

KEYSTONE AUTOMOTIVE INDUSTRIES INC
Form 10-K
June 14, 2006
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended March 31, 2006

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: 0-28568

KEYSTONE AUTOMOTIVE INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

California	95-2920557
(State or other jurisdiction)	(I.R.S. Employer
of incorporation or organization)	Identification Number)
700 East Bonita Avenue, Pomona, California 91767	
(Address of principal executive offices) (Zip Code)	

Registrant's telephone number, including area code: (909) 624-8041

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

None

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

Common Stock, no par value

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of the voting stock held by nonaffiliates of the registrant based upon the closing sales price of its Common Stock on September 30, 2005 on the Nasdaq National Market was approximately \$465.5 million. For purposes of the foregoing calculation, shares of Common Stock held by each officer and director and by each person who may be deemed to be an affiliate have been excluded.

The number of shares of Common Stock outstanding as of June 1, 2006: 16,290,668.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III is incorporated by reference to portions of the Registrant's definitive proxy statement for the 2006 Annual Meeting of Stockholders which will be filed with the Securities and Exchange Commission within 120 days after the close of the 2006 fiscal year.

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FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), that involve risks and uncertainties, such as statements of the Company s strategies, plans, objectives, expectations and intentions. The Company s actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under Risk Factors in Item 1A below and elsewhere in this Annual Report. The cautionary statements made in this Annual Report should be read as being applicable to all related forward-looking statements wherever they appear in this Annual Report.

PART I

ITEM 1. BUSINESS

General

Keystone Automotive Industries, Inc. (Keystone or the Company) is the nation s leading distributor of aftermarket collision replacement parts produced by independent manufacturers for automobiles and light trucks. Keystone distributes products primarily to collision repair shops throughout most of the United States and certain areas in Canada. In addition, the Company recycles and produces chrome plated and plastic bumpers and remanufactures alloy and steel wheels. The Company s principal product lines consist of automotive body parts, bumpers and remanufactured alloy wheels, as well as paint and other materials used in repairing a damaged vehicle. Keystone currently offers more than 19,000 stock keeping units to over 25,000 collision repair shop customers, out of an estimated 51,000 shops nationwide. Founded in Southern California in 1947, the Company operates a hub and spoke distribution system consisting of 136 distribution centers, 22 of which serve as regional hubs, and 14 depots, located in 38 states throughout the United States, as well as in the provinces of Ontario, Quebec and British Columbia in Canada. From these distribution centers, Keystone has over 1,700 customer service and salespersons who call on or have contact with collision repair shops. In addition, the Company operates 13 wheel remanufacturing facilities and 54 plastic and steel bumper recycling facilities. The Company is currently organizing an operation in northeast Mexico to remanufacture plastic bumpers.

The Company became certified as an ISO 9001 distributor in September 2002. ISO 9001 implementation policies and procedures include quality and service, performance, lot traceability, customer satisfaction and complaint resolution. The Company believes that it is one of only a few companies in its industry which is ISO 9001 certified.

To emphasize the high quality of aftermarket parts distributed by Keystone, the Company instituted its Keystone Platinum Plus program in September 2000. This program carries only the highest quality parts, which are covered by a limited lifetime warranty for as long as the owner of the repaired vehicle maintains ownership. The Company believes that Platinum Plus is the first and only premium brand of independently produced collision replacement parts. To date, Platinum Plus product categories include radiators and condensers, wheels, grilles, lights, hoods, fenders and certain bumpers. The Company continually adds additional products to the Platinum Plus program.

The Company makes available its quarterly, annual and other periodic and current reports required by the Securities and Exchange Commission (the SEC), and any amendments to such reports, as well as other information about the Company, including its Code of Conduct and Ethics, on its corporate website (www.keystone-auto.com), free of charge, to individuals interested in acquiring such reports. The reports can be accessed at www.keystone-auto.com (under Investor Info or Corporate Governance) as soon as reasonably practicable after the reports are electronically filed with the SEC.

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Industry Overview

History. More than a majority of the collision parts market consists of parts produced by or for the original equipment manufacturers of the vehicles (OEMs). A substantial number of collision parts are available exclusively from OEMs and are likely to remain so. The balance of the collision parts market consists of parts supplied by the aftermarket distributors, such as the Company, and parts obtained from salvage vehicles. The growth in sales of aftermarket collision parts over the last decade has been due primarily to the increased availability of quality parts and to cost containment efforts by the insurance industry.

During the 1960s and 1970s, due to prohibitive tariffs in Taiwan on imported automobiles and restrictions on foreign ownership of manufacturing facilities in Taiwan, certain Taiwanese automobile manufacturers commenced producing automobiles for sale in Taiwan, which created the need for additional parts manufacturers to supply the assembly lines. Since the early 1980s, these Taiwanese manufacturers have sought to reduce the effect on their business of the cyclical demand for new automobiles by producing aftermarket collision parts. Prior to 1980, automotive collision parts were almost exclusively manufactured by OEMs.

