

MOTORCAR PARTS AMERICA INC

Form 10-Q/A

July 31, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q/A  
(Amendment No. 1)**

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

**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005.**

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

**FOR THE TRANSITION PERIOD FROM TO  
Commission File No. 0-23538  
MOTORCAR PARTS OF AMERICA, INC.  
(Exact name of registrant as specified in its charter)**

New York

11-2153962

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

2929 California Street, Torrance, California

90503

(Address of principal executive offices)

Zip Code

Registrant's telephone number, including area code: (310) 212-7910

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 Act). Yes  No   
There were 8,208,955 shares of Common Stock outstanding at November 11, 2005.

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**EXPLANATORY NOTE**

Explanatory Note: This Form 10-Q/A amends our report on Form 10-Q for the period ended September 30, 2005 to restate our unaudited consolidated financial statements for the three-month and six-month periods ended September 30, 2005 and 2004 that were included in that Form 10-Q. The unaudited quarterly financial statements for each of the three-month and six-month periods ended September 30, 2005 and 2004 have been restated to correct misstatements which occurred when we (i) failed to record unreturned core inventory and core charge revenue for the core portion of certain finished goods sold, (ii) overstated inventory by not properly tracking unreturned core inventory from POS sales and (iii) incorrectly calculated the value of finished goods to be returned from customers through stock adjustments.

Except as required to reflect the effects of the restatement noted above, no attempt has been made in this Form 10-Q/A to modify or update other disclosures presented in the original report on Form 10-Q. Accordingly, this Form 10-Q/A, including the financial statements and notes thereto included herein, generally do not reflect events occurring after the date of the original filing of the Form 10-Q or modify or update those disclosures affected by subsequent events. Consequently, all other information not affected by the restatement is unchanged and reflects the disclosures made at the time of the original filing of the Form 10-Q on November 14, 2005. For a description of subsequent events, this Form 10-Q/A should be read in conjunction with our filings made subsequent to the filing of the original Form 10-Q, including the amended quarterly report on Form 10-Q/A for the quarter ended June 30, 2005, our annual report on Form 10-K for the fiscal year ended March 31, 2006, our quarterly report on Form 10-Q for the period ended December 31, 2005 and our Current Reports on Form 8-K filed since November 14, 2005.

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## Item 1. Financial Statements.

## MOTORCAR PARTS OF AMERICA, INC. AND SUBSIDIARIES

## Consolidated Balance Sheets

	<b>September 30, 2005 (Unaudited and Restated)</b>	<b>March 31, 2005</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,257,000	\$ 6,211,000
Short term investments	632,000	503,000
Accounts receivable net	12,056,000	11,513,000
Inventory net	59,293,000	48,587,000
Deferred income tax asset	6,156,000	6,378,000
Inventory unreturned	3,713,000	2,409,000
Income tax receivable	149,000	
Prepaid expenses and other current assets	1,661,000	1,365,000
 Total current assets	 84,917,000	 76,966,000
 Plant and equipment net	 8,599,000	 5,483,000
Other assets	1,334,000	899,000
 TOTAL ASSETS	 \$ 94,850,000	 \$ 83,348,000
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable	\$ 23,691,000	\$ 14,502,000
Accrued liabilities	350,000	1,378,000
Accrued salaries and wages	1,920,000	2,235,000
Accrued workers compensation claims	2,776,000	2,217,000
Line of credit	6,831,000	
Income tax payable		183,000
Deferred compensation	535,000	450,000
Deferred income	133,000	133,000
Other current liabilities	174,000	89,000
Credit due customer	7,746,000	12,543,000
Current portion of capital lease obligations	697,000	416,000
 Total current liabilities	 44,853,000	 34,146,000
Deferred income, less current portion	454,000	521,000
Deferred income tax liability	443,000	519,000
Other liabilities	44,000	
Capitalized lease obligations, less current portion	1,940,000	938,000
 TOTAL LIABILITIES	 47,734,000	 36,124,000

**SHAREHOLDERS EQUITY**

Preferred stock; par value \$.01 per share, 5,000,000 shares authorized; none issued		
Series A junior participating preferred stock; par value \$.01 per share, 20,000 shares authorized; none issued		
Common stock; par value \$.01 per share, 20,000,000 shares authorized; 8,208,955 and 8,183,955 shares issued and outstanding at September 30, 2005 and March 31, 2005	82,000	82,000
Additional paid-in capital	53,751,000	53,627,000
Accumulated other comprehensive loss	(48,000)	(55,000)
Accumulated deficit	(6,669,000)	(6,430,000)
<b>TOTAL SHAREHOLDERS EQUITY</b>	<b>47,116,000</b>	<b>47,224,000</b>
<b>TOTAL LIABILITIES &amp; SHAREHOLDERS EQUITY</b>	<b>\$ 94,850,000</b>	<b>\$ 83,348,000</b>

The accompanying condensed notes to consolidated financial statements are an integral part hereof.

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MOTORCAR PARTS OF AMERICA, INC. AND SUBSIDIARIES  
 Consolidated Statements of Operations  
 (Unaudited and Restated)

	<b>Six Months Ended</b>		<b>Three Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Net sales	\$ 51,490,000	\$ 46,202,000	\$ 30,139,000	\$ 24,993,000
Cost of goods sold	40,354,000	35,335,000	22,389,000	17,997,000
Gross profit	11,136,000	10,867,000	7,750,000	6,996,000
Operating expenses:				
General and administrative	8,057,000	5,037,000	4,047,000	2,416,000
Sales and marketing	1,629,000	1,133,000	764,000	511,000
Research and development	589,000	388,000	275,000	209,000
Total operating expenses	10,275,000	6,558,000	5,086,000	3,136,000
Operating income	861,000	4,309,000	2,664,000	3,860,000
Interest expense net of interest income	1,202,000	800,000	654,000	449,000
Income (loss) before income tax expense (benefit)	(341,000)	3,509,000	2,010,000	3,411,000
Income tax expense (benefit)	(102,000)	1,303,000	829,000	1,262,000
Net income (loss)	\$ (239,000)	\$ 2,206,000	\$ 1,181,000	\$ 2,149,000
Basic net income (loss) per share	\$ (0.03)	\$ 0.27	\$ 0.14	\$ 0.26
Diluted net income (loss) per share	\$ (0.03)	\$ 0.26	\$ 0.14	\$ 0.25
Weighted average number of shares outstanding:				
basic	8,189,829	8,125,982	8,195,640	8,157,172
diluted	8,189,829	8,590,254	8,729,235	8,603,916

The accompanying condensed notes to consolidated financial statements are an integral part hereof.

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MOTORCAR PARTS OF AMERICA, INC. AND SUBSIDIARIES  
Consolidated Statements of Cash Flows  
(Unaudited and Restated)

	<b>Six Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
Cash flows from operating activities:		
Net income (loss)	\$ (239,000)	\$ 2,206,000
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Depreciation and amortization	988,000	1,006,000
Deferred income taxes	144,000	1,206,000
Tax benefit from employee stock options exercised	101,000	219,000
Changes in current assets and liabilities:		
Accounts receivable	(543,000)	3,981,000
Inventory	(10,702,000)	(17,633,000)
Prepaid income tax		(49,000)
Inventory unreturned	(1,304,000)	(516,000)
Prepaid expenses and other current assets	(304,000)	(90,000)
Other current assets	(437,000)	5,000
Accounts payable and accrued liabilities	8,392,000	6,824,000
Income tax payable	(331,000)	(122,000)
Deferred compensation	85,000	101,000
Deferred income	(67,000)	
Credit due customer	(4,797,000)	12,912,000
Other current liabilities	131,000	(82,000)
Net cash (used in) provided by operating activities	(8,883,000)	9,968,000
Cash flows from investing activities:		
Purchase of property, plant and equipment	(2,532,000)	(364,000)
Change in short term investments	(95,000)	(108,000)
Net cash used in investing activities	(2,627,000)	(472,000)
Cash flows from financing activities:		
Net borrowings (payments) under line of credit	6,831,000	(3,000,000)
Net payments on capital lease obligations	(279,000)	(212,000)
Exercise of stock options	23,000	241,000
Net cash provided by (used in) financing activities	6,575,000	(2,971,000)
Effect of exchange rate changes on cash	(19,000)	(1,000)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(4,954,000)	6,524,000
CASH AND CASH EQUIVALENTS BEGINNING OF PERIOD	6,211,000	7,630,000
CASH AND CASH EQUIVALENTS END OF PERIOD	\$ 1,257,000	\$ 14,154,000



Supplemental disclosures of cash flow information:

Cash paid during the period for:

Interest	\$ 1,216,000	\$ 830,000
Income taxes	\$	\$ 50,000

Non-cash investing and financing activities:

Property acquired under capital lease	\$ 1,562,000	\$
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The accompanying condensed notes to consolidated financial statements are an integral part hereof.

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MOTORCAR PARTS OF AMERICA, INC. AND SUBSIDIARIES  
Condensed Notes to Consolidated Financial Statements  
September 30, 2005 and 2004  
(Unaudited and Restated)

The accompanying consolidated financial statements include the accounts of Motorcar Parts of America, Inc. and its wholly owned subsidiaries, MVR Products Pte. Ltd., Unijoh Sdn. Bhd. and Motorcar Parts de Mexico, S.A. de C.V. All significant intercompany accounts and transactions have been eliminated.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six and three months ended September 30, 2005 are not necessarily indicative of the results that may be expected for the year ending March 31, 2006. March 31, 2005 balances were derived from the Company's audited consolidated financial statements as of March 31, 2005. For further information, refer to the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended March 31, 2005, filed on September 6, 2005.

**NOTE A Company Background and Organization**

Motorcar Parts of America, Inc. and its subsidiaries (the Company or MPA) remanufacture and distribute alternators and starters for import and domestic cars and light trucks. These replacement parts are sold for use on vehicles after initial vehicle purchase. These automotive parts are sold to automotive retail chain stores and warehouse distributors throughout the United States and Canada. The Company also sells after-market replacement alternators and starters to a major automobile manufacturer.

The Company obtains used alternators and starters, commonly known as cores, primarily from its customers (retailers) as trade-ins and by purchasing them from vendors (core brokers). The retailers grant credit to the consumer when the used part is returned to them, and the Company in turn provides a credit to the retailer upon return to the Company. These cores are an essential material needed for the remanufacturing operations. The Company has remanufacturing, warehousing and shipping/receiving operations for alternators and starters in California, Singapore and Malaysia, and in June 2005 began remanufacturing in Mexico. In addition, the Company opened a warehouse distribution facility in Nashville, Tennessee in August 2005.

