dividend policy that provides for regular quarterly cash dividends of \$0.07 per share, the payment of cash dividends in the future will depend on a number of factors, including, but not limited to, our future financial performance and our available cash resources and the cash requirements of our business and possibly also, the consents of third parties, such as the lender under our revolving credit facility. As a result, there can be no assurance that future quarterly dividends will be equal to the \$0.07 per share called for by our current dividend policy or that we will not find it necessary to suspend or even terminate the payment of cash dividends in the future.

Other risks that could affect our future financial performance are described in Item 1A, entitled "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2006 filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended, and readers are urged to review those risks as well.

Due to these and other possible uncertainties and risks, readers are cautioned not to place undue reliance on forward-looking statements contained in this Report, which speak only as of the date of this report. We also disclaim any obligations to update forward-looking information contained in this report, whether as a result of new information, future events or otherwise.



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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our exposure to market risk with respect to financial instruments is primarily related to changes in interest rates with respect to borrowing activities, which may adversely affect our financial position, results of operations and cash flows. To a lesser degree, we are exposed to market risk from foreign currency fluctuations associated with our Canadian operations and our Canadian currency denominated debt. We do not use financial instruments for trading or other speculative purposes and are not party to any derivative financial instruments.

In seeking to minimize the risks from interest rate fluctuations, we manage exposures through our regular operating and financing activities. The fair value of borrowings under our revolving credit facility approximates the carrying value of such obligations. As of June 30, 2007, we had outstanding approximately \$35.1 million under our revolving credit facility.

We sometimes enter into forward exchange agreements to reduce the effect of foreign currency fluctuations on a portion of our inventory purchases in Canada for our Canadian operations. The gains and losses on these contracts are reflected in earnings in the period during which the transactions being hedged are recognized. We believe that these agreements do not subject us to significant market risk from exchange rate movements because the agreements offset gains and losses on the balances and transactions being hedged. As of June 30, 2007, there were no such agreements outstanding.

Approximately 21% of our bank debt is denominated in Canadian currency, which also exposes us to market risk associated with exchange rate movements. Historically, we have not used derivative financial instruments to manage our exposure to foreign currency rate fluctuations since the market risk associated with our foreign currency denominated debt has not been considered significant.

**ITEM 4. CONTROLS AND PROCEDURES**

Our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under Securities Exchange Act of 1934, as amended (the Exchange Act ), are designed to provide reasonable assurance that information required to be disclosed in our reports filed under that Act, such as this Quarterly Report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified in the rules of the Securities and Exchange Commission. Our disclosures controls and procedures also are designed to provide reasonable assurance that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures in effect as of June 30, 2007. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2007, our disclosure controls and procedures were effective to provide reasonable assurance that material information relating to the Company and its consolidated subsidiaries, required to be included in our Exchange Act reports, including this Quarterly Report on Form 10-Q, is made known to management, including the Chief Executive Officer and Chief Financial Officer, on a timely basis.

There was no change in our internal control over financial reporting that occurred during the quarter ended June 30, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II****ITEM 1A. RISK FACTORS**

Except for any updates set forth in Item 2 of Part I of this Report, under the caption Forward Looking Information and Factors that Could Affect Our Future Financial Performance, there were no material changes in the risk factors that were disclosed in Item 1A, under the caption Risk Factors in Part I of our Annual Report on Form 10-K for our fiscal year ended December 31, 2006.

**ITEM 2. UNREGISTERED SALES OF SECURITIES AND USE OF PROCEEDS****Share Repurchases.**

The following table sets forth information regarding our share repurchases in each of the months during the quarter ended June 30, 2007.

|                                   | (a)                              | (b)                          | (c)   | (d)   |
|-----------------------------------|----------------------------------|------------------------------|---|---|
|                                   | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Programs | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Programs |
| April 1 to April 30, 2007         | 0                                | \$                           |   | \$ 545,615  |
| May 1 to May 31, 2007             | 880                              | \$ 6.90                      | 880   | \$ 539,543  |
| September 1 to September 30, 2007 | 0                                | \$                           |   | \$ 539,543  |
| Total                             | 880                              | \$ 6.90                      | 880   |   |

The above shares were purchased pursuant to a stock repurchase program that was publicly announced on June 3, 2005 and at that time authorized up to \$1.5 million of share repurchases. On December 9, 2005, the Company publicly announced that its Board of Directors had authorized the Company to make up to an additional \$1.2 million of share repurchases under this program. This program does not have an expiration date and it is the Company's current intention to make additional share purchases under this program. However, the Company may elect (i) to suspend share repurchases at any time or from time to time, or (ii) to terminate the program prior to the repurchase of all of the shares authorized for repurchase under this program. Accordingly, there is no assurance that any additional shares will be repurchased under this program.

**ITEM 6. EXHIBITS**

| Exhibit No.  | Description of Exhibit   |
|--------------|--|
| Exhibit 31.1 | Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 31.2 | Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 32.1 | Certification of Chief Executive Officer under Section 906 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 32.2 | Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002 |



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**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.

THE COAST DISTRIBUTION SYSTEM, INC.

Dated: August 14, 2007

By: /s/ SANDRA A. KNELL  
Sandra A. Knell

Executive Vice President and

Chief Financial Officer

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**INDEX TO EXHIBITS**

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