

MONRO MUFFLER BRAKE INC

Form 10-Q

February 02, 2006

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**FORM 10-Q  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

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

**For the quarterly period ended December 24, 2005.**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File No. 0-19357**

**MONRO MUFFLER BRAKE, INC.**

(Exact name of registrant as specified in its charter)

New York

16-0838627

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification #)

200 Holleder Parkway, Rochester, New York

14615

(Address of principal executive offices)

(Zip code)

585-647-6400

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):  
Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of January 20, 2006, 13,933,108 shares of the Registrant's Common Stock, par value \$.01 per share, were outstanding.

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## Item 1. Financial Statements

**MONRO MUFFLER BRAKE, INC.  
CONSOLIDATED BALANCE SHEET**

	(Unaudited)	
	<b>December 24, 2005</b>	<b>March 26, 2005</b>
	(Dollars in thousands)	
<b>Assets</b>		
Current assets:		
Cash and equivalents	\$	\$ 888
Trade receivables	1,964	2,162
Inventories	63,438	59,753
Deferred income tax asset	978	798
Other current assets	13,883	13,918
Total current assets	80,263	77,519
Property, plant and equipment	288,189	279,561
Less Accumulated depreciation and amortization	(125,057)	(115,252)
Net property, plant and equipment	163,132	164,309
Goodwill	37,790	37,218
Intangible assets and other noncurrent assets	13,614	5,939
Deferred income tax asset	46	
Total assets	\$ 294,845	\$ 284,985
<b>Liabilities and Shareholders Equity</b>		
Current liabilities:		
Current portion of long-term debt	\$ 342	\$ 1,928
Trade payables	20,980	23,791
Federal and state income taxes payable	2,810	682
Accrued payroll, payroll taxes and other payroll benefits	8,888	8,736
Accrued insurance	4,395	4,622
Other current liabilities	10,083	10,602
Total current liabilities	47,498	50,361
Long-term debt	47,178	55,438
Accrued rent expense	7,465	7,829
Other long-term liabilities	3,175	3,332
Deferred income tax liability		536
Total liabilities	105,316	117,496

Commitments

Shareholders' equity:

Class C Convertible Preferred Stock, \$1.50 par value, \$.144 conversion value, 150,000 shares authorized; 65,000 shares issued and outstanding	97	97
Common Stock, \$.01 par value, 20,000,000 shares authorized; 13,926,033 and 13,702,455 issued and outstanding at December 24, 2005 and March 26, 2005, respectively	139	137
Treasury Stock, 325,200 shares, at cost	(1,831)	(1,831)
Additional paid-in capital	56,507	52,484
Accumulated other comprehensive income		(17)
Retained earnings	134,617	116,619
 Total shareholders' equity	 189,529	 167,489
 Total liabilities and shareholders' equity	 \$ 294,845	 \$ 284,985

The accompanying notes are an integral part of these financial statements.

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**MONRO MUFFLER BRAKE, INC.**  
**CONSOLIDATED STATEMENT OF INCOME**  
 (UNAUDITED)

	Quarter Ended		Nine Months Ended	
	Fiscal December		Fiscal December	
	2005	2004	2005	2004
		Restated		Restated
	(Dollars in thousands, except per share data)			
Sales	\$ 90,188	\$ 80,522	\$ 280,454	\$ 256,290
Cost of sales, including distribution and occupancy costs	55,300	48,898	165,119	150,765
Gross profit	34,888	31,624	115,335	105,525
Operating, selling, general and administrative expenses	27,463	25,371	81,142	76,225
Operating income	7,425	6,253	34,193	29,300
Interest expense, net of interest income for the quarter of \$6 in 2005 and \$16 in 2004, and year-to-date of \$22 in 2005 and \$38 in 2004	845	638	2,537	1,811
Other expense (income), net	30	(61)	333	231
Income before provision for income taxes	6,550	5,676	31,323	27,258
Provision for income taxes	2,489	2,157	11,903	10,359
Net income	\$ 4,061	\$ 3,519	\$ 19,420	\$ 16,899
Earnings per share:				
Basic	\$ .30	\$ .27	\$ 1.43	\$ 1.29
Diluted	\$ .27	\$ .24	\$ 1.30	\$ 1.16

The accompanying notes are an integral part of these financial statements.

**Table of Contents****MONRO MUFFLER BRAKE, INC.****CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY**

(UNAUDITED)

(Dollars in thousands)

	Preferred Stock	Common Stock	Treasury Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total
Balance at March 26, 2005	\$ 97	\$ 137	\$ (1,831)	\$ 52,484	\$ (17)	\$ 116,619	\$ 167,489
Net income						19,420	19,420
Other comprehensive income: SFAS No. 133 adjustment for the nine months ended December 24, 2005					17		17
Total comprehensive income							19,437
Cash dividends:							
Preferred						(68)	(68)
Common						(1,354)	(1,354)
Tax benefit from employer stock plans				647			647
Exercise of stock options		1		1,367			1,368
Exercise of warrants		1		2,009			2,010
Balance at December 24, 2005	\$ 97	\$ 139	\$ (1,831)	\$ 56,507	\$	\$ 134,617	\$ 189,529

The accompanying notes are an integral part of these financial statements.