The Company changed its name to Motorcar Parts of America, Inc. from Motorcar Parts & Accessories, Inc. on January 8, 2004. The Company operates in one business segment pursuant to Statement of Financial Accounting Standards (SFAS) No. 131, Disclosures about Segments of Enterprise and Related Information.

**NOTE B Restatement of Financial Statements for the Three and Six Months Ended September 30, 2005 and September 30, 2004**

The consolidated balance sheet as of September 30, 2005, the consolidated statements of operations for the three and six months ended September 30, 2005 and September 30, 2004 and the consolidated statements of cash flows for the six months ended September 30, 2005 and September 30, 2004 have been restated to correct misstatements which occurred when the Company (i) failed to record unreturned core inventory and core charge revenue for the core portion of certain finished goods sold (core deposit adjustment), (ii) overstated inventory by not properly tracking unreturned core inventory from POS sales (consignment core adjustment) and (iii) incorrectly calculated the value of finished goods to be returned from customers through stock adjustments (unit stock adjustment). The estimated tax effect of the misstatements noted above is also reflected in the restatements. The condensed notes to the financial statements for the three and six months ending September 30, 2005 and 2004 were also restated as required to reflect the effect of the restatements noted above.

The impact of this restatement, which has been reflected throughout the consolidated financial statements and accompanying notes, is as follows:

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## Consolidated Balance Sheet

	<b>September 30, 2005</b>		
	<b>(Unaudited)</b>		
	<b>Previously Reported</b>	<b>Adjustment</b>	<b>Restated</b>
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	\$ 1,257,000		\$ 1,257,000
Short term investments	632,000		632,000
Accounts receivable net, as previously reported	11,222,000		
Core deposit adjustment		\$ 842,000	
Unit stock adjustment		(8,000)	
Accounts receivable net, as restated			12,056,000
Inventory net, as previously reported	59,577,000		
Consignment core adjustment		(284,000)	
Inventory net, as restated			59,293,000
Deferred income tax asset	6,156,000		6,156,000
Inventory unreturned, as previously reported	5,168,000		
Core deposit adjustment		(1,240,000)	
Unit stock adjustment		(215,000)	
Inventory unreturned, as restated			3,713,000
Prepaid expenses and other current assets	1,661,000		1,661,000
Total current assets	85,673,000	(905,000)	84,768,000
Plant and equipment net	8,599,000		8,599,000
Other assets	1,334,000		1,334,000
<b>TOTAL ASSETS</b>	<b>\$ 95,606,000</b>	<b>\$ (905,000)</b>	<b>\$ 94,701,000</b>
<b>LIABILITIES</b>			
Current liabilities:			
Accounts payable	\$ 23,691,000		\$ 23,691,000
Accrued liabilities	350,000		350,000
Accrued salaries and wages	1,920,000		1,920,000
Accrued workers compensation claims	2,776,000		2,776,000
Line of credit	6,831,000		6,831,000
Income tax payable, as previously reported	177,000		
Core deposit adjustment		\$ (143,000)	
Consignment core adjustment		(102,000)	
Unit stock adjustment		(81,000)	
Income tax payable (receivable), as restated			(149,000)
Deferred compensation	535,000		535,000
Deferred income	133,000		133,000
Other current liabilities	174,000		174,000
Credit due customer	7,746,000		7,746,000

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Current portion of capital lease obligations	697,000		697,000
Total current liabilities	45,030,000	(326,000)	44,704,000
Deferred income, less current portion	454,000		454,000
Deferred income tax liability	443,000		443,000
Other liabilities	44,000		44,000
Capitalized lease obligations, less current portion	1,940,000		1,940,000
<b>TOTAL LIABILITIES</b>	<b>47,911,000</b>	<b>(326,000)</b>	<b>47,585,000</b>
<b>SHAREHOLDERS EQUITY</b>			
Preferred stock; par value \$.01 per share, 5,000,000 shares authorized; none issued			
Series A junior participating preferred stock; par value \$.01 per share, 20,000 shares authorized; none issued			
Common stock; par value \$.01 per share, 20,000,000 shares authorized; 8,208,955 and 8,183,955 shares issued and outstanding at September 30, 2005 and March 31, 2005	82,000		82,000
Additional paid-in capital	53,751,000		53,751,000
Accumulated other comprehensive loss	(48,000)		(48,000)
Accumulated deficit, as previously reported	(6,090,000)		
Core deposit adjustment		(255,000)	
Consignment core adjustment		(182,000)	
Unit stock adjustment		(142,000)	
Accumulated deficit, as restated			(6,669,000)
<b>TOTAL SHAREHOLDERS EQUITY</b>	<b>47,695,000</b>	<b>(579,000)</b>	<b>47,116,000</b>
<b>TOTAL LIABILITIES &amp; SHAREHOLDERS EQUITY</b>	<b>\$ 95,606,000</b>	<b>\$ (905,000)</b>	<b>\$ 94,701,000</b>

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## Consolidated Statements of Operations

	<b>Six Months Ended September 30, 2005</b>		
	<b>(Unaudited)</b>		
	<b>Previously Reported</b>	<b>Adjustment</b>	<b>Restated</b>
Net sales, as previously reported	\$ 50,656,000		
Core deposit adjustment		\$ 841,000	
Unit stock adjustment		(7,000)	
Net sales, as restated			\$ 51,490,000
Cost of goods sold, as previously reported	38,615,000		
Core deposit adjustment		1,240,000	
Consignment core adjustment		283,000	
Unit stock adjustment		216,000	
Cost of goods sold, as restated			40,354,000
Gross margin	12,041,000	(905,000)	11,136,000
Operating expenses:			
General and administrative	8,057,000		8,057,000
Sales and marketing	1,629,000		1,629,000
Research and development	589,000		589,000
Total operating expenses	10,275,000		10,275,000
Operating income	1,766,000	(905,000)	861,000
Interest expense net	1,202,000		1,202,000
Income (loss) before income tax expense	564,000	(905,000)	(341,000)
Income tax expense, as previously reported	(224,000)		
Core deposit adjustment		143,000	
Consignment core adjustment		102,000	
Unit stock adjustment		81,000	
Income tax benefit, as restated			102,000
Net income (loss)	\$ 340,000	\$ (579,000)	\$ (239,000)
Basic income (loss) per share	\$ 0.04	\$ (0.07)	\$ (0.03)
Diluted income (loss) per share	\$ 0.04	\$ (0.07)	\$ (0.03)
Weighted average shares outstanding:			
basic	8,189,829		8,189,829
diluted	8,739,232	(549,403)	8,189,829

Dilutive common stock equivalents are excluded from the calculation when there is a net loss in a fiscal period.

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## Consolidated Statements of Operations (continued)

	<b>Three Months Ended September 30, 2005</b>		
	<b>(Unaudited)</b>		
	<b>Previously Reported</b>	<b>Adjustment</b>	<b>Restated</b>
Net sales, as previously reported	\$ 29,721,000		
Core deposit adjustment		\$ 461,000	
Unit stock adjustment		(43,000)	
Net sales, as restated			\$ 30,139,000
Cost of goods sold, as previously reported	21,190,000		
Core deposit adjustment		748,000	
Consignment cores adjustment		161,000	
Unit stock adjustment		290,000	
Cost of goods sold, as restated			22,389,000
Gross margin	8,531,000	(781,000)	7,750,000
Operating expenses:			
General and administrative	4,047,000		4,047,000
Sales and marketing	764,000		764,000
Research and development	275,000		275,000
Total operating expenses	5,086,000		5,086,000
Operating income	3,445,000	(781,000)	2,664,000
Interest expense net	654,000		654,000
Income before income tax expense	2,791,000	(781,000)	2,010,000
Income tax expense, as previously reported	1,110,000		
Core deposit adjustment		(103,000)	
Consignment core adjustment		(58,000)	
Unit stock adjustment		(120,000)	
Income tax expense, as restated			829,000
Net income	\$ 1,681,000	\$ (500,000)	\$ 1,181,000
Basic income per share	\$ 0.21	\$ (0.07)	\$ 0.14
Diluted income per share	\$ 0.19	\$ (0.05)	\$ 0.14
Weighted average shares outstanding:			
basic	8,195,640		8,195,640
diluted	8,729,235		8,729,235

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## Consolidated Statements of Operations (continued)

	<b>Six Months Ended September 30, 2004</b>		
	<b>(Unaudited)</b>		
	<b>Previously Reported</b>	<b>Adjustment</b>	<b>Restated</b>
Net sales, as previously reported	\$ 46,229,000		
Unit stock adjustment		\$ (27,000)	
Net sales, as restated			\$ 46,202,000
Cost of goods sold, as previously reported	35,040,000		
Consignment core adjustment		227,000	
Unit stock adjustment		68,000	
Cost of goods sold, as restated			35,335,000
Gross margin	11,189,000	(322,000)	10,867,000
Operating expenses:			
General and administrative	5,037,000		5,037,000
Sales and marketing	1,133,000		1,133,000
Research and development	388,000		388,000
Total operating expenses	6,558,000		6,558,000
Operating income	4,631,000	(322,000)	4,309,000
Interest expense net	800,000		800,000
Income before income tax expense	3,831,000	(322,000)	3,509,000
Income tax expense, as previously reported	1,425,000		
Consignment core adjustment		(86,000)	
Unit stock adjustment		(36,000)	
Income tax expense, as restated			1,303,000
Net income	\$ 2,406,000	\$ (200,000)	\$ 2,206,000
Basic income per share	\$ 0.30	\$ (0.03)	\$ 0.27
Diluted income per share	\$ 0.28	\$ (0.02)	\$ 0.26
Weighted average shares outstanding:			
basic	8,125,982		8,125,982
diluted	8,590,254		8,590,254

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## Consolidated Statements of Operations (continued)

	<b>Three Months Ended September 30, 2004</b>		
	<b>(Unaudited)</b>		
	<b>Previously Reported</b>	<b>Adjustment</b>	<b>Restated</b>
Net sales, as previously reported	\$ 24,997,000		
Unit stock adjustment		\$ (4,000)	
Net sales, as restated			\$ 24,993,000
Cost of goods sold, as previously reported	18,014,000		
Consignment core adjustment		38,000	
Unit stock adjustment		(55,000)	
Cost of goods sold, as restated			17,997,000
Gross margin	6,983,000	13,000	6,996,000
Operating expenses:			
General and administrative	2,416,000		2,416,000
Sales and marketing	511,000		511,000
Research and development	209,000		209,000
Total operating expenses	3,136,000		3,136,000
Operating income	3,847,000	13,000	3,860,000
Interest expense net	449,000		449,000
Income before income tax expense	3,398,000	13,000	3,411,000
Income tax expense, as previously reported	1,257,000		
Consignment core adjustment		(14,000)	
Unit stock adjustment		19,000	
Income tax expense, as restated			1,262,000
Net income	\$ 2,141,000	\$ 8,000	\$ 2,149,000
Basic income per share	\$ 0.26	\$	\$ 0.26
Diluted income per share	\$ 0.25	\$	\$ 0.25
Weighted average shares outstanding:			
basic	8,157,172		8,157,172
diluted	8,603,916		8,603,916