The Company estimates that approximately 85% of all automobile collision repair work is paid for in part by insurance. Accordingly, major insurance companies exert significant influence over the selection of collision parts used by collision repair shops. The availability of aftermarket collision parts has been a major factor in the insurance industry's efforts to contain the escalating cost of collision repairs.

Aftermarket collision parts generally sell for between 20% and 40% less than comparable OEM parts, resulting in substantial savings for insurance companies by providing consumers with less expensive aftermarket parts and creating competition, often resulting in lower prices for comparable OEM parts. This also positively impacts insurance premiums for consumers. The Company believes that it may be somewhat insulated from downturns in the general economy as a result of the fact that most automobile collision repair work is paid for in part by insurance.

Quality Assurance. In 1987, the Certified Automotive Parts Association (CAPA) was founded to provide insurance companies, distributors, collision repair shops and consumers with an objective method of evaluating the functional equivalence of aftermarket collision parts and OEM collision parts. CAPA, a non-profit association of insurance companies, manufacturers, importers, distributors, collision repair shops and consumer groups, establishes the specifications for, tests and certifies the quality of aftermarket automotive collision parts. Through independent testing laboratories, CAPA develops engineering specifications for aftermarket collision parts based upon an examination of OEM parts; certifies the factories, manufacturing processes and quality control procedures used by independent manufacturers; and certifies the materials, fit and finish of specific aftermarket collision parts. Most major insurance companies have adopted policies recommending or requiring the use of parts certified by CAPA, when available. The Company distributes parts certified by CAPA when available and actively participates with CAPA, insurance companies and consumer groups in encouraging independent manufacturers of collision parts to seek CAPA certification.

The Company generally meets the requirements of the Manufacturers' Qualification and Validation Program (MQVP). MQVP defines expectations and part quality requirements for manufacturers, suppliers and distributors of aftermarket collision parts. The Company's implementation of the ISO 9001 program and participation in MQVP reflects its commitment to quality parts and customer satisfaction.

Strategy

The Company's growth strategy involves a combination of increased sales to existing customers, increased penetration of markets Keystone is currently serving, the introduction of new products and expansion into new

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markets through acquisitions and start-ups. Higher sales of existing products reflects increased demand for our premium brand Platinum Plus product line and a concerted effort by the sales force to sell our full line of products to each of our customers. The Platinum Plus product line and the Company's participation in quality programs such as CAPA and MQVP are key to increasing our penetration of existing markets. While Keystone has the largest distribution network of any aftermarket crash parts distributor, it believes that there are important markets not now served which can be accessed either through the acquisition of an existing distributor or the opening a new distribution center.

In addition to growing sales, management has put in place a number of initiatives designed to improve profitability and leverage the Company's increasing sales, including: improving inventory turns and fulfillment rates to our customers; ongoing enhancements to the Company's management information systems which should aid in managing business operations, a vigorous budgeting process and the development and retention of a highly productive workforce.

Products

The Company distributes more than 19,000 stock keeping units of aftermarket collision parts and repair materials for most popular models of domestic and foreign automobiles and light trucks, generally for the eight most recent model years. The Company's principal product lines consist of automotive body parts, bumpers, paint and other materials, remanufactured alloy wheels, autoglass and light truck accessories. In addition, the Company recycles, produces and distributes new and remanufactured plastic and chrome bumpers to wholesale bumper distributors and to manufacturers of truck accessories.

Automotive Body Parts. The Company distributes automotive and light truck parts manufactured by multiple foreign and domestic manufacturers, including fenders, hoods, radiators and condensers and head and tail light assemblies. These products accounted for approximately \$322.9 million, or 51.4% of the Company's net sales in the fiscal year ended March 31, 2006.

Bumpers. The Company distributes new and remanufactured plastic bumper covers and steel bumpers manufactured by multiple domestic and foreign manufacturers. For the fiscal year ended March 31, 2006, sales of plastic and steel bumpers accounted for approximately \$188.3 million, or 30.0% of the Company's net sales. The Company believes that it is one of the nation's largest non-OEM providers of new and recycled chrome plated bumpers for the collision repair and restoration markets.

Beginning in the late 1970s and the early 1980s, manufacturers of new automobiles began changing from an almost exclusive use of chrome plated steel bumpers to painted plastic bumpers. By the 1996 model year, manufacturers were using painted plastic bumpers almost exclusively for their automobiles. Chrome plated steel bumpers are still used extensively on light trucks and sport utility vehicles. On an annual basis, the Company electroplates approximately 22,000 steel plated bumpers for automobiles and light trucks. Bumpers used in the operations include new steel stampings, collision-damaged bumpers that require straightening and replating and older model or antique bumpers that require restoration and replating. The bumper repair and replating process generally includes some or all of the following steps: straightening or reforming to original dimensions; welding breaks or cracks; surface grinding to remove rust and corrosion; chemical stripping to remove the original electroplated finishes; metal polishing and buffing; electroplating layers of copper, nickel and chromium; and inspecting and packaging.