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**MONRO MUFFLER BRAKE, INC.**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**  
(UNAUDITED)

	<b>Nine Months Ended Fiscal December</b>	
	<b>2005</b>	<b>2004 Restated</b>
	<b>(Dollars in thousands)</b>	
	<b>Increase (Decrease) in Cash</b>	
Cash flows from operating activities:		
Net income	\$ 19,420	\$ 16,899
Adjustments to reconcile net income to net cash provided by operating activities -		
Depreciation and amortization	13,249	11,719
Net change in deferred income taxes	(773)	730
(Gain) loss on disposal of property, plant and equipment	(111)	79
Change in assets and liabilities, net of effects from acquisitions:		
Decrease (increase) in trade receivables	198	(325)
Increase in inventories	(3,767)	(5,919)
Decrease in other current assets	200	289
Increase in intangible assets and other noncurrent assets	(1,250)	(365)
(Decrease) increase in trade payables	(2,876)	5,926
Decrease in accrued expenses	(639)	(547)
Increase in federal and state income taxes payable	2,776	2,424
(Decrease) increase in other long-term liabilities	(379)	222
Total adjustments	6,628	14,233
Net cash provided by operating activities	26,048	31,132
Cash flows from investing activities:		
Capital expenditures	(12,354)	(14,044)
Acquisitions, net of cash acquired		(3,658)
Proceeds from the disposal of property, plant and equipment	1,855	1,971
Investment in R & S Parts and Service, Inc.	(2,000)	
Loan to R & S Parts and Service, Inc.	(5,000)	
Net cash used for investing activities	(17,499)	(15,731)
Cash flows from financing activities:		
Proceeds from borrowings	166,142	95,759
Principal payments on long-term debt and capital lease obligations	(177,535)	(113,028)
Exercise of stock options	1,368	1,214
Exercise of warrants	2,010	
Dividends to shareholders	(1,422)	



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Net cash used for financing activities	(9,437)	(16,055)
Decrease in cash	(888)	(654)
Cash at beginning of period	888	1,533
Cash at end of period	\$	\$ 879

The accompanying notes are an integral part of these financial statements.

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## MONRO MUFFLER BRAKE, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Condensed Consolidated Financial Statements

The consolidated balance sheet as of December 24, 2005, the consolidated statements of income for the quarters and nine months ended December 24, 2005 and December 25, 2004, the consolidated statements of cash flows for the nine months ended December 24, 2005 and December 25, 2004 and the consolidated statement of changes in shareholders' equity for the nine months ended December 24, 2005, include Monro Muffler Brake, Inc. and its wholly owned subsidiaries (the Company). These unaudited condensed consolidated financial statements have been prepared by the Company and are subject to year-end adjustments. In the opinion of management, all known adjustments (consisting of normal recurring accruals or adjustments) have been made to state fairly the financial position, results of operations and cash flows for the unaudited periods presented.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended March 26, 2005. The results of operations for the interim periods being reported on herein are not necessarily indicative of the operating results for the full year.

The Company reports its results on a 52/53 week fiscal year with the fiscal year ending on the last Saturday in March of each year. The following are the dates represented by each fiscal period reported in these condensed financial statements:

Quarter Ended Fiscal December 2005 :	September 25, 2005	December 24, 2005 (13 weeks)
Quarter Ended Fiscal December 2004 :	September 26, 2004	December 25, 2004 (13 weeks)
Nine Months Ended Fiscal December 2005 :	March 27, 2005	December 24, 2005 (39 weeks)
Nine Months Ended Fiscal December 2004 :	March 28, 2004	December 25, 2004 (39 weeks)

Certain reclassifications have been made to the prior year's consolidated financial statements to conform to the current year's presentation.

**RESTATEMENT**

During the fourth quarter of fiscal 2005, the Company conducted a review of its lease accounting practices. As a result of the review, the Company revised its lease accounting policies to comply with generally accepted accounting principles.

Historically, the Company followed a practice in which it computed straight-line rent expense for the current term of the lease only, while depreciating buildings and leasehold improvements over longer periods. The Company has revised its lease accounting policies to recognize rent expense including rent escalations, on a straight-line basis over the reasonably assured lease term, as defined in Statement of Financial Accounting Standards No. 98 (SFAS 98),

Accounting for Leases. Additionally, the Company modified its accounting to depreciate buildings and leasehold improvements over the shorter of their estimated useful lives or the reasonably assured lease term.

The effects of the restatement on previously reported Consolidated Financial Statements as of December 25, 2004 are summarized below.