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## Consolidated Statements of Cash Flows

	<b>Six Months Ended September 30, 2005</b>		
	<b>(Unaudited)</b>		
	<b>Previously Reported</b>	<b>Adjustment</b>	<b>Restated</b>
Cash flows from operating activities:			
Net income, as previously reported	\$ 340,000		
Core deposit adjustment		\$ (255,000)	
Consignment core adjustment		(182,000)	
Unit stock adjustment		(142,000)	
Net loss, as restated			\$ (239,000)
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Depreciation and amortization	988,000		988,000
Deferred income taxes	144,000		144,000
Tax benefit from employee stock options exercised	101,000		101,000
Changes in current assets and liabilities:			
Accounts receivable, as previously reported	291,000		
Core deposit adjustment		(842,000)	
Consignment core adjustment		8,000	
Accounts receivable, as restated			(543,000)
Inventory, as previously reported	(10,986,000)		
Consignment core adjustment		284,000	
Inventory, as restated			(10,702,000)
Inventory unreturned, as previously reported	(2,759,000)		
Core deposit adjustment		1,240,000	
Unit stock adjustment		215,000	
Inventory unreturned, as restated			(1,304,000)
Prepaid expenses and other current assets	(304,000)		(304,000)
Other current assets	(437,000)		(437,000)
Accounts payable and accrued liabilities	8,392,000		8,392,000
Income tax payable, as previously reported	(5,000)		
Core deposit adjustment		(143,000)	
Consignment core adjustment		(102,000)	
Unit stock adjustment		(81,000)	
Income tax payable, as restated			(331,000)
Deferred compensation	85,000		85,000
Deferred income	(67,000)		(67,000)
Credit due to customer	(4,797,000)		(4,797,000)
Other liabilities	131,000		131,000
Net cash used in operating activities	\$ (8,883,000)	\$	\$ (8,883,000)

There were no changes to previously reported cash flows from investing and financing activities.

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## Consolidated Statements of Cash Flows (continued)

	<b>Six Months Ended September 30, 2004</b>		
	<b>(Unaudited)</b>		
	<b>Previously Reported</b>	<b>Adjustment</b>	<b>Restated</b>
Cash flows from operating activities:			
Net income, as previously reported	\$ 2,406,000		
Core deposit adjustment		\$ (141,000)	
Unit stock adjustment		(59,000)	
Net income, as restated			\$ 2,206,000
Adjustments to reconcile net income to net cash used in operating activities			
Depreciation and amortization	1,006,000		1,006,000
Deferred income taxes	1,206,000		1,206,000
Tax benefit from employee stock options exercised	219,000		219,000
Changes in current assets and liabilities:			
Accounts receivable, as previously reported	3,954,000		
Unit stock adjustment		27,000	
Accounts receivable, as restated			3,981,000
Inventory, as previously reported	(17,860,000)		
Consignment core adjustment		227,000	
Inventory, as restated			(17,633,000)
Prepaid income tax	(49,000)		(49,000)
Inventory unreturned, as previously reported	(584,000)		
Unit stock adjustment		68,000	
Inventory unreturned, as restated			(516,000)
Prepaid expenses and other current assets	(90,000)		(90,000)
Other current assets	5,000		5,000
Accounts payable and accrued liabilities	6,824,000		6,824,000
Income tax payable, as previously reported			
Consignment core adjustments		(86,000)	
Unit stock adjustments		(36,000)	
Income tax payable, as restated			(122,000)
Deferred compensation	101,000		101,000
Credit due to customer	12,912,000		12,912,000
Other liabilities	(82,000)		(82,000)
Net cash used in operating activities	\$ 9,968,000	\$	\$ 9,968,000

There were no changes to previously reported cash flows from investing and financing activities.

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**NOTE C Revenue Recognition**

The Company recognizes revenue when performance by the Company is complete. Revenue is recognized when all of the following criteria established by the Staff of the Securities and Exchange Commission in Staff Accounting Bulletin 104, Revenue Recognition, have been met:

Persuasive evidence of an arrangement exists,

Delivery has occurred or services have been rendered,

The seller's price to the buyer is fixed or determinable, and

Collectibility is reasonably assured.

For products shipped free-on-board ( FOB ) shipping point, revenue is recognized on the date of shipment. For products shipping FOB destination, revenues are recognized two days after the date of shipment based on the Company's experience regarding the length of transit duration. The Company includes shipping and handling charges in its gross invoice price to customers and classifies the total amount as revenue in accordance with Emerging Issues Task Force Issue ( EITF ) 00-10, Accounting for Shipping and Handling Fees and Costs. Shipping and handling costs are recorded as cost of sales.

The Company accounts for revenues and cost of sales on a net-of-core-value basis. Unit value revenue is recorded based on the Company's price list, net of applicable discounts and allowances. The Company allows customers to return slow moving and other inventory. The Company provides for such returns of inventory in accordance with SFAS 48, Revenue Recognition When Right of Return Exists. The Company reduces revenue and cost of sales for the unit value based on a historical return analysis and information obtained from customers about current stock levels.

Management has determined that the Company's business practices and contractual arrangements result in the return to the Company of more than 90% of all used cores. Accordingly, management excludes the value of cores from revenue in accordance with Statement of Financial Accounting Standards 48, Revenue Recognition When Right of Return Exists ( SFAS 48 ). Core values charged to customers and not included in revenues totaled \$32,783,000 and \$40,883,000 for the six months ended September 30, 2005 and 2004, respectively, and \$16,684,000 and \$22,486,000 for the three months ended September 30, 2005 and 2004, respectively.

When the Company ships a product, it recognizes an obligation to accept a returned core by recording a contra receivable account based upon the agreed upon core charge and establishing an inventory unreturned account at the standard cost of the core expected to be returned. Upon receipt of a core, the Company grants the customer a credit based on the core value billed, and restores the returned core to inventory. The Company generally limits core returns to the number of similar cores previously shipped to each customer. The Company recognizes revenue for cores based upon an estimate of the annual rate in which customers will pay cash for cores in lieu of returning cores for credits. In fiscal year 2005, the Company began to recognize core charge revenue each fiscal quarter based on this estimate. The revenue from core charges had previously been recorded at the end of the fiscal year. The amount of revenue recognized for core charges for the six months ended September 30, 2005 and 2004 was \$3,157,000 and \$2,227,000, respectively, and for the three months ended September 30, 2005 and 2004 was \$2,064,000 and \$1,209,000, respectively.

During fiscal 2004, the Company began to offer products on pay-on-scan ( POS ) arrangement to one of its customers. For POS inventory, revenue is recognized when the customer has notified the Company that it has sold a specifically identified product to another person or entity. POS inventory represents inventory held on consignment at customer locations. This customer bears the risk of loss of any consigned product from any cause whatsoever from the time possession is taken until a third party customer purchases the product or its absence is noted in a cycle or physical inventory count.

The Company also maintains accounts to accrue for estimated returns and to track unit and core returns. The accrual for anticipated returns reduces revenues and accounts receivable. The estimated unit sales returns and estimated core returns account balances are as follows:

	<b>September 30, 2005</b>	<b>March 31, 2005</b>
Estimated sales returns	\$ 177,000	\$ 694,000
Estimated core inventory returns	\$4,404,000	\$2,288,000

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The Company accounts for stock-based employee compensation as prescribed by Accounting Principles Board Opinion ( APB ) No. 25, Accounting for Stock Issued to Employees, and has adopted the disclosure provisions of SFAS 123, Accounting for Stock-Based Compensation, and SFAS 148, Accounting for Stock-Based Compensation-Transition and Disclosure-an amendment of SFAS 123. The following table presents pro forma net income had compensation costs associated with the Company's option arrangements been determined in accordance with SFAS 123:

	<b>Six Months Ended</b>		<b>Three Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	<b>(Restated)</b>	<b>(Restated)</b>	<b>(Restated)</b>	<b>(Restated)</b>
Net income (loss)	\$ (239,000)	\$ 2,206,000	\$ 1,181,000	\$ 2,149,000
Stock-based compensation charges reported in net income (loss)				
Pro forma stock-based compensation, net of tax		(876,000)		(496,000)
Pro forma net income (loss)	\$ (239,000)	\$ 1,330,000	\$ 1,181,000	\$ 1,653,000
Basic income (loss) per share	\$ (0.03)	\$ 0.27	\$ 0.14	\$ 0.26
Basic income (loss) per share pro forma	\$ (0.03)	\$ 0.16	\$ 0.14	\$ 0.20
Diluted income (loss) per share	\$ (0.03)	\$ 0.26	\$ 0.14	\$ 0.25
Diluted income (loss) per share pro forma	\$ (0.03)	\$ 0.15	\$ 0.14	\$ 0.19

**NOTE E Inventory**

Inventory is comprised of the following:

	<b>September</b>	<b>March 31,</b>
	<b>30,</b>	<b>2005</b>
	<b>2005</b>	<b>2005</b>
Raw materials and cores	\$ 21,192,000	\$ 19,864,000
Work-in-process	1,067,000	681,000
Finished goods	21,899,000	13,398,000
	44,158,000	33,943,000
Less allowance for excess and obsolete inventory	(2,350,000)	(2,392,000)
	41,808,000	31,551,000
Pay-on-scan inventory	17,485,000	17,036,000
Total	\$ 59,293,000	\$ 48,587,000

**NOTE F Inventory Unreturned**

Inventory unreturned represents the average value of cores and finished goods shipped to customers and expected to be returned, stated at the lower of cost or market. Upon product shipment, the Company reduces the inventory

account for the amount of product shipped and establishes the inventory unreturned asset account for that portion of the shipment that is expected to be returned by the customer. Inventory unreturned is comprised of the following:

	<b>September 30, 2005</b>	<b>March 31, 2005</b>
Cores	\$ 2,481,000	\$ 1,352,000
Finished goods	1,232,000	1,057,000
Total	\$ 3,713,000	\$ 2,409,000

**NOTE G Multi-Year Exclusive Arrangement and Inventory Transaction with Largest Customer**

In May 2004, the Company entered into an agreement with its largest customer to become the customer's primary supplier of import alternators and starters for its eight distribution centers. As part of this four-year agreement, the Company entered into a pay-on-scan (POS) arrangement with the customer. Under this arrangement, the customer is not obligated to purchase the POS merchandise the Company has shipped to the customer until that merchandise is ultimately sold to the end user. As part of this agreement the Company purchased approximately \$24,000,000 of the customer's then-current inventory of import starters and alternators transitioning to the POS program at the price the customer originally paid for this inventory. The Company is paying for

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this inventory over 24 months, without interest, through the issuance of monthly credits against receivables generated by sales to the customer. The contract requires that the Company continue to meet its historical performance and competitive standards.