Paint and Related Materials. The Company distributes paint and other materials used in repairing a damaged vehicle, including sandpaper, abrasives, masking products and plastic filler. The paint and other materials distributed by the Company are purchased from numerous domestic suppliers. For the fiscal year ended March 31, 2006, sales of paint and other materials accounted for approximately \$60.7 million, or 9.7% of the Company's net sales. Certain of these products are distributed under the name Keystone.

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Wheels and Related Products. The Company operates 13 facilities which remanufacture collision damaged alloy wheels and one plant that recycles steel wheels. The average wholesale cost of a new replacement alloy wheel is approximately \$225, compared to an average wholesale cost of approximately \$125 for a remanufactured alloy wheel. The alloy wheel remanufacturing process generally includes some or all of the following steps: straightening, welding minor dents or chips, machining, painting and applying clear powder coat. In addition, the Company sells steel wheels, caps and wheel covers. For the fiscal year ended March 31, 2006, sales of wheels and related products accounted for approximately \$52.7 million, or 8.4% of the Company's net sales.

Distribution, Marketing and Sales

The Company's distribution system is designed to provide responsive customer service and to foster long-term customer relations.

Distribution System. The Company has developed a national hub and spoke distribution system consisting of 136 distribution centers, 22 of which serve as regional hubs, and 14 depots. Each regional hub receives container shipments directly from foreign and domestic manufacturers. Using the Company's fleet of approximately 1,700 delivery trucks, each regional hub makes regular shipments to the distribution centers in its region, which in turn make regular deliveries to its repair shop customers. By maintaining a fleet of delivery trucks, the Company ensures rapid delivery within its distribution system and to its customers. In addition, each distribution center can order products directly from any hub or distribution center. The Company manages its inventory and the ordering, shipment, storage and delivery of products primarily through its centralized information system that allows the regional hubs and distribution centers to obtain timely information regarding the location and availability of products. The continuing increase in the number of makes and models of automobiles and light trucks and the number of aftermarket collision parts has increased the pressure on distributors to maintain larger inventories. The Company believes that its hub and spoke distribution system allows it to offer its customers one of the broadest available selections of aftermarket collision parts and to fill most orders within 24 hours. As of June 1, 2006, the Company has opened three crossdock locations to manage the inventory flow from the suppliers to the Company's distribution centers. The goal is to improve inventory availability while at the same time reducing inventory levels.

Sales and Marketing Staff. The Company has a marketing staff, which operates from its corporate headquarters, and has over 1,700 sales and customer service representatives and route salespersons who operate from its distribution centers. The marketing staff develops all marketing and promotional materials, assists the service centers in recruiting and training sales representatives, route salespersons and customer service representatives. In addition, the marketing staff conducts educational programs for regional insurance executives and claims adjusters to explain the role of aftermarket collision parts in containing the escalating costs of claims and in order to facilitate the implementation of insurance companies' policies favoring aftermarket collision parts.

The general managers of the Company's service centers are actively involved in customer calls. The Company believes that this local control and expertise have contributed significantly to its growth. Through periodic training programs and performance reviews, the Company seeks to enhance the professionalism and technical expertise of its route salespersons. As a result, the Company believes that its route salespersons are highly attendant to the needs of the Company's customers.

Marketing Programs. The Company offers various marketing programs to foster closer customer relations, including a warranty program in which the Company generally warrants its products against defects in material and workmanship for as long as the repair shop's customer owns the vehicle.

Customers

The Company's current customers consist primarily of more than 25,000 collision repair shops located in all 50 states, the District of Columbia and in the provinces of Ontario, Quebec and British Columbia in Canada,

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none of which accounted for more than 1% of the Company's net sales during the fiscal year ended March 31, 2006. The Company also distributes its bumpers to wholesale distributors and to manufacturers of truck accessories. The size of its customer base reduces the Company's dependence on any single customer and its national scope tends to mitigate the effects of regional economic changes and regional weather patterns. The Company estimates that there are over 51,000 collision repair shops nationwide.

The Company also sells collision parts to local distributors who may compete with the Company. These sales accounted for less than 10% of the Company's net sales during the fiscal year ended March 31, 2006 and no distributor accounted for more than 1% of the Company's net sales for such fiscal year.

Suppliers

The products distributed by the Company are manufactured by over 60 manufacturers, and no single supplier provided more than 10% of the products purchased by the Company during fiscal 2006. The Company believes that it is one of the largest customers of each of its ten largest suppliers. In fiscal 2006, by dollar amount, approximately 44% of the products distributed by the Company were manufactured in the United States or Canada, and approximately 56% were imported directly or indirectly from manufacturers in Asia. The Company's orders from domestic suppliers generally are received within 10 days and orders from foreign manufacturers generally are received in between 45 and 90 days.