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MONRO MUFFLER BRAKE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Quarter Ended Fiscal December 2004 (Unaudited)		Nine Months Ended Fiscal December 2004 (Unaudited)	
	As Previously Reported	As Restated	As Previously Reported	As Restated
	(Dollars in thousands, except per share amounts)			
<b>Financial statement caption</b>				
<b>CONSOLIDATED STATEMENT OF INCOME</b>				
Cost of sales, including distribution and occupancy costs	\$48,659	\$48,898	\$150,048	\$150,765
Gross profit	31,863	31,624	106,242	105,525
Operating income	6,492	6,253	30,016	29,300
Other (income) expense, net	(37)	(61)	303	231
Income before provision for income taxes	5,891	5,676	27,901	27,258
Provision for income taxes	2,239	2,157	10,603	10,359
Net income	3,652	3,519	17,298	16,899
Earnings per share basic	\$ .28	\$ .27	\$ 1.32	\$ 1.29
Earnings per share diluted	\$ .25	\$ .24	\$ 1.19	\$ 1.16

**CONSOLIDATED STATEMENT OF CASH  
FLOWS**

Net income	\$ 17,298	\$ 16,899
Depreciation and amortization	11,096	11,719
Net change in deferred income taxes	974	730
Loss on disposal of property, plant and equipment	153	79
Decrease in accrued expenses	(641)	(547)
Total adjustments	13,834	14,233

The restatement resulted in a decrease to other expense as a result of changes in the gain or loss on disposal of assets for which depreciation expense was restated.

**Note 2 Acquisitions**

Effective October 17, 2004, the Company acquired five retail tire and automotive repair stores located in and around Frederick, Maryland from Donald B. Rice Tire Co., Inc. (the Rice Tire Acquisition). On March 6, 2005, the Company acquired 10 retail tire and automotive repair stores located in southern Maryland from Henderson Holdings, Inc. (the Henderson Acquisition). This group of 15 stores produces approximately \$19 million in sales annually. The Company operates 14 of these retail locations under the Mr. Tire brand name and one under the Tread Quarters brand name. The Company purchased all of the operating assets of these stores, including fixed assets and certain inventory, and assumed certain liabilities, including obligations pursuant to the real property leases for certain of the retail store locations. The total purchase price of these stores was approximately \$11.6 million, which was funded through \$5.1 million in cash, the assumption of liabilities and the issuance of 240,206 shares of the Company's common stock, which was valued at \$6.5 million. In addition, the Company recorded buildings and capital lease obligations in the amount of approximately \$7 million in connection with new leases with the seller of Henderson Holdings for eight of

the properties acquired and one of the properties acquired in the Rice Acquisition. The purchase price and the related accounting for these acquisitions is subject to adjustments to reflect final counts of inventory and fixed assets and the completion of the Company's purchase accounting procedures, including finalizing the valuation of certain tangible and intangible assets. The Company expects to complete this for the Henderson Acquisition by the fourth quarter of fiscal 2006. The result of operations of these stores is included in the Company's income statement from their respective dates of acquisition.

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MONRO MUFFLER BRAKE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

On November 1, 2005, the Company acquired a 13 percent stake in R&S Parts and Service, Inc. ( R & S ), a privately owned automotive aftermarket parts and service chain, for \$2,000,000, from GDJ Retail LLC. As part of the transaction, the Company also lent R&S \$5,000,000 under a secured debt agreement that has a five-year term and an 8 percent interest rate. Additionally, the Company will receive \$60,000 per month in consulting fees. The Company has elected to apply the equity method of accounting for this investment and has chosen to report R&S financial results on a three month lag. Therefore, at December 24, 2005, the Company's investment is recorded within Other non-current assets on the Balance Sheet and nothing is recorded in the Income Statement due to the three month reporting lag.

R&S operates 101 retail stores under the name of Strauss Discount Auto ( Strauss ) that provide automotive parts and accessories, 71 of which also have service bays that offer a full range of aftermarket services. The stores generate approximately \$170 million in annual sales and are located throughout New York, New Jersey and Philadelphia.

The Company also has the option to purchase an additional 20 percent stake in Strauss on or before March 31, 2006 for \$3,000,000. If the Company decides to make this investment, it will have the opportunity to buy the remaining 67 percent of R&S for \$9,000,000 cash and \$1,000,000 of the Company's stock any time prior to April 1, 2007.

**Note 3 Derivative Financial Instruments**

The Company reports derivatives and hedging activities in accordance with Statement of Financial Accounting Standards No. 133 ( SFAS 133 ), Accounting for Derivative Instruments and Hedging Activities , as amended. This statement requires that all derivative instruments be recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether the derivative is designated as part of a hedge transaction, and if it is, depending on the type of hedge transaction.

Currently the Company has no hedge agreements. The most recent hedge agreement expired in October 2005.