The Company did not record the inventory acquired from the customer as part of this transaction (the transition inventory) as an asset because it does not meet the description of an asset provided in FASB Concepts Statement No. 6, Elements of Financial Statements (CON 6). Therefore, the Company does not recognize revenues from the customer's POS sales of the transition inventory.

The Company has agreed to issue credits in an amount equal to the transition inventory. Based on the description of a liability in CON 6, the Company recognizes the amount of its obligation to the customer as the customer sells the transition inventory and recognizes a payable to the Company. Since the inception of this arrangement, the customer has sold \$21,296,000 of the transition inventory and the Company has issued credits of \$13,550,000, resulting in a net obligation to the customer of \$7,746,000, as reflected on the Company's September 30, 2005 balance sheet.

As the issuance of credits to the customer generally lagged sales of the transition inventory during the initial phase of this arrangement, the Company received cash in the early months which is now being offset by lower cash collections resulting from credits issued to the customer. As of September 30, 2005, the Company had agreed to issue future credits to the customer in the following amounts:

Q3 2006	\$ 3,270,000
Q4 2006	\$ 3,270,000
Q1 2007	\$ 4,040,000
 Total	 \$ 10,580,000

In connection with this POS arrangement, the Company recognized a liability of approximately \$460,000 to reflect that the price the Company is paying for the cores included within the non-MPA portion of the transition inventory is greater than the market value of these cores.

The Company also agreed to cooperate with the customer to use reasonable commercial efforts to convert all products sold by MPA to the customer to the POS arrangement by April 2006. In the event the conversion is not accomplished by April 2006, the Company agreed to amend the agreement to acquire an additional \$24,000,000 of inventory and to provide the customer with an additional \$24,000,000 of credit memos to be issued and applied in equal monthly installments to current receivables over a 24-month period ending April 2008.

**NOTE H Other Long-Term Agreements with Major Customers**

The Company has long-term agreements with each of its major customers. Under these agreements, which typically have initial terms of at least four years, the Company is designated as the exclusive or primary supplier for specified categories of remanufactured alternators and starters. In consideration for its designation as a customer's exclusive or primary supplier, the Company typically provides the customer with a package of marketing incentives. These incentives differ from contract to contract and can include (i) the issuance of a specified amount of credits against receivables in accordance with a schedule set forth in the relevant contract, (ii) support for a particular customer's research or marketing efforts on a scheduled basis, (iii) discounts granted in connection with each individual shipment of product and (iv) other marketing, research, store expansion or product development support. The Company has also entered into agreements to purchase certain customers' core inventory and to issue credits to pay for that inventory according to an agreed upon schedule set forth in the agreement. These contracts typically require that the Company meet ongoing performance, quality and fulfillment requirements, and its contract with one of the largest automobile manufacturers in the world includes a provision (standard in this manufacturer's vendor agreements) granting the manufacturer the right to terminate the agreement at any time for any reason. The Company's contracts with major customers expire at various dates ranging from May 2008 through December 2012.

In addition to the inventory transaction described in Note G, the Company has agreed to acquire other core inventory by issuing \$10,300,000 of credits over a five-year period (subject to adjustment if customer sales decrease in any quarter by more than an agreed upon percentage) on a straight-line basis. As the Company issues these credits,

it establishes a long-term asset account for the value of the core inventory estimated to be in customer hands and subject to repurchase upon agreement termination, and reduces revenue by the amount by which the credit exceeds the estimated core inventory value. As of September 30, 2005, the long-term asset account



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was approximately \$470,000. The Company will regularly review the long-term asset account for impairment and make any necessary adjustment to the carrying value of this asset.

**NOTE I Marketing Allowances**

The Company records the cost of all marketing allowances provided to its customers in accordance with EITF 01-9, Accounting for Consideration Given by a Vendor to a Customer. Such allowances include sales incentives and concessions. Voluntary marketing allowances related to a single exchange of product are recorded as a reduction of revenues at the time the related revenues are recorded or when such incentives are offered. Other marketing allowances are recorded as a reduction to revenues as issued in accordance with the schedule set forth in the customer agreement. Sales incentive amounts are recorded based on the value of the incentive provided. For the six months ended September 30, 2005 and 2004, the Company recorded a reduction in revenues of \$3,610,000 and \$1,164,000, respectively, attributable to marketing allowances granted in connection with long-term contracts and a reduction of \$5,856,000 and \$4,713,000, respectively, attributable to marketing allowances related to a single exchange of product. For the three months ended September 30, 2005 and 2004, the Company recorded a reduction in revenues of \$520,000 and \$582,000, respectively, attributable to marketing allowances granted in connection with long-term contracts and a reduction of \$3,247,000 and \$2,170,000, respectively, attributable to marketing allowances related to a single exchange of product.

The following table presents the marketing allowances, not associated with a single exchange of product, which will be recognized as a charge against revenues in accordance with the terms of the relevant long-term contracts:

**Year ending March 31,**

2006 Remaining six months	\$	4,473,000
2007		2,084,000
2008		2,022,000
2009		1,289,000
2010		1,289,000
Thereafter		2,233,000
Total	\$	13,390,000

**NOTE J Major Customers**

The Company's three largest customers accounted for the following total percentage of sales and accounts receivable:

	<b>Six Months Ended</b>		<b>Three Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
<b>Sales</b>	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Customer A	71%	74%	73%	74%
Customer B*	12%	12%	13%	13%
Customer C*	10%	8%	8%	6%
			<b>September</b>	<b>March</b>
			<b>30,</b>	<b>31,</b>
<b>Accounts Receivable</b>			<b>2005</b>	<b>2005</b>
Customer A			64%	68%
Customer B*			15%	10%
Customer C*			5%	18%

\* Between September 30, 2004 and September 30, 2005, the identity of our second and third largest customers changed.

**NOTE K Line of Credit; Factoring Agreements**

On May 28, 2004 the Company secured a \$15,000,000 credit facility with a new bank. This revolving credit line, which replaced the Company's previous asset-based facility, bears interest either at the LIBOR rate plus 2% or the bank's reference rate, at the Company's option. The bank holds a security interest in substantially all of the Company's assets. As of September 30, 2005, the Company had an outstanding balance under this line of credit of \$6,831,000 and had reserved \$4,301,000 of the line for standby letters of credit for worker's compensation insurance. The loan agreement matures on October 2, 2006.

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Effective September 30, 2005, the financial covenants in the credit facility agreement were amended. The amended agreement includes various financial covenants, including covenants requiring the Company (i) to maintain tangible net worth of not less than \$39,000,000, increased by 75% of net profit after taxes each quarter, EBITDA of not less than \$3,000,000 for each quarter and \$13,000,000 for the four most recent fiscal quarters, a fixed charge ratio of not less than 1.50 to 1.00 as of the last day of each quarter, and a current ratio of not less than 1.60 to 1.00 as of the close of each quarter and (ii) to limit capital expenditures to \$6,000,000 and operating lease obligations to \$3,000,000 during any fiscal year. At September 30, 2005, the Company was in compliance with all the revised covenants. See subsequent events in Note Q for a further discussion of these changes to the financial covenants.

Under two separate agreements, executed on July 30, 2004 and August 21, 2003 with two customers and their respective banks, the Company may sell those customers' receivables to those banks at an agreed-upon discount set at the time the receivables are sold. This discount arrangement has allowed the Company to accelerate collection of the customers' receivables aggregating \$35,627,000 and \$46,819,000 for the six months ended September 30, 2005 and 2004, respectively, by an average of 193 days and 171 days, respectively. On an annualized basis the weighted average discount rate on the receivables sold to the banks during the six months ended September 30, 2005 and 2004 was 5.5% and 3.6%, respectively. The amount of the discount on these receivables, \$1,022,000 and \$716,000 for the six months ended September 30, 2005 and 2004, respectively, was recorded as interest expense.

**NOTE L Net Income Per Share**

The following represents a reconciliation of basic and diluted net income per share:

	Six Months Ended September 30,		Three Months Ended September 30,	
	2005 (Restated)	2004 (Restated)	2005 (Restated)	2004 (Restated)
Net income (loss)	\$ (239,000)	\$ 2,206,000	\$ 1,181,000	\$ 2,149,000
Basic Shares	8,189,829	8,125,982	8,195,640	8,157,172
Effect of dilutive stock options		464,272	533,595	446,744
Diluted shares	8,189,829	8,590,254	8,729,235	8,603,916
Basic income (loss) per share	\$ (0.03)	\$ 0.27	\$ 0.14	\$ 0.26
Diluted income (loss) per share	\$ (0.03)	\$ 0.26	\$ 0.14	\$ 0.25

The effect of dilutive options and warrants excludes 15,875 options with exercise prices ranging from \$11.81 to \$19.13 per share for the six months ended September 30, 2005, and 368,525 options with exercise prices ranging from \$8.70 to \$19.13 per share for the six months ended September 30, 2004 all of which were anti-dilutive. The effect of dilutive options and warrants excludes 15,875 options with exercise prices ranging from \$11.81 to \$19.13 per share for the three months ended September 30, 2005, and 368,525 options with exercise prices ranging from \$8.70 to \$19.13 per share for the three months ended September 30, 2004 all of which were anti-dilutive.

**NOTE M Comprehensive Income**

SFAS 130, Reporting Comprehensive Income, established standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income is defined as the change in equity during a period resulting from transactions and other events and circumstances from non-owner sources. The Company's total comprehensive income consists of net income and foreign currency translation adjustments, as follows:

	Six Months Ended September 30,		Three Months Ended September 30,	
	2005 (Restated)	2004 (Restated)	2005 (Restated)	2004 (Restated)

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Net income (loss)	\$ (239,000)	\$ 2,206,000	\$ 1,181,000	\$ 2,149,000
Foreign currency translation	(5,000)	(5,000)	(10,000)	(4,000)
Comprehensive income (loss)	\$ (244,000)	\$ 2,201,000	\$ 1,171,000	\$ 2,145,000

**Table of Contents****NOTE N New Lease**

In April 2005, the Company entered in an agreement to lease approximately 82,600 square feet of warehouse and office space in Nashville, Tennessee for a term of five years and two months, with a starting base rent of \$20,994 per month. This facility opened for operations in August 2005.

