Builders FirstSource, Inc.
Form 10-Q
May 04, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

**Form 10-Q**

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

**For the quarterly period ended March 31, 2006**

**OR**

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

**For the transition period from to**

**Commission File Number 0-51357**

**BUILDERS FIRSTSOURCE, INC.**
*(Exact name of registrant as specified in its charter)*

| | |
|---|---|
| **Delaware** | **52-2084569** |
| *(State or other jurisdiction of incorporation or organization)* | *(I.R.S. Employer Identification No.)* |
| **2001 Bryan Street, Suite 1600 Dallas, Texas** | **75201** |
| *(Address of principal executive offices)* | *(Zip Code)* |

**(214) 880-3500**
*(Registrant s telephone number, including area code)*

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 þ No o

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.

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

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

The number of shares of the issuer s common stock, par value $0.01, outstanding as of April 28, 2006 was 34,150,377.

**BUILDERS FIRSTSOURCE, INC.**
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## PART I FINANCIAL INFORMATION

**Item 1.** ***Financial Statements (unaudited)***

**BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

| | Three Months Ended March 31, 2006 | Three Months Ended March 31, 2005 |
|---|---|---|
| | (In thousands, except per share amounts) (Unaudited) | |
| Sales | $ 588,627 | $ 509,342 |
| Cost of sales | 438,262 | 388,407 |
| Gross margin | 150,365 | 120,935 |
| Selling, general and administrative expenses | 112,202 | 133,266 |
| Income (loss) from operations | 38,163 | (12,331) |
| Interest expense | 7,176 | 19,204 |
| Income (loss) before income taxes | 30,987 | (31,535) |
| Income tax expense (benefit) | 11,669 | (12,675) |
| Net income (loss) | $ 19,318 | $ (18,860) |
| *Net income (loss) per share:* | | |
| Basic | $ 0.58 | $ (0.75) |
| Diluted | $ 0.54 | $ (0.75) |
| *Weighted average common shares outstanding:* | | |
| Basic | 33,105 | 25,148 |
| Diluted | 35,986 | 25,148 |

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

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**BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED BALANCE SHEETS**

| | March 31, 2006 | December 31, 2005 |
|---|---|---|
| | (In thousands, except per share amounts) (Unaudited) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 32,583 | $ 30,736 |
| Accounts receivable, less allowances of $6,522 and $6,135 at March 31, 2006 and December 31, 2005, respectively | 255,758 | 237,695 |
| Inventories | 160,878 | 149,397 |
| Other current assets | 24,077 | 24,753 |
| Total current assets | 473,296 | 442,581 |
| Property, plant and equipment, net | 99,838 | 99,862 |
| Goodwill | 163,030 | 163,030 |
| Other assets, net | 19,758 | 18,934 |
| Total assets | $ 755,922 | $ 724,407 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 152,359 | $ 127,998 |
| Accrued liabilities | 65,713 | 83,572 |
| Current maturities of long-term debt | 237 | 102 |
| Total current liabilities | 218,309 | 211,672 |
| Long-term debt, net of current maturities | 319,090 | 314,898 |
| Other long-term liabilities | 22,605 | 26,702 |
| | 560,004 | 553,272 |
| Commitments and contingencies (Note 4) | | |
| Stockholders equity: | | |
| Preferred stock, $0.01 par value, 10,000 shares authorized; zero shares issued and outstanding at March 31, 2006 and December 31, 2005, respectively | | |
| Common stock, $0.01 par value, 200,000 shares authorized; 33,865 and 32,998 shares issued and outstanding at March 31, 2006 and December 31, 2005, respectively | 335 | 330 |
| Additional paid-in capital | 115,476 | 111,979 |
| Unearned stock compensation | | (1,087) |
| Retained earnings | 77,399 | 58,081 |
| Accumulated other comprehensive income | 2,708 | 1,832 |

| | | | | |
|---|---|---|---|---|
| Total stockholders equity | | 195,918 | | 171,135 |
| Total liabilities and stockholders equity | $ | 755,922 | $ | 724,407 |