**Note 4 Earnings Per Share**

Basic earnings per common share (EPS) amounts are computed by dividing earnings after the deduction of preferred stock dividends by the average number of common shares outstanding. Diluted EPS amounts assume the issuance of common stock for all potentially dilutive equivalents outstanding.

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## MONRO MUFFLER BRAKE, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a reconciliation of basic and diluted EPS for the respective periods:

	<b>Quarter Ended</b>		<b>Nine Months Ended</b>	
	<b>Fiscal December</b>		<b>Fiscal December</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
		<b>Restated</b>		<b>Restated</b>
	<b>(Dollars in thousands, except per share data)</b>			
<b>Numerator for earnings per common share calculation:</b>				
Net Income	\$ 4,061	\$ 3,519	\$ 19,420	\$ 16,899
Less: Preferred stock dividends	(34)		(68)	
<b>Income available to common stockholders</b>	<b>\$ 4,027</b>	<b>\$ 3,519</b>	<b>\$ 19,352</b>	<b>\$ 16,899</b>
<b>Denominator for earnings per common share calculation:</b>				
Weighted average common shares, basic	13,583	13,120	13,500	13,077
Effect of dilutive securities:				
Preferred Stock	675	675	675	675
Stock options and warrants	780	759	795	778
Weighted average number of common shares, diluted	15,038	14,554	14,970	14,530
<b>Basic Earnings per common share:</b>	<b>\$ .30</b>	<b>\$ .27</b>	<b>\$ 1.43</b>	<b>\$ 1.29</b>
<b>Diluted Earnings per common share:</b>	<b>\$ .27</b>	<b>\$ .24</b>	<b>\$ 1.30</b>	<b>\$ 1.16</b>

The computation of diluted EPS excludes the effect of the assumed exercise of approximately 300 and 2,300 stock options, respectively, for the three and nine months ended fiscal December 2005 and 56,400 for the three and nine months ended fiscal December 2004.

Such amounts were excluded as the exercise prices of these options were greater than the average market value of the Company's common stock for those periods, resulting in an anti-dilutive effect on diluted EPS.

**Note 5 Stock-Based Compensation**

The Company applies the intrinsic-value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations including FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB Opinion No. 25, issued in March 2000, to account for its fixed-plan stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price. The Company's policy generally is to grant stock options at fair market value at the date of grant.

Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, (SFAS 123) established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS 123, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS 123, as amended by SFAS 148, Accounting for Stock-Based Compensation-Transition and Disclosure an Amendment of FASB Statement No. 123. The following table illustrates the effect on net income if the fair-value-based method had been applied to all outstanding and unvested awards in each period.

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MONRO MUFFLER BRAKE, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	<b>Quarter Ended Fiscal December</b>		<b>Nine Months Ended Fiscal December</b>	
	<b>2005</b>	<b>2004 Restated</b>	<b>2005</b>	<b>2004 Restated</b>
	<b>(Dollars in thousands, except per share data)</b>			
Net income, as reported	\$ 4,061	\$ 3,519	\$ 19,420	\$ 16,899
Add: Total stock-based employee compensation expense recorded in accordance with APB 25, net of related tax effect				
Deduct: Total stock-based employee compensation expense determined under fair-value-based method for all awards, net of related tax effects	(250)	(210)	(1,231)	(843)
Pro forma net income	\$ 3,811	\$ 3,309	\$ 18,189	\$ 16,056
Earnings per share:				
Basic as reported	\$ .30	\$ .27	\$ 1.43	\$ 1.29
Basic pro forma	\$ .28	\$ .25	\$ 1.34	\$ 1.23
Diluted as reported	\$ .27	\$ .24	\$ 1.30	\$ 1.16
Diluted pro forma	\$ .25	\$ .23	\$ 1.21	\$ 1.10

The weighted average fair value of options granted was \$5.15 for the nine months ended fiscal December 2005, and \$10.30 and \$11.06, respectively for the three and nine months ended fiscal December 2004. The fair values of the options granted were estimated on the date of their grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	<b>Quarter Ended Fiscal December</b>		<b>Nine Months Ended Fiscal December</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Risk free interest rate	N/A	4.12%	4.14%	4.53%
Expected life	N/A	9years	6years	9years
Expected volatility	N/A	28.7%	28.4%	28.9%
Expected dividend yield	N/A	0%	4.51%	0%

N/A Not applicable. No options were granted in the quarter ended December 24, 2005.

Forfeitures are recognized as they occur.

**Note 6 Supplemental Disclosure of Cash Flow Information**

The following transactions represent non-cash investing and financing activities during the periods indicated:  
 NINE MONTHS ENDED DECEMBER 24, 2005:

In connection with the disposal of assets, the Company reduced both fixed assets and long-term liabilities by \$94,000.

In connection with the recording of capital leases, the Company increased fixed assets by \$1,086,000, goodwill by \$502,000 and long-term debt by \$1,588,000.