In late 2003, the Company entered into manufacture/supply agreements with substantially all of the major suppliers of Platinum Plus products, however, no one agreement is material to the Company. These agreements automatically renew for additional 12 month periods unless written notice is given. Other than as set forth above, the Company has no manufacturing agreements with any of its suppliers. While Keystone competes with other distributors for production capacity, the Company believes that its sources of supply and its relationships with its suppliers are satisfactory.

Information Technology

The Company believes that Information Technology is a strategic tool that can be leveraged to help manage its various locations and operations of the Company. As of June 1, 2005, the Company completed the consolidation of 13 separate management systems to one single distribution management system. Only the Company's Canadian locations remain on a separate system. The primary functions of the system include Sales, Order Processing, Inventory and Warehouse Management, Purchasing and Replenishment, and Financial Management and Reporting. Additional third party software packages have been implemented to leverage the centralized data and information that a single system provides such as a data warehouse to conduct enhanced analytics and reporting, an integrated budgeting system, a supply chain collaboration and EDI tool, and eCommerce tools to enhance the Company's online, Business-to-Business initiative, OrderKeystone.com.

The Company's critical management systems are housed at a third-party, offsite data center that is fully redundant across its infrastructure to ensure operations are continuously maintained. The data center is secure and monitored 24-hours a day throughout the year by competent and skilled technical staff. All hardware used by the Company is from proven providers in the technology industry including the companies that supply data and telecommunication services. Systems are backed up daily and stored offsite with a third party storage and archiving company.

Systems are continually evaluated to ensure all critical systems remain scaleable and operational as the Company continues to grow.

Competition

Based upon industry estimates, the Company believes that more than a majority of collision parts by dollar amount used in the repair of damaged vehicles are supplied by OEMs with the balance being supplied by

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distributors of aftermarket collision parts and by distributors of salvage parts. The Company encounters intense competition from OEMs, all of which have substantially greater financial, distribution, marketing and other resources, including greater brand recognition and a broader selection of collision parts, than the Company. Accordingly, OEMs are in a position to exert pricing and other competitive pressure on the Company. The distribution industry for aftermarket collision parts is highly fragmented and the Company's competitors, other than OEMs, generally are independently owned distributors having from one to three distribution centers. In addition to intense competition from OEMs, the Company is encountering significant competition from other distributors of aftermarket parts including automobile dealerships, who are able to offer repair shops one-stop procurement; distributors of salvage parts, in particular, LKQ Corporation; and buying groups.

The Company competes with OEMs on the basis of price and product quality, and it competes with distributors of aftermarket collision parts primarily on the basis of the competitive advantages provided by its position as the market leader with a nationwide distribution system, its Platinum Plus product line, experienced executive management and service center managers, entrepreneurial corporate culture, superior customer service, its relationship with certain insurance companies, and, to a lesser extent, on the basis of price.

The Company's chrome bumper plating operations compete in the wholesale bumper distribution segment of the market with many small chrome bumper platers or distributors in virtually every geographical market in which it operates. The Company competes with small chrome bumper platers and distributors primarily on the basis of quality and service. Over the last 10 years, there has been a significant decrease in the number of small bumper platers as a result of the decreasing use of chrome plated bumpers on new automobiles and the increasing environmental requirements for electroplaters. The Company believes that this trend will continue, creating more sales opportunities for larger regional chrome bumper platers, who are capable of meeting the increased financial and environmental requirements. The Company also encounters competition from the OEM's who supply new replacement bumpers to the collision repair market and it competes with these OEM's on the basis of price and perceived product quality.

Government Regulation and Environmental Hazards

The Company is subject to increasing restrictions imposed by various federal, state and local laws and regulations. Various state and federal regulatory agencies, such as the Occupational Safety and Health Administration, the United States Environmental Protection Agency (EPA) and the Department of Transportation have jurisdiction over the Company's operations with respect to matters including worker safety, community and employee right-to-know laws, shipping and laws regarding clean air and water. In addition, certain state legislatures and regulators are considering imposing, or have imposed, restrictions on the use of aftermarket collision parts. The General Accounting Office (GAO) report to the United States Congress, released in January 2001, captioned "NHTSA's Ability to Detect and Recall Defective Replacement Crash Parts is Limited" may eventually result in hearings in Congress and possible legislation which could be adverse to the interests of Keystone. See "Risk Factors" below for additional information about governmental activities with respect to aftermarket collision replacement parts.

See "Risk Factors" below for information with respect to the Company's environmental exposure.

Employees

At June 1, 2006, the Company had 3,761 full-time team members, of whom 395 were engaged in corporate management and administration, 1,759 in sales and customer service, 865 in warehousing and shipping and 742 in remanufacturing. None of the Company's team members are covered by collective bargaining agreements. The Company considers its relations with its team members to be satisfactory.

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ITEM 1A. RISK FACTORS

We encounter intense competition from OEMs, all of which have substantially greater financial, distribution, marketing and other resources.