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

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**BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | Three Months Ended March 31, | |
|---|---|---|
| | **2006** | **2005** |
| | (In thousands) (Unaudited) | |
| Cash flows from operating activities: | | |
| Net income (loss) | $ 19,318 | $ (18,860) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 5,135 | 4,712 |
| Amortization of deferred loan costs | 653 | 10,365 |
| Bad debt expense | 237 | 1,129 |
| Non-cash stock based compensation | 648 | |
| Deferred income taxes | (61) | 1,406 |
| Net loss (gain) on sales of assets | 279 | (75) |
| Changes in assets and liabilities: | | |
| Accounts receivable | (18,300) | (28,099) |
| Inventories | (11,481) | (14,066) |
| Other current assets | 676 | (235) |
| Other assets and liabilities | 210 | 514 |
| Accounts payable | 24,361 | 34,583 |
| Accrued liabilities | (17,859) | (59) |
| Net cash provided by (used in) operating activities | 3,816 | (8,685) |
| Cash flows from investing activities: | | |
| Purchases of property, plant and equipment | (6,091) | (5,487) |
| Proceeds from sale of property, plant and equipment | 186 | 1,275 |
| Net cash used in investing activities | (5,905) | (4,212) |
| Cash flows from financing activities: | | |
| Net borrowing under revolving credit facilities | | 10,000 |
| Proceeds from credit agreement | | 225,000 |
| Proceeds from issuance of floating rate notes | | 275,000 |
| Payments on long-term debt | (5) | (313,275) |
| Deferred loan costs | | (21,149) |
| Payment of dividend | | (201,186) |
| Exercise of stock options | 3,941 | |
| Net cash provided by (used in) financing activities | 3,936 | (25,610) |
| Net increase (decrease) in cash and cash equivalents | 1,847 | (38,507) |
| Cash and cash equivalents at beginning of period | 30,736 | 50,628 |

| | | |
|---|---|---|
| Cash and cash equivalents at end of period | $ 32,583 | $ 12,121 |

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

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**BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**(unaudited)**

## 1. Basis of Presentation and Significant Accounting Policies

Builders FirstSource, Inc. and subsidiaries (the Company ) is a leading provider of manufactured components, building materials and construction services to professional homebuilders and contractors in the United States.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements include all recurring adjustments and normal accruals necessary for a fair statement of the Company s financial position, results of operations and cash flows for the dates and periods presented. Results for interim periods are not necessarily indicative of the results to be expected during the remainder of the current year or for any future period. All significant intercompany accounts and transactions have been eliminated in consolidation.

The condensed consolidated balance sheet as of December 31, 2005 is derived from the audited consolidated financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. This condensed consolidated balance sheet as of December 31, 2005 and the unaudited condensed consolidated financial statements included herein should be read in conjunction with the more detailed audited consolidated financial statements for the years ended December 31, 2005 included in the Company s most recent annual report on Form 10-K. Accounting policies used in the preparation of these unaudited condensed consolidated financial statements are consistent with the accounting policies described in the Notes to Consolidated Financial Statements included in the Company s Form 10-K.

***Accounting Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from those estimates.

Estimates are used when accounting for items such as revenue, vendor rebates, allowances for returns, discounts and doubtful accounts, employee compensation programs, depreciation and amortization periods, taxes, inventory values, insurance programs, and when evaluating potential impairment of goodwill, other intangible assets and long-lived assets.

***Net Income (Loss) per Common Share***

Net income (loss) per common share ( EPS ) is calculated in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 128, *Earnings per Share,* which requires the presentation of basic and diluted EPS. Basic EPS is computed using the weighted average number of common shares outstanding during the period. Diluted EPS is computed using the weighted average number of common shares outstanding during the period, plus the dilutive effect of potential common stock. For the purpose of computing diluted EPS, weighted average shares outstanding have been adjusted for common shares underlying options of 4.2 million for the three months ended March 31, 2006. Weighted average shares outstanding for the three months ended March 31, 2006 have also been adjusted for 0.4 million shares of restricted stock. There was no restricted stock outstanding at March 31, 2005. Options to purchase 0.5 million and 4.5 million shares of common stock were not included in the computations of diluted EPS for the three months ended March 31, 2006 and 2005, respectively, because their effect was anti-dilutive.

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**BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**(unaudited)**

The table below presents a reconciliation of weighted average common shares used in the calculation of basic and diluted EPS (in thousands):

| | Three Months Ended March 31, | |
|---|---|---|
| | **2006** | **2005** |
| Weighted average shares for basic EPS | 33,105 | 25,148 |
| Dilutive effect of stock awards and options | 2,881 | |
| Weighted average shares for diluted EPS | 35,986 | 25,148 |

***Comprehensive Income***

Comprehensive income is defined as the change in equity (net assets) of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. It consists of net income and other gains and losses affecting stockholders equity that, under accounting principles generally accepted in the United States, are excluded from net income.

The Company entered into two interest rate swap agreements during 2005 in order to obtain a fixed rate with respect to $200.0 million of its outstanding floating rate debt and thereby reduce its exposure to interest rate volatility. The interest rate swaps qualify as fully effective, cash-flow hedging instruments. Therefore, the gain or loss of the qualifying cash flow hedges are reported in other comprehensive income and reclassified into earnings in the same period in which the hedge transactions affect earnings. At March 31, 2006, the fair value of the interest rate swaps was a receivable of $4.6 million.