In connection with recording the value of the Company's interest rate swap contracts, other comprehensive income increased by \$17,000, other long-term liabilities decreased by \$28,000 and the deferred income tax liability was increased by \$11,000.

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## MONRO MUFFLER BRAKE, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In connection with the accounting for income tax benefits related to the exercise of stock options, the Company reduced current liabilities and increased paid-in-capital by \$647,000.

NINE MONTHS ENDED DECEMBER 25, 2004:

In connection with the sale or disposal of assets, the Company reduced both fixed assets and other current liabilities by \$151,000.

In connection with the recording of capital leases, the Company increased both fixed assets and long-term debt by \$350,000 .

In connection with recording the value of the Company's swap contracts, other comprehensive income increased by \$47,000, other long-term liabilities decreased by \$75,000 and the deferred income tax liability was increased by \$28,000.

In connection with the accounting for income tax benefits related to the exercise of stock options, the Company decreased current liabilities by \$600,000 and increased paid-in-capital by \$600,000.

During the nine months ended December 2004, the Company recorded purchase accounting adjustments for the Mr. Tire acquisition that increased goodwill by \$630,000, comprised primarily of adjustments to deferred income tax assets, inventory, property, plant and equipment, intangible assets and other current liabilities.

In connection with the acquisition of Rice Tire, liabilities were assumed as follows:

Fair value of assets acquired	\$ 3,800,000
Cash paid, net of cash acquired	(3,660,000)
Liabilities assumed	\$ 140,000

## CASH PAID DURING THE PERIOD:

	<b>Nine Months Ended Fiscal December</b>	
	<b>2005</b>	<b>2004</b>
Interest, net	\$ 2,456,000	\$ 1,606,000
Income taxes, net	\$ 9,899,000	\$ 8,068,000

Note 7 Cash Dividend

In May 2005, the Company's Board of Directors declared a regular quarterly cash dividend of \$.05 per common share or common share equivalent to be paid to shareholders of record on July 19, 2005. The dividend was paid on July 29, 2005 and amounted to \$34,000 for preferred shareholders and \$693,000 for common shareholders.

In October 2005, the Company's Board of Directors declared a regular quarterly cash dividend of \$.05 per common share or common share equivalent to be paid to shareholders of record on October 21, 2005. The dividend was paid on October 31, 2005 and amounted to \$34,000 for preferred shareholders and \$661,000 for common shareholders.

In January 2006, the Company's Board of Directors declared a regular quarterly cash dividend of \$.05 per common share or common share equivalent to be paid to shareholders of record on January 20, 2006. The dividend will be paid on January 30, 2006. However, the declaration of and any determination as to the payment of future dividends will be at the discretion of the Board of Directors and will depend on the Company's financial condition, results of operations, capital requirements, compliance with charter and contractual restrictions, and such other factors as the Board of Directors deems relevant.

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MONRO MUFFLER BRAKE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8 Credit Facility Agreement

In July 2005, the Company entered into a new five-year, \$125 million Revolving Credit Facility agreement (the Credit Facility ) with five banks in the lending syndicate that provided the Company's prior financing arrangement. Interest only is payable monthly throughout the Credit Facility's term. The Credit Facility increased the Company's current borrowing capacity by \$15 million and includes a provision allowing the Company to expand the amount of the overall facility to \$160 million, subject to existing or new lender(s) commitments at that time. The terms of the Credit Facility immediately reduced the spread the Company pays on LIBOR-based borrowings by 50 basis points and permit the payment of cash dividends not to exceed 25% of the preceding year's net income. Additionally, the new Credit Facility is not secured by the Company's real property, although the Company has entered into an agreement not to encumber its real property, with certain permissible exceptions. Other terms of the Credit Facility are generally consistent with the Company's prior financing agreement.

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

The statements contained in this Form 10-Q that are not historical facts, including (without limitation) statements made in the Management's Discussion and Analysis of Financial Condition and Results of Operations, may contain statements of future expectations and other forward-looking statements made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results to differ materially from those expressed. These factors include, but are not necessarily limited to, product demand, dependence on and competition within the primary markets in which the Company's stores are located, the need for and costs associated with store renovations and other capital expenditures, the effect of economic conditions, the impact of competitive services and pricing, product development, parts supply restraints or difficulties, industry regulation, risks relating to leverage and debt service (including sensitivity to fluctuations in interest rates), continued availability of capital resources and financing, risks relating to integration of acquired businesses and other factors set forth or incorporated elsewhere herein and in the Company's other Securities and Exchange Commission filings. The Company does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company.

During the fourth quarter of fiscal 2005, the Company conducted a review of its lease accounting practices. As a result of the review, the Company revised its lease accounting policies to comply with generally accepted accounting principles.