It is estimated that substantially in excess of 50% of collision parts by dollar amount are supplied by OEMs, with the balance being supplied by distributors like the Company and by distributors of salvage parts. The OEMs are therefore in a position to exert pricing pressure in marketplace. We compete with the OEMs primarily on price and to a lesser extent on perceived quality. Recently, several OEMs have experimented with reducing prices on specific products to meet the lower-priced aftermarket products. If such price reductions were to become widespread, it could have a material adverse impact on the Company. In addition, a number of large OEM dealers have recently begun distributing aftermarket collision parts in addition to distributing OEM collision parts, offering collision repair facilities one-stop shopping.

Other OEM direct and indirect activities designed to eliminate the aftermarket as competition have increased our expenses and are designed to threaten our business.

During the past ten years, legislation has been introduced or considered in over 40 states seeking to prohibit or limit the use of aftermarket parts in collision repair and/or require special disclosure before using aftermarket parts in repairs covered by insurance. This legislature is generally introduced and supported at the behest of the OEMs and/or their dealers.

At the present time, legislation regulating the use of aftermarket parts has been adopted in over 40 states. The most common form of regulation, adopted in 35 states, requires disclosure to the vehicle owner that aftermarket crash parts will be used in the repair of the vehicle. An estimated 21 states require the aftermarket part to have the name or logo of the manufacturer affixed to the part. A few states (i) require some form of consent from the vehicle owner before aftermarket parts can be used in the repair, (ii) require that before an aftermarket part can be used in the repair of the vehicle, the part must generally be equal or equivalent in fit, quality and performance to the original equipment part it is replacing or (iii) require the use, under certain circumstances, of aftermarket parts which have been certified by an independent testing facility to be of like kind and quality to the original equipment part. Some states require a combination of the types of regulations described above.

Ford and General Motors are attempting to use litigation based upon claims of infringement of trademarks or design patents against the Company and certain aftermarket manufacturers located in Taiwan to restrict or eliminate the sale of aftermarket parts. If they are successful it could have a material adverse impact on the Company and the entire aftermarket collision parts industry. For details, refer to Item 3. Legal Proceedings below.

We depend upon the continued acceptance of aftermarket collision parts by insurance companies in the repair of policyholders' vehicles.

Based upon industry sources, the Company estimates that approximately 85% of automobile collision repair work is paid for in part by insurance; accordingly, the Company's business is highly dependent upon the continued acceptance of aftermarket collision replacement parts by the insurance industry and the governmental agencies that regulate insurance companies and the ability of insurers to recommend the use of such parts for collision repair jobs, as opposed to OEM parts.

Our business has been negatively impacted by litigation challenging the use of aftermarket collision replacement parts in the repair of vehicles covered by insurance.

Over the past 15 years, there have been numerous lawsuits relating to the use of aftermarket parts in repairing motor vehicles. The majority of these cases have been brought by class action attorneys against

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insurance companies, primarily alleging a violation of the insurance contract and state consumer protection laws because of the specification of aftermarket crash parts for the repair of policyholders' vehicles. Plaintiffs' attorneys allege that aftermarket parts are inferior to OEM parts and thus are incapable of restoring a vehicle to its pre-loss condition as required by many insurance policies.

The leading case involving aftermarket crash parts, *Avery v. State Farm Insurance Company*, was brought in the Circuit Court in Marion, Illinois in July 1997 (Madison County). In that case, plaintiffs asserted claims for breach of contract, consumer fraud and equitable relief relating to State Farm's practice at that time of sometimes specifying aftermarket parts rather than OEM parts when adjusting claims for the damage to insured vehicles. It was alleged that this practice breached State Farm's insurance agreements with its policyholders and was a violation of the Illinois Consumer Fraud and Deceptive Business Practices Act. In October 1999, after a lengthy trial, the jury in *Avery* awarded plaintiffs compensatory damages of approximately \$586 million. In addition, the judge assessed punitive damages against State Farm of over \$600 million. In April 2001, the Appellate Court of Illinois, Fifth District, upheld the verdict, reducing the damages by \$130 million, resulting in an aggregate award of \$1.06 billion. Thereafter, a Petition for Allowance of Appeal to the Illinois Supreme Court was filed by State Farm. In October 2002, the Illinois Supreme Court agreed to hear the appeal. On August 18, 2005, the Illinois Supreme Court reversed the judgments of the Circuit and Appellate Courts resulting in a termination of the case in favor of State Farm. The Illinois Supreme Court denied plaintiffs' request for a rehearing. Plaintiffs filed a writ of certiorari with the United States Supreme Court seeking a reversal of the action by the Illinois Supreme Court. The United States Supreme Court did not grant certiorari and the dismissal of the *Avery* case is now final.

Currently, there are a number of other aftermarket parts cases pending in various jurisdictions across the country, including a statewide class action against the Farmers Group in the State of California. The Company has not been made a party in any of these cases. There can be no assurance, however, that the Company will not be brought into one of these cases or some other aftermarket parts case in the future.

A substantial portion of the Company's business consists of the distribution of aftermarket crash parts to collision repair shops. The vast majority of the customers of the repair shops are covered by insurance policies. In the event aftermarket crash parts are no longer specified by a number of insurance companies to repair insured vehicles, the aggregate cost to consumers could be substantial and the impact on the Company would be material and adverse.