The following table presents the components of comprehensive income for the three months ended March 31, 2006 and 2005 (in thousands):

| | Three Months Ended March 31, | |
|---|---|---|
| | **2006** | **2005** |
| Net income (loss) | $ 19,318 | $ (18,860) |
| Other comprehensive income change in fair value of interest rate swap agreements, net of related tax effect | 2,708 | |
| Total comprehensive income (loss) | $ 22,026 | $ (18,860) |

***Stock-based Compensation***

At March 31, 2006, the Company has two stock-based employee compensation plans, which are described more fully in Note 3. The Company issues new common stock shares upon exercises of stock options and grants of restricted stock. Prior to January 1, 2006, the Company accounted for these plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* ( APB 25 ) and related Interpretations, as permitted by SFAS No. 123, *Accounting for Stock-Based Compensation*

( SFAS 123 ). No stock-based compensation was recognized under the fair value recognition provisions for stock options in the statements of operations for the years ended December 31, 2005, 2004 and 2003, as all grants under the plans had an exercise price equal to the market value or minimum value of the underlying common stock on the date of grant. Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123 (Revised 2004), *Share-Based Payment,* ( SFAS 123(R) ) using the modified prospective transition method. Accordingly, the Company will record expense for (i) the unvested portion of grants issued during 2005 and (ii) new grant issuances, both of which will be expensed over the requisite service (i.e., vesting) periods. The Company utilized the

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**BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**(unaudited)**

minimum value method for option grants issued prior to 2005, and these options will continue to be accounted for under APB 25 in accordance with SFAS 123(R). Results for prior periods have not been restated.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions for the three months ended March 31, 2006: expected life 5.0 years, expected volatility 40.9%, expected dividend yield 0.00%, and risk-free rate 4.05%. There were no options granted during the three months ended March 31, 2005. The expected life represents the period of time the options are expected to be outstanding. We consider the contractual term, the vesting period and the expected lives used by a peer group with similar option terms in determining the expected life assumption. As a newly public company, we utilize the volatility of a peer group over a recent historical period equal to the expected life of the option. The expected dividend yield is based on the Company s history of not paying regular dividends in the past and its current intention to not pay regular dividends in the foreseeable future. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant and has a term equal to the expected life of the options.

As a result of adopting SFAS 123(R), the Company s results of operations for the three months ended March 31, 2006 included compensation expense of $0.6 million ($0.4 million net of taxes), representing a $0.01 impact to both basic and diluted earnings per share.

Prior to the adoption of SFAS 123(R), the Company presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the statement of cash flows. SFAS 123(R) requires the cash flows resulting from the tax benefits of deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. Financing cash inflows of $3.9 million for the first quarter 2006 represent $1.7 million of cash received from the exercise of stock options and $2.2 million related to the tax benefits of deductions in excess of the compensation cost recognized for the exercise of stock options. The excess tax benefits classified as financing cash inflows would have been classified as operating cash inflows prior to the adoption of SFAS 123(R).

No pro forma disclosure is included for the three months ended March 31, 2005 as the Company used the minimum value method for pro forma disclosure purposes for all options outstanding during the period. No expense would be recorded for these options as a result of adopting SFAS 123(R).

***Reclassifications***

Certain prior year amounts have been reclassified to conform to the current year presentation.

**2. Debt**

Long-term debt consisted of the following (in thousands):

| | March 31, 2006 | December 31, 2005 |
|---|---|---|
| Term loan | $ 40,000 | $ 40,000 |
| Floating rate notes | 275,000 | 275,000 |
| Other | 4,327 | |
| | 319,327 | 315,000 |
| Less: current portion of long-term debt | 237 | 102 |
| Total long-term debt | $ 319,090 | $ 314,898 |

On February 11, 2005, the Company entered into a $350.0 million senior secured credit agreement (the 2005 Agreement ) with a syndicate of banks. The 2005 Agreement was initially comprised of a

**BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**(unaudited)**

$110.0 million long-term revolver due February 11, 2010; a $225.0 million term loan; and a $15.0 million pre-funded letter of credit facility due August 11, 2011. During the year ended December 31, 2005, the Company repaid $185.0 million of the term loan with proceeds from its initial public offering and cash generated from operations. These repayments permanently reduced the borrowing capacity under the term loan; eliminated the required installment payments through December 2006; reduced the quarterly installment payments to $0.1 million; and reduced the final payment to $38.1 million. At March 31, 2006, the available borrowing capacity of the revolver totaled $108.8 million after being reduced by outstanding letters of credit under the revolver of approximately $1.2 million. The Company also has $15.0 million of outstanding letters of credit under the pre-funded letter of credit facility. The weighted-average interest rate at March 31, 2006 for borrowings under the 2005 Agreement was 7.49%.