Historically, the Company followed a practice in which it computed straight-line rent expense for the current term of the lease only, while depreciating buildings and leasehold improvements over longer periods. The Company has revised its lease accounting policies to recognize rent expense including rent escalations, on a straight-line basis over the reasonably assured lease term, as defined in Statement of Financial Accounting Standards No. 98 ( SFAS 98 ),

Accounting for Leases . Additionally, the Company modified its accounting to depreciate buildings and leasehold improvements over the shorter of their estimated useful lives or the reasonably assured lease term. See Note 1 for additional information regarding the restatement.

The following table sets forth income statement data of Monro Muffler Brake, Inc. ( Monro or the Company ) expressed as a percentage of sales for the fiscal periods indicated:

	<b>Quarter Ended</b>		<b>Nine Months Ended</b>	
	<b>Fiscal December</b>	<b>Fiscal December</b>	<b>Fiscal December</b>	<b>Fiscal December</b>
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
		<b>Restated</b>		<b>Restated</b>
Sales	100.0%	100.0%	100.0%	100.0%
Cost of sales, including distribution and occupancy costs	61.3	60.7	58.9	58.8
Gross profit	38.7	39.3	41.1	41.2
Operating, selling, general and administrative expenses	30.5	31.5	28.9	29.8
Operating income	8.2	7.8	12.2	11.4
Interest expense net	.9	.8	.9	.7
Other expense net			.1	.1

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Income before provision for income taxes	7.3	7.0	11.2	10.6
Provision for income taxes	2.8	2.6	4.3	4.0
Net income	4.5%	4.4%	6.9%	6.6%

**Table of Contents*****Third Quarter and Nine Months Ended December 24, 2005 Compared To Third Quarter and Nine Months Ended December 25, 2004***

Sales were \$90.2 million for the quarter ended December 24, 2005 as compared with \$80.5 million in the quarter ended December 25, 2004. The increase of \$9.7 million, or 12.0% in sales was due to an increase of \$6.7 million related to new stores and a comparable store sales increase of 4.7%. The Company also sold some slower moving inventory for approximately \$.6 million to ICON International, a barter company. Partially offsetting this was a decrease in sales related to closed stores amounting to \$1.2 million.

At December 24, 2005, the Company had 625 company-operated stores compared with 611 stores at December 25, 2004. During the quarter ended December 24, 2005, the Company added three stores and closed three.

There were 77 selling days in the quarter ended December 24, 2005 as compared to 76 selling days in the quarter ended December 25, 2004. Adjusting for days, comparable store sales increased 3.3%.

Sales for the nine months ended December 24, 2005 were \$280.5 million compared with \$256.3 million for the comparable period in the prior year. The sales increase of \$24.2 million is due to an increase of \$21.6 million related to new stores and a comparable store sales increase of 2.3%. Partially offsetting this was a decrease in sales related to closed stores amounting to \$3.9 million.

Gross profit for the quarter ended December 24, 2005 was \$34.9 million or 38.7% of sales as compared with \$31.6 million or 39.3% of sales for the quarter ended December 25, 2004. Gross profit as a percentage of sales declined for the quarter primarily due to increases in the cost of oil, and a shift in mix to the lower margin service categories of maintenance and tires. A combination of selling price increases, some lower product costs as a result of new vendor agreements and the recognition of vendor rebates against cost of goods in concert with inventory turns, all helped to partially offset the aforementioned pressures on margin.

Additionally, labor and occupancy costs, both components of cost of sales, declined as a percent of sales as compared to the prior year. Labor declined in part due to the shift in mix, but largely due to better labor control and increased productivity as compared to the prior year. Occupancy costs decreased slightly as a percent of sales due to the leveraging of fixed costs against increased sales. The aforementioned sale of inventory to ICON International had no impact on gross margin as a percentage of sales for the quarter.

Gross profit for the nine months ended December 24, 2005 was \$115.3 million, or 41.1% of sales, compared with \$105.5 million or 41.2% of sales for the nine months ended December 25, 2004.

Operating, selling, general and administrative ( SG&A ) expenses for the quarter ended December 24, 2005 increased by \$2.1 million to \$27.5 million from the quarter ended December 25, 2004, and were 30.5% of sales as compared to 31.5% in the prior year quarter. The decrease in SG&A expense as a percentage of sales is partially due to fixed cost leverage, as well as a decrease in Sarbanes-Oxley compliance costs and health insurance expense (largely due to plan and contribution changes).

These decreases were partially offset by an increase in utility costs, management bonus costs (none were paid in the prior year), and a decrease in cooperative advertising credits, primarily related to the recording of those credits against cost of sales in accordance with EITF 02-16.

For the nine months ended December 24, 2005, SG&A expenses increased by \$4.9 million to \$81.1 million from the comparable period of the prior year and were 28.9% of sales compared to 29.8%.

Operating income for the quarter ended December 24, 2005 of approximately \$7.4 million increased 18.7% as compared to operating income for the quarter ended December 25, 2004, and increased as a percentage of sales from 7.8% to 8.2% for the same periods.