**NOTE O Shareholders Equity**

During the six months ended September 30, 2005, options to purchase 25,000 shares of stock at \$0.93 per share were exercised. The following table shows the increase in additional paid in capital as a result of the exercise of those options:

Beginning balance April 1, 2005	\$ 53,627,000
Exercise of options to purchase 25,000 shares	23,000
Tax benefit from employee stock options exercised	101,000
Ending balance September 30, 2005	\$ 53,751,000

**NOTE P Financial Risk Management and Derivatives**

Purchases and expenses denominated in currencies other than the U.S. dollar, which are primarily related to the Company's production facilities overseas, expose the Company to market risk from material movements in foreign exchange rates between the U.S. dollar and the foreign currency. The Company's primary risk exposure is from changes in the rates between the U.S. dollar and the Mexican peso related to the operation of the Company's facility in Mexico. In August 2005, the Company entered into forward foreign exchange contracts to exchange U.S. dollars for Mexican pesos. The extent to which forward foreign exchange contracts are used is modified periodically in response to management's estimate of market conditions and the terms and length of specific purchase requirements to fund those overseas facilities.

The Company enters into forward foreign exchange contracts in order to reduce the impact of foreign currency fluctuations and not to engage in currency speculation. The use of derivative financial instruments allows the Company to reduce its exposure to the risk that the eventual net cash outflow resulting from funding the expenses of the foreign operations will be materially affected by changes in exchange rates. The Company does not hold or issue financial instruments for trading purposes. The forward foreign exchange contracts are designated for forecasted expenditure requirements to fund the overseas operations. These contracts expire in a year or less.

The forward foreign exchange contracts entered into require the Company to exchange Mexican pesos for U.S. dollars at maturity, at rates agreed at the inception of the contracts. The counterparty to this derivative transaction is a major financial institution with investment grade or better credit rating; however, the Company is exposed to credit risk with this institution. The credit risk is limited to the potential unrealized gains in any such contract should this counterparty fail to perform as contracted. Any changes in fair values of foreign exchange contracts are reflected in current period earnings. For the three months ended September 30, 2005, the Company recognized a loss of \$11,000 associated with these forward exchange contracts.

**NOTE Q Subsequent Events**

On November 8, 2005, the existing credit facility agreement was amended to revise several of the financial covenants effective September 30, 2005. These included increasing the allowable fiscal year capital expenditures and capital lease obligations to \$6,000,000 and \$3,000,000, respectively, from \$2,500,000 and \$2,000,000, respectively, reducing the EBITDA for the four most recent fiscal quarters from \$14,000,000 to \$13,000,000, replacing a minimum quick ratio of 0.65 to 1.00 with a minimum current ratio of 1.60 to 1.00 and increasing the minimum fixed charge coverage ratio from 1.25 to 1.00 to 1.50 to 1.00 (at the same time, the definition of debt service used to calculate the fixed charge coverage ratio was revised to eliminate the inclusion of the POS credits issued to the Company's largest customer). In addition, the amendment provides that, for purposes of determining the Company's compliance with the minimum EBITDA covenant, EBITDA for the quarter ended June 30, 2005 will be increased by \$4,891,000 to eliminate the effect of certain fees and expensed incurred during that quarter.

On October 26, 2005, the Company entered into a capital lease agreement with a bank for equipment financing for \$4,110,000, payable in monthly installments of \$80,937 over the sixty month term of the lease agreement, with a one dollar purchase option at the end of the lease term.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The following discussion and analysis presents factors that we believe are relevant to an assessment and understanding of our consolidated financial position and results of operations. This financial and business analysis should be read in conjunction with our March 31, 2005 consolidated financial statements included in our Annual Report on Form 10-K filed on September 6, 2005.

**Disclosure Regarding Private Securities Litigation Reform Act of 1995**

This report contains certain forward-looking statements with respect to our future performance that involve risks and uncertainties. Various factors could cause actual results to differ materially from those projected in such statements. These factors include, but are not limited to: concentration of sales to a few customers, changes in our relationship with any of our customers, including the increasing customer pressure for lower prices and more favorable payment and other terms, the increasing strain on our cash position, our ability to achieve positive cash flows from operations in the second half of fiscal 2006, potential future changes in our accounting policies that may be made as a result of the SEC's review of our previously filed public reports, our failure to meet the financial covenants or the other obligations set forth in our bank credit agreement and the bank's refusal to waive any such defaults, any meaningful difference between projected production needs and ultimate sales to our customers, increases in interest rates, changes in the financial condition of any of our major customers, the impact of high gasoline prices, the potential for changes in consumer spending, consumer preferences and general economic conditions, increased competition in the automotive parts industry, political or economic instability in any of the foreign countries where we conduct operations, unforeseen increases in operating costs and other factors discussed herein and in our other filings with the Securities and Exchange Commission.

**Management Overview**

Sales in the retail and traditional markets in our product category have remained relatively steady. Both markets continue to experience consolidation. We make it a priority to focus our efforts on those customers we believe will be successful in the industry and will provide a strong distribution base for our future. We operate in a very competitive environment, where our customers expect us to provide quality products, in a timely manner at a low cost. To meet these expectations while maintaining or improving gross margins, we have focused on regular changes and improvements to make our manufacturing processes more efficient, and our movement to lean manufacturing cells, increased production in Malaysia, establishment of a production facility in northern Mexico, utilization of advanced inventory tracking technology and development of in-store testing equipment reflect this focus. Our sales are concentrated among a very few customers, and these key customers regularly seek more favorable pricing, marketing allowances, delivery and payment terms as a condition to the continuation of our existing business or an expansion of a particular customer's business. The increased pressure we have experienced from our customers may increasingly and negatively impact our profit margins in the future.

To partially offset some of these customer demands, we have sought to position ourselves as a preferred supplier by working closely with our key customers to satisfy their particular needs and entering into longer-term preferred supplier agreements. While these longer-term agreements strengthen our customer relationships and improve our overall business base, they require a substantial amount of working capital to meet ramped up production demands and typically include marketing and other allowances that meaningfully limit the near-term revenues and associated cash flow from these new or expanded arrangements.

To grow our revenue base, we have broadened our retail and traditional distribution networks by targeting sales to the traditional warehouse and professional installer markets. We continue to expand our product offerings to respond to changes in the marketplace, including those related to the increasing complexity of automotive electronics.

Our results for the six months ended September 30, 2005 reflect the investments we have made to implement our strategy and the progress that we have realized. During the six months ended September 30, 2005, we opened our new manufacturing facility in Mexico (a facility that at September 30, 2005 had approximately 250 employees), significantly increased our production to accommodate the new business we have received from one of the world's largest automobile manufacturers, opened a new distribution facility in Nashville, Tennessee and, we believe, resolved the SEC's inquiries concerning our previously filed public reports (although the SEC has not provided us with any confirmation in this regard). While we have incurred significant costs to achieve these objectives, we believe these

investments have helped position us to capitalize on the market opportunities that we continue to see.



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### **Critical Accounting Policies**

We prepare our consolidated financial statements in accordance with U.S. generally accepted accounting principles, or GAAP. Our significant accounting policies are discussed in detail below and in Note B to our consolidated financial statements included in our Annual Report on Form 10-K filed on September 6, 2005.

In preparing our consolidated financial statements, it is necessary that we use estimates and assumptions for matters that are inherently uncertain. We base our estimates on historical experiences and reasonable assumptions. Our use of estimates and assumptions affects the reported amounts of assets, liabilities and the amount and timing of revenues and expenses we recognize for and during the reporting period. Actual results may differ from estimates.

#### *Revenue Recognition; Net-of-Core-Value Basis*

The price of a finished product sold to customers is generally comprised of separately invoiced amounts for the core included in the product ( core value ) and for the value added by remanufacturing ( unit value ). The unit value is recorded as revenue in accordance with our net-of-core-value revenue recognition policy. This revenue is recorded based on our then current price list, net of applicable discounts and allowances. We do not recognize the core value as revenue when the finished products are sold. For a discussion of our accounting for core revenue from under returns of cores, see Accounting for Under Returns of Cores below.

#### *Stock Adjustments; General Right of Return*

Under the terms of certain agreements with our customers and industry practice, our customers from time to time may be allowed stock adjustments when their inventory quantity of certain product lines exceeds the anticipated quantity of sales to end-user customers. Stock adjustment returns are not recorded until they are authorized by the Company and they do not occur at any specific time during the year. We provide for a monthly allowance to address the anticipated impact of stock adjustments based on customers' inventory levels, movement and timing of stock adjustments. Our estimate of the impact on revenues and cost of goods sold of future inventory overstocks is made at the time revenue is recognized for individual sales and is based on the following factors:

The amount of the credit granted to a customer for inventory overstocks is negotiated between our customers and us and may be different than the total sales value of the inventory returned based on our price lists;

The product mix of anticipated inventory overstocks often varies from the product mix sold; and

The standard costs of inventory received will vary based on the part numbers received.

In addition to stock adjustment returns, we also allow most of our customers to return goods to us that their end-user customers have returned to them. This general right of return is allowed regardless of whether the returned item is defective. We seek to limit the aggregate of customer returns, including slow moving and other inventory, to 20% of unit sales. We provide for such anticipated returns of inventory in accordance with Statement of Financial Accounting Standards 48, Revenue Recognition When Right of Return Exists by reducing revenue and cost of sales for the unit value based on a historical return analysis and information obtained from customers about current stock levels.

#### *Core Inventory Valuation*

We value cores at the lower of cost or market. To take into account the seasonality of our business, market value of cores is recalculated at March and September of each year. The semi-annual recalculation in March reflects the higher seasonal demand which typically precedes the warm summer months and the semi-annual recalculation in September reflects the lower seasonal demand which normally precedes the colder months. Because March generally represents the high point in the core broker market, we revalue cores in March using only the high core broker price. In September, we revalue our cores to high core broker price plus a factor to allow for the temporary decrease in market value during the slower season.