On February 11, 2005, the Company issued $275.0 million in aggregate principal amount of second priority senior secured floating rate notes. The floating rate notes mature on February 15, 2012. During 2005, the Company entered into two three-year interest rate swap agreements in order to obtain a fixed rate with respect to $200.0 million of its outstanding floating rate debt and thereby reduce its exposure to interest rate volatility. The weighted-average interest rate at March 31, 2006 for the floating rate notes was 8.51% including the effect of interest rate swap agreements.

The Company completed construction on a new multi-purpose facility during the first quarter of 2006. Based on the evaluation of the construction project in accordance with Emerging Issues Task Force No. 97-10, *The Effect of Lessee Involvement in Asset Construction,* the Company was deemed the owner of the facility during the construction period. Effectively, a sale and leaseback of the facility occurred when construction was completed and the lease term began. Based on criteria outlined in SFAS No. 98, *Accounting for Leases,* this transaction did not qualify for sale-leaseback accounting. As a result, the building and the offsetting long-term lease obligation are included on the consolidated balance sheet as a component of fixed assets and other debt, respectively. The building is being depreciated over its useful life, and the lease obligation is being amortized such that there will be no gain or loss recorded if the lease is not extended at the end of the term.

Future maturities of long-term debt as of March 31, 2006 were as follows (in thousands):

| | | |
|---|---|---|
| Year ending December 31, | | |
| 2006 | $ | 127 |
| 2007 | | 442 |
| 2008 | | 446 |
| 2009 | | 450 |
| 2010 | | 454 |
| Thereafter | | 317,408 |
| Total long-term debt (including current portion) | $ | 319,327 |

## 3. Employee Stock Based Compensation

***2005 Equity Incentive Plan***

Under its 2005 Equity Incentive Plan ( 2005 Plan ), the Company is authorized to grant stock-based awards in the form of incentive stock options, non-qualified stock options, restricted stock and other common stock-based awards. The maximum number of common shares reserved for the grant of awards under the 2005 Plan is 2,200,000, subject to adjustment as provided by the 2005 Plan. No more than 2,200,000 shares may be made subject to options or stock appreciation rights ( SARs ) granted under the 2005 Plan and no more than

**BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**(unaudited)**

1,100,000 shares may be made subject to stock-based awards other than options or SARs. Stock options and SARs granted under the 2005 Plan may not have a term exceeding 10 years from the date of grant. The 2005 Plan also provides that all awards will become fully vested and/or exercisable upon a change in control (as defined in the 2005 Plan). Other specific terms for awards granted under the 2005 Plan shall be determined by the Company s board of directors (or a committee of its members.) Historically, awards granted under the 2005 Plan generally vest over a three-year period. As of March 31, 2006, 1.2 million shares were available for issuance under the 2005 Plan, 0.7 million of which may be made subject to stock-based awards other than options or SARs.

***1998 Stock Incentive Plan***

Under the Builders FirstSource, Inc. 1998 Stock Incentive Plan ( 1998 Plan ), the Company is authorized to issue shares of common stock pursuant to awards granted in various forms, including incentive stock options, non-qualified stock options and other stock-based awards. The 1998 Plan also authorizes the sale of common stock on terms determined by the Company s board of directors.

Stock options granted under the 1998 generally cliff vest after a period of seven to nine years. A portion of certain option grants are subject to acceleration if certain financial targets are met. These financial targets include return on net assets and earnings before interest, taxes, depreciation and amortization. These targets are based on the performance of the operating group in which the employee performs their responsibilities and the performance of the Company as a whole for employees whose job responsibilities cover all of the company. The expiration date is generally 10 years subsequent to date of issuance. To date, these targets have generally been met. As of January 1, 2005, no further grants will be made under the 1998 Plan.

The following table summarizes the Company s stock option activity for the three months ended March 31, 2006 (shares in thousands):

| | Options | Weighted Average Exercise Price | Weighted Average Remaining Years | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at December 31, 2005 | 4,250 | $ 3.55 | | |
| Granted | 504 | $ 23.87 | | |
| Exercised | (564) | $ 3.12 | | |
| Forfeited | (6) | $ 12.00 | | |
| Outstanding at March 31, 2006 | 4,184 | $ 6.05 | 6.8 | $ 69,704 |
| Exercisable at March 31, 2006 | 2,551 | $ 3.10 | 5.7 | $ 105,190 |

The outstanding options at March 31, 2006, include 0.6 million options granted under the 2005 Plan. None of the 2005 Plan awards were exercisable at March 31, 2006. The weighted average grant date fair value of options granted during the three months ended March 31, 2006 was $9.99 per share. The total intrinsic value of options exercised during the three months ended March 31, 2006 was $11.6 million.

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**BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**(unaudited)**

The following table summarizes the Company s restricted stock activity for the three months ended March 31, 2006 (shares in thousands):