Net interest expense for the quarter ended December 24, 2005 increased by approximately \$.2 million as compared to the same period in the prior year, and increased from .8% to .9% as a percentage of sales for the same periods. There was an increase in the weighted average interest rate for the current year quarter of approximately 250 basis points as compared to the prior year, due to increases in prime and LIBOR interest rates, as well as some new capital leases that carry higher rates than the Company's bank facility. Partially offsetting this was a decrease in the weighted average debt outstanding for the quarter ended December 24, 2005 of approximately \$5.8 million. Net interest expense for the nine months ended December 24, 2005 increased by \$.7 million to \$2.5 million and increased from the prior year as a percentage of sales by .2%.



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The effective tax rate for the quarters and nine months ended December 24, 2005 and December 25, 2004 was 38% of pre-tax income.

Net income for the quarter ended December 24, 2005 of \$4.1 million increased 15.4% from net income for the quarter ended December 25, 2004. Earnings per share on a diluted basis for the quarter ended December 24, 2005 increased 12.5%.

For the nine months ended December 24, 2005, net income of \$19.4 million increased 14.9% and diluted earnings per share increased 12.1%.

*Interim Period Reporting*

The data included in this report are unaudited and are subject to year-end adjustments; however, in the opinion of management, all known adjustments (which consist only of normal recurring adjustments) have been made to state fairly the Company's operating results and financial position for the unaudited periods. The results for interim periods are not necessarily indicative of results to be expected for the fiscal year.

**Capital Resources and Liquidity**

*Capital Resources*

The Company's primary capital requirements in fiscal 2006 are the upgrading of facilities and systems in existing stores and the funding of its store expansion program, including potential acquisitions of existing store chains. For the nine months ended December 24, 2005, the Company spent \$12.4 million principally for equipment and leasehold improvements. It also spent \$2.0 million and \$5.0 million, respectively, for the investment in and loan to R & S Parts and Service, Inc. Funds were provided primarily by cash flow from operations. Management believes that the Company has sufficient resources available (including cash and equivalents, net cash flow from operations and bank financing) to expand its business as currently planned for the next several years.

*Liquidity*

In March 2003, the Company renewed its credit facility agreement. The amended financing arrangement consisted of an \$83.4 million Revolving Credit facility and a non-amortizing credit loan totaling \$26.6 million.

The Revolving Credit portion of the prior facility had a three-year term expiring in September 2006. On June 27, 2003, the Company purchased the entity holding title to the properties and debt under the synthetic lease and, accordingly, consolidated both the assets and debt related to such lease on its balance sheet at that date. In accordance with the Company's prior credit facility agreement, the synthetic lease was converted to a three-year, non-amortizing revolving credit loan, also expiring in September 2006.

The loans bore interest at the prime rate or other LIBOR-based rate options tied to the Company's financial performance. Interest only was payable monthly on the Revolving Credit facility and credit loan throughout the term. The Company also paid a facility fee on the unused portion of the commitment.

The prior credit facility was secured by most of the Company's assets, with certain permissible exceptions.

In July 2005, the Company amended its existing credit facility terms by entering into a five-year, \$125 million Revolving Credit Facility agreement (the "Credit Facility") (of which approximately \$36.5 million was outstanding at December 24, 2005) with five banks in the lending syndicate that provided the Company's prior financing arrangement. Interest only is payable monthly throughout the Credit Facility's term. The Credit Facility increases the Company's current borrowing capacity by \$15 million to \$125 million and includes a provision allowing the Company to expand the amount of the overall facility to \$160 million, subject to existing or new lender(s) commitments at that time. The terms of the Credit Facility immediately reduce the spread the Company pays on LIBOR-based borrowings by 50 basis points and permit the payment of cash dividends not to exceed 25% of the preceding year's net income. Additionally, the amended Credit Facility is not secured by the Company's real property, although the Company has entered into an agreement not to encumber its real property, with certain permissible exceptions. Other terms of the Credit Facility are generally consistent with the Company's prior financing agreement.

The Company financed the land for its office/warehouse facility via a mortgage note payable of \$.7 million due in a balloon payment in 2015. In addition, the Company has financed certain store properties and equipment with capital leases, which amount to \$10.3 million and are due in installments through 2023.



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Certain of the Company's long-term debt agreements require, among other things, the maintenance of specified interest and rent coverage ratios and amounts of net worth. They also contain restrictions on cash dividend payments as described above. At December 24, 2005, the Company is in compliance with the applicable debt covenants.

The Company enters into interest rate hedge agreements, which involve the exchange of fixed and floating rate interest payments periodically over the life of the agreement without the exchange of the underlying principal amounts. The differential to be paid or received is accrued as interest rates change and is recognized over the life of the agreements as an offsetting adjustment to interest expense. Currently the Company has no hedge agreements. The most recent hedge agreement expired in October 2005.