#### *Accounting for Under Returns of Cores*

Based on our experience, contractual arrangements with customers and inventory management practices, we typically receive and purchase a used but remanufacturable core from customers for more than 90% of the remanufactured alternators or starters we sell to customers. However, both the sales and receipt of cores throughout the year are seasonal with the receipt of cores lagging sales. Our



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customers typically purchase more cores than they return during the months of April through September (the first six months of the fiscal year) and return more cores than they purchase during the months of October through March (the last six months of the fiscal year). In accordance with our net-of-core-value revenue recognition policy, when we ship a product, we record an amount to the inventory unreturned account for the standard cost of the core expected to be returned. In fiscal year 2005, we began to recognize core charge revenue from under return of cores on a quarterly basis. The rate at which core revenue is recognized is based on our historical experience of customers paying cash for cores in lieu of returning cores for credit.

*Sales Incentives*

We provide various marketing allowances to our customers, including sales incentives and concessions. Voluntary marketing allowances related to a single exchange of product are recorded as a reduction of revenues at the time the related revenues are recorded or when such incentives are offered. Other marketing allowances, which may only be applied against future purchases, are recorded as a reduction to revenues in accordance with the timetable for issuing the credits as set forth in the relevant agreement. Sales incentive amounts are recorded based on the value of the incentive provided.

*Financial Risk Management and Derivatives*

We are exposed to market risk from material movements in foreign exchange rates between the U.S. dollar and the currencies of the foreign countries in which we operate. Our primary risk relates to changes in the rates between the U.S. dollar and the Mexican peso associated with our growing operations in Mexico. To mitigate the risk of currency fluctuation between the U.S. dollar and the peso, in August 2005 we began to enter into forward foreign exchange contracts to exchange U.S. dollars for pesos. The extent to which we use forward foreign exchange contracts is periodically reviewed in light of our estimate of market conditions and the terms and length of anticipated requirements. The use of derivative financial instruments allows us to reduce our exposure to the risk that the eventual net cash outflow resulting from funding the expenses of the foreign operations will be materially affected by changes in exchange rates. We do not engage in currency speculation or hold or issue financial instruments for trading purposes. These contracts expire in a year or less. Any changes in fair values of foreign exchange contracts are reflected in current period earnings. For the three months ended September 30, 2005, we recognized a loss of \$11,000 associated with these forward exchange contracts.

**Results of Operations for the six months ended September 30, 2005 and 2004**

The following discussion and analysis should be read in conjunction with the financial statements and notes to the financial statements included in this report.

The following table summarizes certain key operating data for the periods indicated:

	<b>Six Months Ended September</b>	
	<b>30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(Restated)</b>	
Gross margin	21.6%	23.5%
EBITDA(1)	\$ 1,863,000	\$ 5,345,000
Cash flow from operations	\$ (8,883,000)	\$ 9,968,000
Finished goods turnover (annualized)(2)	2.31	3.33
Finished goods turnover, excluding POS inventory (annualized)(3)	4.57	5.09
Annualized return on equity(4)	(1.0)%	10.9%

(1) EBITDA is computed as earnings before gross interest expense, taxes, depreciation and

amortization.

We believe this is a useful measure of our ability to operate successfully.

- (2) Annualized finished goods turnover for the six months ended September 30, 2005 and September 30, 2004 is calculated by multiplying cost of sales for each six month period by 2 and dividing the result by the average between beginning inventory and ending inventory for each six month period. We believe this provides a useful measure of our ability to turn production into revenues.
- (3) Calculated on the same basis as note (2) except for the exclusion of pay-on-scan inventory in the denominator. We believe this provides a useful measure of our ability to manage

inventory which  
is within our  
physical control.

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- (4) Annualized return on equity is calculated by multiplying net income for the six months ended September 30, 2005 and September 30, 2004 by 2 and dividing the result by beginning shareholders equity. We believe this provides a useful measure of our ability to invest shareholders funds profitably.

*Non-GAAP Measures* A reconciliation of EBITDA to net income (loss) is provided below:

	<b>Six Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(Restated)</b>	
EBITDA	\$ 1,863,000	\$ 5,345,000
Depreciation and amortization	(988,000)	(1,006,000)
Interest expense gross	(1,216,000)	(830,000)
Income tax benefit (expense)	102,000	(1,303,000)
Net income (loss)	\$ (239,000)	\$ 2,206,000

Following is our unaudited results of operations, reflected as a percentage of net sales:

	<b>Six Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(Restated)</b>	
Net sales	100.0%	100.0%
Cost of goods sold	78.4%	76.5%
Gross margin	21.6%	23.5%
General and administrative expenses	15.6%	10.9%
Sales and marketing expenses	3.2%	2.5%
Research and development expenses	1.1%	0.8%

Operating income	1.7%	9.3%
Interest expense net of interest income	2.3%	1.7%
Income tax expense (benefit)	(0.2)%	2.8%
Net income (loss)	(0.4)%	4.8%

Our results for the six months ended September 30, 2005 reflect the investments we have made to implement our strategy and the progress that we have realized. During the six months ended September 30, 2005, we opened our new manufacturing facility in Mexico (a facility that at September 30, 2005 had approximately 250 employees), significantly increased our production to accommodate the new business we have received from one of the world's largest automobile manufacturers, opened a new distribution facility in Nashville, Tennessee and resolved, we believe, the SEC's inquiries concerning our previously filed public reports. While we have incurred significant costs to achieve these objectives, we believe these investments have helped position us to capitalize on the market opportunities that we continue to see.

*Net Sales.* Our net sales for the six months ended September 30, 2005 were \$51,490,000, an increase of \$5,288,000 or 11.4% compared to net sales for the six months ended September 30, 2004 of \$46,202,000. Gross sales increased by \$8,238,000 due primarily to higher sales to our existing customers. In addition, there was an increase in royalty income of \$495,000. These increases were offset by an increase of \$3,589,000 in marketing allowances (which reduce net sales) from \$5,877,000 for the six months ended September 30, 2004 to \$9,466,000 for the six months ended September 30, 2005. Cost of goods sold as a percentage of net sales was positively impacted by the increase in royalty income noted above, for which there is no cost of goods sold, and higher core charge revenue, which has a higher margin than unit sales.

*Cost of Goods Sold.* Cost of goods sold as a percentage of net sales slightly increased for the six months ended September 30, 2005 to 78.4% when compared to 76.5% for the six months ended September 30, 2004. For the six months ended September 30, 2005, this percentage was positively impacted by the decrease in direct labor costs during the three months ended September 30, 2005. This positive impact was offset by the front-loaded marketing allowance we provided to one of the world's largest automobile manufacturers which reduced reported sales but did not impact the cost of goods associated with those sales. Cost of goods sold was also negatively impacted by the higher per unit manufacturing costs incurred during the three months ended June 30, 2005 to meet the demands of the new business we received, including increased overtime and temporary labor costs, and the manufacturing inefficiencies at our Mexican facility.

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*General and Administrative.* Our general and administrative expenses increased from \$5,037,000 for the six months ended September 30, 2004 to \$8,057,000 for the six months ended September 30, 2005. This 60% increase is principally due to an increase in the outside professional and consulting fees associated with the SEC's review of our SEC filings and the related restatement of our financial statements from \$613,000 for the six months ended September 30, 2004 to \$1,762,000 for the six months ended September 30, 2005; additional expenses of \$1,081,000 and \$76,000 related to our new production facility in Mexico and our new distribution facility in Nashville, Tennessee, respectively; consulting fees of \$265,000 incurred to comply with the Sarbanes-Oxley Act of 2002; an increase in our Human Resource Department expenses from \$283,000 for the six months ended September 30, 2004 to \$520,000 for the six months ended September 30, 2005 related to the hiring of additional staff to support the new business we have received; and an increase in our accounting and finance department staff expenses from \$230,000 in the prior six-month period to \$586,000 for the current prior six-month period. These increases were partially offset by a decline in the indemnification expenses we incurred in connection with the SEC and U.S. Attorney's Office's investigation of our former President and Chief Operating Officer from \$249,000 for the six months ended September 30, 2004 to \$225,000 for the six months ended September 30, 2005. We believe payment of these indemnification expenses is essentially complete.

*Sales and Marketing.* Our sales and marketing expenses increased over the periods by \$496,000 or 43.8% to \$1,629,000 for the six months ended September 30, 2005 from \$1,133,000 for the six months ended September 30, 2004. This increase is principally attributable to an increase of approximately \$348,000 in costs incurred to support customer sales initiatives, such as salaries and benefits, advertising and travel, for the new business we received. We also incurred \$130,000 in increased catalog expenses.

*Research and Development.* Our research and development expenses increased over this period by \$201,000, or 51.8%, to \$589,000 for the six months ended September 30, 2005 from \$388,000 for the six months ended September 30, 2004. This increase was attributable to the increased costs of supporting the new business we obtained.

*Interest Expense.* For the six months ended September 30, 2005, interest expense, net of interest income, was \$1,202,000. This represents an increase of \$402,000 over net interest expense of \$800,000 for the six months ended September 30, 2004. This increase was principally attributable to new borrowings on the line of credit during the current six month period and to an increase in short-term interest rates associated with the accounts receivables we discounted under our factoring arrangements. The increase in short-term interest rates was partially offset by a decline in the aggregate amount of receivables that were discounted during the most recent six month period. Interest expense is comprised principally of interest paid under our bank credit agreement, discounts recognized in connection with our receivables discounting arrangements and interest on our capital leases.

*Income Tax.* For the six months ended September 30, 2005 and September 30, 2004, we recognized an income tax benefit of \$102,000 and an income tax expense of \$1,303,000, respectively. For income tax purposes, we have available \$1,150,000 of federal carry forwards which expire in varying amounts through 2023.

**Results of Operations for the three months ended September 30, 2005 and 2004**

The following discussion and analysis should be read in conjunction with the financial statements and notes thereto appearing elsewhere herein.

The following table summarizes certain key operating data for the periods indicated:

	<b>Three Months Ended</b>	
	<b>September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(Restated)</b>	<b>(Restated)</b>
Gross margin	25.7%	28.0%
EBITDA(1)	\$ 3,158,000	\$ 4,302,000
Cash flow from operations	\$ (4,905,000)	\$ 3,904,000
Finished goods turnover (annualized)(2)	2.32	2.96
Finished goods turnover, excluding POS inventory (annualized)(3)	4.28	5.10
Annualized return on equity(4)	10.3%	21.2%



- (1) EBITDA is computed as earnings before gross interest expense, taxes, depreciation and amortization. We believe this is a useful measure of our ability to operate successfully.

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- (2) Annualized finished goods turnover for the three months ended September 30, 2005 and September 30, 2004 is calculated by multiplying cost of sales for such three month period by 4 and dividing the result by the average between beginning inventory and ending inventory for each such fiscal quarter. We believe this provides a useful measure of our ability to turn production into revenues.
- (3) Calculated on the same basis as note (2) except for the exclusion of pay-on-scan inventory in the denominator. We believe this provides a useful measure of our ability to manage inventory which is within our physical control.
- (4) Annualized return on equity

is computed as net income for the three months ended September 30, 2005 and September 30, 2004 by 4 and dividing the result by beginning shareholders equity. We believe this provides a useful measure of our ability to invest shareholders funds profitably.