We are dependent upon a relatively small group of suppliers and may be adversely impacted by raw material shortages, primarily steel and nickel and price increases in these materials.

The Company is dependent on a relatively small number of suppliers. Although alternative suppliers exist for substantially all products distributed by the Company, the loss of any one supplier could have a material adverse effect on the Company until alternative suppliers are located and have commenced providing products. In fiscal 2006, approximately 44% of the products distributed by the Company by dollar amount were manufactured in the United States or Canada and approximately 56% were imported directly or indirectly from manufacturers in Asia. As a result, the Company's operations are subject to the customary risks of doing business abroad, including, among other things, transportation delays, political instability, currency fluctuations and the imposition of tariffs, import and export controls and other non-tariff barriers (including changes in the allocation of quotas), as well as the uncertainty regarding future relations between China and Taiwan.

Because a substantial volume of our sales involves parts manufactured from sheet metal, we can be adversely impacted if sheet metal becomes unavailable or is only available at higher prices, which we may not be able to pass on to our customers.

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We rely upon a fleet of our trucks to deliver substantially all of our products to our customers and increases in fuel prices or other difficulties with our fleet may be material to our results of operations.

We use a fleet of trucks to deliver the majority of the products we sell. We are subject to the risks associated with providing trucking services, including inclement weather, disruptions in the transportation infrastructure, availability and price of fuel, liabilities arising from accidents to the extent we are not covered by insurance and insurance premium increases. In addition, our failure to deliver products in a timely and accurate manner could harm our reputation, which could have an adverse effect on our business.

We estimate that our fleet of trucks travel over 67.2 million miles per year and increases in fuel prices have a negative impact on our results of operations.

A decline in the number of collision repairs could have a material adverse impact on the Company.

Because our business depends on vehicle accidents for the demand for repairs using our products, factors which influence the number and/or severity of accidents, including, but not limited to, the number of vehicles on the road, the number of miles driven, the ages of drivers, distracted drivers, the congestion of traffic, the occurrence and severity of certain weather conditions, and the conditions of the roadways impact our business. In this regard, a number of states municipalities have adopted, or are considering adopting, legislation banning the use of handheld cellular telephones while driving and such restrictions could lead to a decline in accidents. Moreover, rising fuel prices may cause the number of vehicles on the road to decline as motorists seek alternative transportation options and this also could lead to a decline in accidents.

We are subject to numerous factors that impact our sales and earnings both short-term and long-term, many of which may be adverse.

We experience intense competition not only from OEMs but from the many distributors located throughout the country. We compete on the basis of price and service with the other distributors and our ability to raise prices depends not only on these competitors but on the prices being charged by the OEMs for similar parts. Aftermarket parts must be priced at a discount to OEM parts to be competitive. Other factors discussed above also impact our results.

While our sales have increased substantially over each of the last five fiscal years and our net income during the last fiscal year was substantially higher than in the prior fiscal year, there can be no assurance that the Company will be able to maintain similar increases in the future.

We rely heavily on Information Technology in most aspects of our business from order entry through billing and collection to financial statement preparation and disruptions may adversely impact our business.

We employ approximately 47 persons in our Information Technology group. In addition, we rely heavily upon third parties for updating our software systems and operating offsite facilities. Disruptions in our relationships with these outside vendors could be material and adverse to the Company. Further, disruptions in our systems would negatively impact our ability to do business with our customers and if the disruptions continued over a period of time could have a material adverse impact on the Company's results of operations.

We are subject to compliance with government laws and regulations, including environmental restrictions.

The Company is subject to increasing restrictions imposed by various federal, state and local laws and regulations. Various state and federal regulatory agencies, such as the Occupational Safety and Health Administration, the EPA and the United States Department of Transportation, have jurisdiction over the Company's operations with respect to matters including worker safety, community and employee

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right-to-know laws, and laws regarding clean air and water. Under various federal, state and local laws and regulations, an owner or lessee of real estate or the operator of a business may be liable for the costs of removal or remediation of certain hazardous or toxic substances located on or in, or emanating from, property owned or used in the business, as well as related costs of investigation and property damage. Such laws often impose such liability without regard to whether the owner, lessee or operator knew of, or was responsible for, the presence of such hazardous or toxic substances. Other than as described below with respect to its bumper plating operations, at two locations, the Company does not currently generate substantial hazardous waste in the ordinary course of its business. The Company believes that it currently is in substantial compliance with all applicable laws and regulations, and is not aware of any material environmental problem at any of its current or former facilities. No assurance can be given, however, that the Company's prior activities or the activities of a prior owner or operator of an acquired service center or other facility did not create a material environmental problem for which the Company could be responsible or that future uses or conditions (including, without limitation, changes in applicable laws and regulations) will not result in material environmental liability to the Company. Furthermore, compliance with legislative or regulatory changes may cause future increases in the Company's operating costs or otherwise adversely affect operations. Certain of the Company's products, such as paints and solvents, are highly flammable. Accordingly, the storage and transportation of these materials expose the Company to the inherent risk of fire. During the past three years, two locations have been destroyed by fire, in each case covered by insurance.