**Recent Accounting Pronouncements**

In June 2005, the FASB issued Statement of Financial Accounting Standards No. 154, *Accounting Changes and Error Corrections*, a replacement of APB Opinion No. 20 and FASB Statement No. 3 (SFAS 154). SFAS 154 requires retrospective application to prior period financial statements for changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle should be recognized in the period of the accounting change. SFAS 154 further requires a change in depreciation, amortization or depletion method for long-lived, non-financial assets to be accounted for as a change in accounting estimate effected by a change in accounting principle. SFAS 154 is effective for fiscal years beginning after December 15, 2005. The Company does not believe the adoption of SFAS 154 will have a material impact on its financial statements.

In June 2005, the FASB ratified Emerging Issues Task Force (EITF) consensus on Issue No. 05-6, *Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination* (EITF 05-6). EITF 05-6 provides guidance regarding the amortization period for leasehold improvements acquired in a business combination and the amortization period of leasehold improvements that are placed in service significantly after and not contemplated at the beginning of the lease term. EITF 05-6 became effective during the Company's second quarter of fiscal 2006. The adoption of EITF 05-6 did not have a material impact on the Company's financial statements.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123R, *Share-Based Payment* (SFAS 123R), which requires that the cost of all employee stock options, as well as other equity-based compensation arrangements, be reflected in the financial statements based on the estimated fair value of the awards on the grant date (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award or the requisite service period (usually the vesting period). SFAS 123R is effective for public entities as of the beginning of the first annual reporting period that begins after June 15, 2005 (the Company's fiscal year 2007). The Company discloses the pro forma impact of expensing stock options in accordance with SFAS 123, as originally issued, in Note 5 to the consolidated financial statements and is still assessing the impact that SFAS 123R will have on its financial statements.

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151 (SFAS 151), *Inventory Costs*, which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) by requiring these items to be recognized as current-period charges. SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005, with earlier application permitted. The Company does not believe the adoption of SFAS 151 will have a material impact on its financial statements.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 153 (SFAS 153), *Exchanges of Nonmonetary Assets*, an amendment of APB Opinion No. 29. This Statement addresses the measurement of exchanges of nonmonetary assets. It eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB 29 and replaces it with an exception for exchanges that do not have commercial substance. SFAS 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not believe the adoption of SFAS 153 will have a material impact on its financial statements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

For a description of the Company's market risks see Item 7a "Quantitative and Qualitative Disclosures About Market Risk" in the Company's Annual Report on Form 10-K for the fiscal year ended March 26, 2005. The Company's exposure to market risks has not changed materially from the description in the Annual Report on Form 10-K.

Item 4. Controls and Procedures

*Disclosure controls and procedures*

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in reports that the Company files or submits pursuant to the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Security and Exchange Commission's (SEC) rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

In conjunction with the close of each fiscal quarter and under the supervision of the Chief Executive Officer and Chief Financial Officer, the Company conducts an update, a review and an evaluation of the effectiveness of the Company's disclosure controls and procedures. It is the conclusion of the Company's Chief Executive Officer and Chief Financial Officer, based upon an evaluation completed as of the end of the most recent fiscal quarter reported on herein, that the Company's disclosure controls and procedures were effective.

*Changes in internal controls*

There were no changes in the Company's internal control over financial reporting during the quarter ended December 24, 2005 that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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MONRO MUFFLER BRAKE, INC.  
PART II OTHER INFORMATION

Item 1A. Risk Factors

We operate on a 52-53 week fiscal year ending on the last Saturday in March of each year and fiscal quarters ending on the last Saturday of June, September and December. As a result, our past practice has been to file our Annual Report on Form 10-K in June and our Quarterly Reports on Form 10-Q in August, November and February, respectively. Consistent with our past practice, therefore, we are filing this Form 10-Q after December 1. Although this Item 1A requires us to disclose material changes from risk factors previously disclosed in our Form 10-K, we are unable to do so because we have not previously included risk factors in our Form 10-K. We will include risk factors in our Form 10-K for fiscal 2006 (which we anticipate will be filed in June 2006), and in all Forms 10-Q filed thereafter we will include, in accordance with this item, all material changes from risk factors previously disclosed in our Form10-K.

Item 6. Exhibits

a. Exhibits

- 31.1 Certification of Robert G. Gross pursuant to Section 302 of the Sarbanes Oxley Act of 2002
- 31.2 Certification of Catherine D Amico pursuant to Section 302 of the Sarbanes Oxley Act of 2002
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MONRO MUFFLER BRAKE, INC.

DATE: February 2, 2006

By /s/ Robert G. Gross

Robert G. Gross  
President and Chief Executive Officer

DATE: February 2, 2006

By /s/ Catherine D Amico

Catherine D Amico  
Executive Vice President-Finance, Treasurer  
and Chief Financial Officer

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**EXHIBIT INDEX**

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31.2	Certification of Catherine D Amico pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	22
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	23