*Non-GAAP Measures* A reconciliation of EBITDA to net income is provided below:

	<b>Three Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(Restated)</b>	<b>(Restated)</b>
EBITDA	\$ 3,158,000	\$ 4,302,000
Depreciation and amortization	(490,000)	(428,000)
Interest expense gross	(658,000)	(463,000)
Income tax expense	(829,000)	(1,262,000)
Net income	\$ 1,181,000	\$ 2,149,000

Following is our unaudited results of operations, reflected as a percentage of net sales:

	<b>Three Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(Restated)</b>	
Net sales	100.0%	100.0%
Cost of goods sold	74.3%	72.0%
Gross margin	25.7%	28.0%
General and administrative expenses	13.4%	9.7%
Sales and marketing expenses	2.5%	2.0%
Research and development expenses	0.9%	0.8%
Operating income	8.9%	15.5%
Interest expense net of interest income	2.2%	1.8%
Income tax expense	2.8%	5.1%

Net income	3.9%	8.6%
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*Net Sales.* Our net sales for the three months ended September 30, 2005 were \$30,139,000, an increase of \$5,146,000 or 20.6% compared to net sales for the three months ended September 30, 2004 of \$24,993,000. Gross sales increased by \$6,515,000 due primarily to higher sales to our existing customers which were partially offset by an increase of \$1,015,000 in marketing allowances (which reduce net sales) from \$2,752,000 for the three months ended September 30, 2004 to \$3,767,000 for the three months ended September 30, 2005.

*Cost of Goods Sold.* Cost of goods sold as a percentage of net sales slightly increased for the three months ended September 30, 2005 to 74.3% when compared to 72.0% for the three months ended September 30, 2004. Although cost of goods sold was positively impacted by the decrease in direct labor costs, the gross margin percentage was reduced by the increase in marketing allowances which reduce net sales, but not the cost associated with those sales. Cost of goods sold as a percentage of net sales was positively impacted by the increase in core charge revenue, which has a higher margin than unit sales.

*General and Administrative.* Our general and administrative expenses increased from \$2,416,000 for the three months ended September 30, 2004 to \$4,047,000 for the three months ended September 30, 2005. This 67.5% increase is principally due to an increase in outside professional and consulting fees associated with the SEC's review of our SEC filings and the related restatement of our financial statements from \$147,000 for the three months ended September 30, 2004 to \$572,000 for the three months ended September 30, 2005; additional expenses of \$485,000 and \$73,000 related to our new production facility in Mexico and our new

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distribution facility in Nashville, Tennessee, respectively; consulting fees of \$265,000 to comply with the Sarbanes-Oxley Act of 2002: an increase in our Human Resource Department expenses from \$134,000 for the three months ended September 30, 2004 to \$264,000 for the three months ended September 30, 2005 related to the hiring and recruitment of additional staff to support the new business we have received; and an increase in our accounting and finance department staff expenses from \$229,000 in the earlier period to \$299,000 for the current period. Additionally, the indemnification expenses we incurred in connection with the SEC and U.S. Attorney's Office's investigation of our former President and Chief Operating Officer increased from \$26,000 for the three months ended September 30, 2004 to \$56,000 for the three months ended September 30, 2005. We believe payment of these indemnification expenses is essentially complete.

*Sales and Marketing.* Our sales and marketing expenses increased over the periods by \$253,000 or 49.5% to \$764,000 for the three months ended September 30, 2005 from \$511,000 for the three months ended September 30, 2004. This increase is principally attributable to an increase of approximately \$241,000 in costs incurred to support customer sales initiatives, such as salaries and benefits, and consulting fees, for the new business we received.

*Research and Development.* Our research and development expenses increased over this period by \$66,000, or 31.6%, to \$275,000 for the three months ended September 30, 2005 from \$209,000 for the three months ended September 30, 2004. This increase was attributable to the increased costs of supporting the new business we obtained.

*Interest Expense.* For the three months ended September 30, 2005, interest expense, net of interest income, was \$654,000. This represents an increase of \$205,000 over net interest expense of \$449,000 for the three months ended September 30, 2004. This increase was principally attributable to new borrowings on the line of credit during the current fiscal quarter and an increase in short-term interest rates associated with the accounts receivables we discounted under our factoring arrangements. The increase in short-term interest rates was partially offset by a decline in the aggregate amount of customer receivables that were discounted during the most recent fiscal quarter. Interest expense is comprised principally of interest paid under our bank credit agreement, discounts recognized in connection with our receivables discounting arrangements and interest on our capital leases.

*Income Tax.* For the three months ended September 30, 2005 and 2004, we recognized income tax expense of \$829,000 and \$1,262,000, respectively. For income tax purposes, we have available \$1,150,000 of federal carry forwards which expire in varying amounts through 2023.

**Liquidity and Capital Resources**

We have financed our operations through cash flows from operating activities, the receivable discount programs we have established with two of our customers, and the use of our bank credit facility. Our working capital needs have increased significantly in light of the ramped up production demands associated with our new or expanded customer arrangements and the adverse impact that the marketing allowances that we have typically granted our customers in connection with these new or expanded relationships have on the near-term revenues and associated cash flow from these arrangements. Since the sales program to one of the world's largest automobile manufacturers under an agreement we signed with this customer during the fourth quarter of fiscal 2005 was not fully launched in the expected timeframe, the inventory buildup we made in connection with this new agreement has put an additional strain on our working capital. Because our net operating loss carry forwards for tax purposes have been substantially utilized, we anticipate that our future cash flow will be negatively impacted by future tax payments. In addition, while our cash position did benefit from the way in which the purchase of the transition inventory associated with our POS arrangement was structured, as anticipated, satisfaction of the credit due customer through the issuance of credits against that customer's receivables is now having a negative impact on our cash flow. Although we cannot provide assurance, we believe our cash and short term investments on hand, cash flows from operations, the availability under our bank credit facility and our recently established capital lease financing will be sufficient to satisfy our currently expected working capital needs, capital lease commitments and capital expenditure obligations over the next year.

***Working Capital and Net Cash Flow***

At September 30, 2005, we had working capital of \$40,064,000, a ratio of current assets to current liabilities of 1.90:1, and cash and cash equivalents of \$1,257,000, which compares to working capital of \$42,820,000, a ratio of current assets to current liabilities of 2.25:1 and cash and cash equivalents of \$6,211,000 at March 31, 2005. In addition, at March 31, 2005, we had not borrowed any amounts against our line of credit. At September 30, 2005, we

had borrowed \$6,831,000 against the line of credit.

Because of the factors discussed under the caption *Liquidity and Capital Resources* , our cash position has been strained. Net cash used in operating activities was \$8,883,000 for the six months ended September 30, 2005, as compared to net cash provided by

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operating activities of \$9,968,000 for the six months ended September 30, 2004. The structure of our purchase of transition inventory associated with our POS arrangement and the marketing allowances we provided to our customers have had a negative impact on our cash flow. During the six months ended September 30, 2005, the POS arrangement reduced our cash flow from operations by \$4,797,000. During the six months ended September 30, 2004, this arrangement increased our cash flow from operations by \$12,912,000. The credit due our customer under the POS arrangement has declined from \$12,543,000 at March 31, 2005 to \$7,746,000 at September 30, 2005. The net cash from operating activities was also impacted by our net loss during the current fiscal quarter of \$239,000, compared to the net income of \$2,206,000 during the September 2004 six month period.

Inventory and accounts payable were significantly impacted by our expanded customer arrangements. Inventory and inventory unreturned increased by a combined total of \$12,006,000 principally due to our POS arrangement and new business we have been awarded. As a result of increased production related to this new business, our accounts payable and accrued liabilities increased by approximately \$8,392,000 from March 31, 2005 to September 30, 2005. Even though inventory increased by over \$10,702,000, our excess and obsolete inventory reserve remained essentially unchanged because the increase in inventory was largely related to our production of a new line of remanufactured starters and alternators for which we believe there is a high demand.

Net accounts receivable decreased by \$543,000 as of September 30, 2005 compared to March 31, 2005, primarily due to increased sales discounts partially offset by the increase in sales volume and a reduction in the volume of receivables that we discounted.

We used net cash in investing activities in the six months ended September 30, 2005. These investing activities were primarily related to capital expenditures of \$2,532,000 during this period. We expect to use cash in investing activities for the balance of fiscal 2006.

During each of the six months ended September 30, 2005 and 2004, the cash we used in financing activities primarily related to our capital lease obligations.

**Capital Resources***Line of Credit*

In May 2004, we entered into a loan agreement which provides for borrowings of up to \$15,000,000 without reference to a borrowing base. The interest rate on this credit facility fluctuates and is based upon the (i) bank's reference rate or (ii) LIBOR, as adjusted to take into account any bank reserve requirements, plus a margin of 2.00%, at our option. The bank holds a security interest in substantially all of our assets. As of September 30, 2005, we had reserved \$4,301,000 of our line for standby letters of credit for worker's compensation insurance, and had an outstanding balance under this line of credit of \$6,831,000. This loan agreement expires on October 2, 2006. As of November 9, 2005, we had borrowed \$3,702,000 against our line of credit and reserved \$4,301,000 of the line for standby letters of credit for worker's compensation insurance, resulting in \$6,997,000 remaining available at November 9, 2005. We reduced our line of credit on November 3, 2005 with the proceeds of the capital lease financing discussed below.

The loan agreement includes various financial conditions, including minimum levels of tangible net worth, cash flow, fixed charge coverage ratio and a number of restrictive covenants, including prohibitions against additional indebtedness, payment of dividends, pledge of assets and capital expenditures as well as loans to officers and/or affiliates. In addition, it is an event of default under the loan agreement if Selwyn Joffe is no longer our CEO. Pursuant to the loan agreement, we have agreed to pay a fee of 3/8% per year on any difference between the \$15,000,000 commitment and the outstanding amount of credit we actually use, determined by the average of the daily amount of credit outstanding during the specified period.