Our Common Stock is subject to significant fluctuations for a variety of reasons, many of which are beyond the control of the Company.

The trading price of the Company's Common Stock may be subject to significant fluctuations as a result of variations in the Company's actual or anticipated operating results, changes in general market conditions and other factors. In recent years, the stock market generally has experienced significant price and volume fluctuations which often have been unrelated or disproportionate to the operating performance of a specific company or industry. There can be no assurance that the market price of the Company's Common Stock will not decline below the current market price or that results in the future may not disappoint and cause an erosion of the stock price.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company's principal executive offices are currently located in Pomona, California, on premises owned by the Company, which contain approximately 11,000 square feet. The Company also leases approximately 7,500 square feet of office space contiguous to the owned property, as well as approximately 3,100 square feet of additional corporate executive offices throughout the United States. In addition, the Company owns facilities used as distribution centers in Chicago, Illinois; Quincy, Illinois; Bethlehem, Pennsylvania; Windber, Pennsylvania; Denver, Colorado; and Palmyra, New Jersey, of which two of the facilities also serve as regional hubs and three serve as wheel remanufacturing facilities. The Company has moved its distribution center in New Albany, Indiana from property owned by the Company to leased premises and has put its property up for sale, for which a sales contract is presently pending. The Company leases its remaining facilities.

Effective April 20, 2006, the Company entered into a 15-year lease commitment on a build-to-suit office complex comprising 52,000 square feet in Nashville, Tennessee. The aggregate base rent obligation for this complex totals \$11,310,000 over the term and includes a purchase option for \$9,200,000. Once completed, the Company's principal executive offices will be located in this facility.

The Company's regional hub facilities range from approximately 30,000 square feet to 238,000 square feet. Its distribution facilities range from approximately 1,500 square feet to 129,000 square feet. All of its leased

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properties are leased for terms expiring on dates ranging from on or about the date hereof to the year 2016, many with options to extend the lease term. The Company believes that no single lease is material to its operations, that its facilities are adequate for the foreseeable future and that alternative sites presently are available at market rates.

Of the Company's distribution centers, seven are leased from parties in which a current officer of the Company has an interest. The Company believes that the terms and conditions of these leases are no less favorable to the Company than could have been obtained from unaffiliated parties in arms-length transactions at the time of the execution of such leases. In addition, leases on two distribution centers were entered into in arms-length negotiations immediately prior to the Veng USA LLC acquisition. After closing, the former owner of Veng USA LLC, became an officer of the Company.

ITEM 3. LEGAL PROCEEDINGS

As previously disclosed, in November 2002 General Motors Corporation instituted a suit against the Company and a Taiwan-based manufacturer in the Federal District Court for the Eastern District of Michigan, Southern Division. The complaint alleges that the Company is distributing replacement grilles for General Motors vehicles with a placeholder matched exactly to the Chevrolet Bow Tie design emblem and the GMC mark emblem, which infringes on General Motors' federal, state and common law trademarks. The suit claims this violates the Lanham Act and constitutes unfair competition under Michigan law. Recent General Motors filings have disclosed that it is seeking compensatory damages of between \$2.0 and \$2.3 million as well as certain equitable relief, including an injunction. In September 2004, General Motors moved for Summary Judgment on the Company's defenses of waiver, ratification and unclean hands. On November 5, 2004, the Company moved for summary judgment on the issues of liability and damages and on the same date, General Motors moved for summary judgment on the issue of liability. After a hearing in May 2005, the Court granted the Company's motion for summary judgment and dismissed General Motors' complaint. On May 24, 2005, General Motors filed a Notice of Appeal and on April 27, 2006, oral argument was heard by the Federal Sixth Circuit Court of Appeals. A decision on the appeal is expected later this summer.

On December 2, 2005, Ford Global Technologies, LLC (Ford) filed a complaint with the United States International Trade Commission (USITC) against the Company and five other named Respondents, including four Taiwan-based manufacturers. On December 12, 2005, Ford filed an Amended Complaint. Both the Complaint and the Amended Complaint charge the Company and the other Respondents with infringement of 14 design patents that Ford alleges cover eight parts on the 2004-2005 Ford F-150 truck (the Ford Design Patents). Ford has asked the USITC to issue a permanent general exclusion order excluding from entry into the United States all automotive parts that infringe the Ford Design Patents and that are imported into the United States, sold for importation in the United States, or sold within the United States after importation. Ford also seeks a permanent order directing the Company and the other Respondents to cease and desist from, among other things, selling, marketing, advertising, distributing and offering for sale imported automotive parts that infringe the Ford Design Patents. On December 28, 2005, the USITC issued a Notice of Investigation based on Ford's Amended Complaint. The USITC's Notice of Investigation was published in the Federal Register on January 4, 2006. On January 23, 2006, the Company filed its Response to the Complaint and Notice of Investigation. In the Response, the Company denies, among other things, that any of the Ford Design Patents is valid and/or enforceable and, accordingly, denies each and every allegation of infringement. The Company further asserts several affirmative defenses, any of which, if successful, would preclude the USITC from granting any of Ford's requested relief. The Administrative Law Judge (ALJ) recently struck the Company's affirmative defenses of patent exhaustion, permissible repair, license and patent misuse. This interlocutory ruling will eventually be reviewed by the USITC Commissioners following the ALJ's ruling on the overall investigation. The ALJ's ruling does not impact the Company's other affirmative defenses. A hearing before the ALJ is scheduled for August 2006. The deadline for the ALJ's ruling is December 4, 2006. The deadline for a determination by the USITC is March 5, 2007. The Company will continue to vigorously defend this action. To date, the Company's sales of these parts have been minimal, but as the design for the 2004 model is incorporated into later year models of the