As discussed in Note Q Subsequent Events, the financial covenants in the loan agreement have been modified in a way that, we believe, more appropriately reflects the manner in which our business and customer relationships are managed. Prior to this amendment, we were regularly in default under our loan agreement for failing to meet a number of financial covenants in the agreement and for failing to provide the bank with required information, including our public reports filed with the SEC. While no assurance in this regard can be given, we believe the modifications to these financial covenants meaningfully reduce the likelihood of a financial covenant default. In addition, we are now current with our SEC filings, and we believe we have resolved the issues raised during the course of the SEC's review

of our previously-filed public reports (although the SEC has not provided us with any confirmation in this regard). As a result, we believe we should be able to provide the bank the information it is entitled to within the time frame provided for in the loan agreement.



**Table of Contents***Capital Lease Financing*

On October 26, 2005, we entered into a capital lease agreement with our bank for equipment financing for \$4,110,000, payable in monthly installments of \$80,937 over the sixty month term of the lease agreement, with a one dollar purchase option at the end of the lease term. This financing arrangement has an effective interest rate of 7%.

*Receivable Discount Program*

Our liquidity has been positively impacted by receivable discount programs we have with two of our customers and their respective banks. Under this program, we have the option to sell the customers' receivables to their banks at an agreed upon discount set at the time the receivables are sold. The discount averaged 3.0% during the six months ended September 30, 2005 and has allowed us to accelerate collection of receivables aggregating \$35,627,000 by an average of 193 days. On an annualized basis, the weighted average discount rate on receivables sold to banks during the six months ended September 30, 2005 was 5.5%. While this arrangement has reduced our working capital needs, there can be no assurance that it will continue in the future. These programs resulted in interest costs of \$1,022,000 during the six months ended September 30, 2005. These interest costs will increase as interest rates rise and as our customers increase their utilization of this discounting arrangement.

*Multi-year Vendor Agreements*

We have significantly expanded our production during the past 12 months to meet the obligations arising under our multi-year vendor agreements. This increased production caused significant increases in our inventories, accounts payable and employee base. With respect to merchandise covered by the pay-on-scan arrangement with our largest customer, the customer is not obligated to purchase the goods we ship to it until that merchandise is purchased by one of its customers. While this arrangement will defer recognition of income from sales to this customer, we do not believe it will ultimately have an adverse impact on our liquidity. In addition, although the significant marketing allowances we have provided our customers as part of these multi-year agreements meaningfully limit the near-term revenues and associated cash flow from these new or expanded arrangements, we believe this incremental business will improve our overall liquidity and cash flow from operations over time.

As part of our POS arrangement with our largest customer, we agreed to purchase the customer's inventory of alternators and starters that was transitioned to a POS basis. The customer is paying us the proceeds from its POS sale of this transition inventory, and we are paying for this inventory through the issuance of monthly credits to this customer, which will continue through April 2006. Because we collected cash for the transition inventory before we issued the monthly credits to purchase this inventory during the initial phase of this arrangement, this transaction helped finance our inventory build-up to meet production requirements. As anticipated, satisfaction of the credit due customer through the issuance of credits against that customer's receivables is now having a negative impact on our cash flow. While we did not record the approximately \$24,000,000 of transition inventory that we purchased or the associated payment liability on our balance sheet, the accounting treatment that we have adopted to account for this purchase resulted in a net liability to this customer of \$7,746,000 at September 30, 2005. (For an explanation of this accounting treatment, see Note G to the Consolidated Financial Statements included in this report.)

We have long-term agreements with each of our major customers. Under these agreements, which typically have initial terms of at least five years, we are designated as the exclusive or primary supplier for specified categories of remanufactured alternators and starters. In consideration for its designation as a customer's exclusive or primary supplier, we typically provide the customer with a package of marketing incentives. These incentives differ from contract to contract and can include (i) the issuance of a specified amount of credits against receivables in accordance with a schedule set forth in the relevant contract, (ii) support for a particular customer's research or marketing efforts that can be provided on a scheduled basis, (iii) discounts that are granted in connection with each individual shipment of product and (iv) other marketing, research, store expansion or product development support. We have also entered into agreements to purchase certain customers' core inventory and to issue credits to pay for that inventory according to an agreed upon schedule set forth in the agreement. These contracts typically require that we meet ongoing performance, quality and fulfillment requirements, and its contract with one of the largest automobile manufacturers in the world includes a provision (standard in this manufacturer's vendor agreements) granting the manufacturer the right to terminate the agreement at any time for any reason. Our contracts with major customers expire at various dates ranging from May 2008 through December 2012.

Our customers continue to aggressively seek extended payment terms, pay-on-scan inventory arrangements, significant marketing allowances, price concessions and other terms that adversely affect our liquidity and reported operating results.

**Table of Contents****Capital Expenditures and Commitments**

Our capital expenditures were \$2,532,000 for the six months ended September 30, 2005. Approximately \$1,878,000 of these expenditures relate to our Mexico production facility, with the remainder for recurring capital expenditures. The amount and timing of capital expenditures during fiscal 2006 may vary depending on the final build-out schedule for the Mexico production facility.

**Contractual Obligations**

The following summarizes our contractual obligations and other commitments as of September 30, 2005, and the effect such obligations could have on our cash flow in future periods:

<b>Contractual Obligations</b>	<b>Total</b>	<b>Payments due by period</b>			<b>More than 5 years</b>
		<b>Less than 1 year</b>	<b>1-3 years</b>	<b>3-5 years</b>	
Long-Term Debt Obligation					
Capital (Finance) Lease Obligations	\$ 2,637,000	\$ 697,000	\$ 1,284,000	\$ 656,000	
Operating Lease Obligations	\$ 9,245,000	\$ 2,245,000	\$ 2,405,000	\$ 1,691,000	\$ 2,904,000
Purchase Obligations	\$ 20,644,000	\$ 13,309,000	\$ 4,401,000	\$ 2,934,000	
Other Long-Term Obligations	\$ 13,390,000	\$ 5,514,000	\$ 3,709,000	\$ 2,578,000	\$ 1,589,000
<b>Total</b>	<b>\$ 45,916,000</b>	<b>\$ 21,765,000</b>	<b>\$ 11,799,000</b>	<b>\$ 7,859,000</b>	<b>\$ 4,493,000</b>

Capital Lease Obligations represent amounts due under finance leases of various types of machinery and computer equipment that are accounted for as capital leases.

Operating Lease Obligations represent amounts due for rent under our leases for office and warehouse facilities in California, Tennessee, North Carolina, Malaysia, Singapore and Mexico.

Purchase Obligations represent our obligation to issue credits to (i) a large customer for the acquisition of transition inventory from that customer and (ii) another large customer for the acquisition of that customer's core inventory.

Other Long-Term Obligations represent commitments we have with certain customers to provide marketing allowances in consideration for supply agreements to provide products over a defined period.

**Customer Concentration**

We are substantially dependent upon sales to our major customers. During the six months ended September 30, 2005 and 2004, sales to our three largest customers constituted approximately 93% and 94% of our total sales, respectively. We expect our customer concentration to continue to decline as we add important new customers to our business base. Any meaningful reduction in the level of sales to any of our significant customers, deterioration of any customer's financial condition or the loss of a customer could have a materially adverse impact upon us. In addition, the concentration of our sales and the competitive environment in which we operate has increasingly limited our ability to negotiate favorable prices and terms for our products. Because of the very competitive nature of the market for remanufactured starters and alternators and the limited number of customers for these products, our customers have increasingly sought and obtained price concessions, significant marketing allowances and more favorable payment terms. The increased pressure we have experienced from our customers may increasingly and adversely impact our profit margins in the future.

**Offshore Manufacturing**

To take further advantage of the production savings associated with manufacturing outside the United States, on October 28, 2004, our wholly owned subsidiary, Motorcar Parts de Mexico, S.A. de C.V., entered into a build-to-suit lease covering approximately 125,000 square feet of industrial premises in Tijuana, Baja California, Mexico for a remanufacturing facility. We guarantee the payment obligations of our subsidiary under the terms of the lease. The lease provides for a monthly rent of \$47,500, which increases by 2% each year beginning with the third year of the lease term. The lease has a term of 10 years from May 2005, the date the facility was available for occupancy, and Motorcar Parts de Mexico has an option to extend the lease term for two additional 5-year periods. In May 2005, we took possession of these premises, and in June 2005, we began limited remanufacturing at the location. In April 2006,

Motorcar Parts de Mexico will lease an additional 41,000 square feet adjoining its existing space. During the six months ended September 30, 2005 and 2004, units produced outside the United States constituted 20.5% and 12.0%, respectively, of our total production. During the ramp-up of production in our Mexican facility, we have incurred significant remanufacturing costs that are being expensed currently rather than fully absorbed by the goods produced. This has negatively impacted the per unit cost of

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manufacturing in Mexico. Because our foreign operations are expected to experience lower production costs for the same remanufacturing process as production increases, however, we expect to continue to grow the portion of our remanufacturing operations that is conducted outside the United States.

*Seasonality of Business*

Due to the nature and design as well as the current limits of technology, alternators and starters traditionally fail when operating in extreme conditions. That is, during the summer months, when the temperature typically increases over a sustained period of time, alternators and starters are more apt to fail and thus, an increase in demand for our products typically occurs. Similarly, during winter months, when the temperature is colder, alternators and starters tend to fail but not to the same extent as summer months. These parts require replacing immediately to maintain the operation of the vehicle. As such, summer months tend to show an increase in overall volume with a few spikes in the winter.

*Off-Balance Sheet Arrangements*

We do not have any off-balance sheet financing arrangements or liabilities. In addition, we do not have any majority-owned subsidiaries or any interests in, or relationships with, any material special-purpose entities that are not included in the consolidated financial statements.

*Related Party Transactions*

Our related party transactions primarily consist of employment and director agreements, and stock purchase agreements. Other than the changes to the employment agreement with Selwyn Joffe, our Chairman and Chief Executive Officer, which are summarized in the Current Report on Form 8-K we filed on April 25, 2005, our related party transactions have not changed since March 31, 2005.

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**PART II OTHER INFORMATION**

**Item 6. Exhibits and Reports on Form 8-K.**

(a) Exhibits:

- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K:

Current report on Form 8-K filed on July 14, 2005 which reported Charles Yeagley, the registrant's chief financial officer, tendered his resignation for health reasons, effective on August 31, 2005.

Current report on Form 8-K filed on September 2, 2005 which reported that the registrant, in consultation with its independent public accountants, concluded that its previously-issued unaudited interim income statements for the fiscal quarters ended September 30, 2003, March 31, 2004, June 30, 2004 and September 30, 2004 contained errors and should no longer be relied upon. This current report also included restated interim results that reflected the correction of these errors.

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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.

MOTORCAR PARTS OF AMERICA,  
INC

Dated: July 28, 2006

By: /s/ Mervyn McCulloch

Mervyn McCulloch  
Chief Financial Officer

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