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F-150 and these trucks have been on the road longer, the sale of aftermarket replacement parts will increase substantially. If the USITC were to uphold each of the 14 design patents in question, it is not anticipated that the loss of sales of these parts over time would be materially adverse to the financial condition or results of operations of the Company. However, depending upon the nature and extent of any adverse ruling, other car manufacturers may attempt to assert similar allegations based upon design patents on a significant number of parts for several of its models, which over time could have a material adverse impact on the entire aftermarket parts industry.

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

None.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED SHAREHOLDER MATTERS**

The Company's Common Stock began trading publicly on The Nasdaq Stock Market under the symbol KEYS on June 20, 1996. The following table sets forth, for the periods indicated, the range of high and low sale prices for Keystone's Common Stock as reported by The Nasdaq Stock Market.

	High	Low
Fiscal 2005		
First Quarter	\$ 28.44	\$ 25.13
Second Quarter	28.74	21.40
Third Quarter	23.78	17.83
Fourth Quarter	23.74	21.00
Fiscal 2006		
First Quarter	\$ 25.59	\$ 19.04
Second Quarter	32.80	23.69
Third Quarter	33.40	25.22
Fourth Quarter	46.92	31.06

On June 7, 2006, the last reported sale price for the Common Stock of the Company, as reported on The Nasdaq Stock Market, was \$41.65 per share. As of June 7, 2006, there were approximately 290 shareholders of record of the Common Stock.

The Company has never paid cash dividends on its Common Stock. The Company currently intends to retain any future earnings to provide funds to operate and expand its business and does not anticipate paying cash dividends on its Common Stock in the foreseeable future. The payment of dividends is within the discretion of the Company's Board of Directors, and will depend upon, among other things, the Company's earnings, financial condition and capital requirements, general business conditions and any restrictions in credit agreements.

The following table sets forth information about the Company's Common Stock that may be issued upon the exercise of stock options under all of the Company's equity compensation plans as of March 31, 2006.

Equity Compensation Plan Information

	(a)	March 31, 2006 (b)	(c)
	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	515,256	\$ 20.15	1,668,078
Total	515,256	\$ 20.15	1,668,078

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The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and notes thereto and Item 7, Management's Discussion and Analysis Financial Condition and Results of Operations also included elsewhere in this Annual Report on Form 10-K.

	Fiscal year ended(1)				
	March 31, 2006	April 1, 2005	March 26, 2004	March 28, 2003	March 29, 2002
(In thousands, except per share amounts)					
Consolidated Statement of Operations Data:					
Net sales	\$ 628,328	\$ 557,705	\$ 501,108	\$ 439,139	\$ 382,274
Cost of sales	346,362	314,792	282,079	247,913	218,475
Gross profit	281,966	242,913	219,029	191,226	163,799
Selling and distribution expenses	189,665	167,721	148,371	129,822	114,276
General and administrative expenses	56,732	54,258	43,333	38,424	32,816
Non-recurring expenses					6,796
Operating income	35,569	20,934	27,325	22,980	9,911
Other income	2,243	2,881	2,235	1,782	1,895
Interest expense	(770)	(259)	(671)	(553)	(698)
Income before income taxes and cumulative effect of a change in accounting principle	37,042	23,556	28,889	24,209	11,108
Income taxes	14,784	9,296	11,167	9,462	4,450
Net income before cumulative effect of a change in accounting principle	22,258	14,260	17,722	14,747	6,658
Cumulative effect of change in accounting principle (net of tax)					(28,691)
Net income (loss)	\$ 22,258	\$ 14,260	\$ 17,722	\$ 14,747	\$ (22,033)
Per Common Share:					
Income (loss) before cumulative effect of a change in accounting principle:					
Basic	\$ 1.39	\$.91	\$ 1.18	\$ 1.01	\$ 0.46
Diluted	\$ 1.38	\$.90	\$ 1.16	\$ 0.99	\$ 0.45
Cumulative effect of a change in accounting principle (net of tax):					
Basic					\$ (1.98)
Diluted					