

Builders FirstSource, Inc.
Form 10-Q
August 05, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2016

OR

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

For the transition period from _____ to _____

Commission File Number 0-51357

BUILDERS FIRSTSOURCE, INC.

(Exact name of registrant as specified in its charter)

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

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(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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

The number of shares of the issuer's common stock, par value \$0.01, outstanding as of August 2, 2016 was 110,866,674.

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 AND COMPREHENSIVE INCOME (LOSS)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
	(Unaudited)			
	(In thousands, except per share amounts)			
Sales	\$1,677,300	\$461,521	\$3,074,415	\$832,507
Cost of sales	1,258,969	350,907	2,306,335	638,160
Gross margin	418,331	110,614	768,080	194,347
Selling, general and administrative expenses	341,909	94,664	668,878	177,664
Income from operations	76,422	15,950	99,202	16,683
Interest expense, net	42,802	12,573	78,027	20,180
Income (loss) from continuing operations before income taxes	33,620	3,377	21,175	(3,497)
Income tax expense (benefit)	4,179	(199)	8,714	(3)
Net Income (loss)	\$29,441	\$3,576	\$12,461	\$(3,494)
Comprehensive Income (loss)	\$29,441	\$3,576	\$12,461	\$(3,494)
Net income (loss) per share:				
Basic	\$0.27	\$0.04	\$0.11	\$(0.04)
Diluted	\$0.26	\$0.03	\$0.11	\$(0.04)
Weighted average common shares:				
Basic	110,339	99,163	110,133	98,677
Diluted	113,504	102,978	112,922	98,677

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

BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2016 (Unaudited)	December 31, 2015
	(In thousands, except per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$6,192	\$65,063
Accounts receivable, less allowance of \$9,683 and \$8,049 at June 30, 2016 and December 31, 2015, respectively	667,905	528,544
Other receivables	37,583	57,778
Inventories, net	578,776	513,045
Other current assets	28,429	29,899
Total current assets	1,318,885	1,194,329
Property, plant and equipment, net	698,969	734,329
Assets held for sale	9,063	5,585
Goodwill	740,411	739,625
Intangible assets, net	174,908	189,604
Other assets, net	22,954	18,566
Total assets	\$2,965,190	\$2,882,038
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Checks outstanding	\$39,458	\$46,833
Accounts payable	482,629	365,347
Accrued liabilities	246,564	293,905
Current maturities of long-term debt and lease obligations	28,540	29,153
Total current liabilities	797,191	735,238
Long-term debt and lease obligations, net of current maturities, debt discount and deferred loan costs	1,909,823	1,922,518
Other long-term liabilities	89,055	75,087
Total liabilities	2,796,069	2,732,843
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, \$0.01 par value, 10,000 shares authorized; zero shares issued and outstanding		
at June 30, 2016 and December 31, 2015, respectively	—	—

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Common stock, \$0.01 par value, 200,000 shares authorized; 110,839 and 109,726 shares issued

and outstanding at June 30, 2016 and December 31, 2015, respectively	1,108	1,097
Additional paid-in capital	519,256	511,802
Accumulated deficit	(351,243)	(363,704)
Total stockholders' equity	169,121	149,195
Total liabilities and stockholders' equity	\$2,965,190	\$2,882,038

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

BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Six months ended

June 30,
2016 2015
(Unaudited)

(In thousands)

Cash flows from operating activities:		
Net income (loss)	\$ 12,461	\$(3,494)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	61,349	6,782
Asset impairments	1,357	—
Amortization of deferred loan costs	3,721	1,232
Amortization of debt discount	363	—
Gain on extinguishment of debt	(7,065)	—
Accretion of lease finance obligation	456	—
Fair value adjustment of stock warrants	—	4,563
Deferred income taxes	6,650	28
Bad debt expense	(87)	161
Stock compensation expense	5,127	3,369
Net gain on sale of assets	(361)	(114)
Changes in assets and liabilities, net of assets acquired and liabilities assumed:		
Receivables	(124,728)	(37,194)
Inventories	(67,472)	(6,976)
Other current assets	3,448	2,942
Other assets and liabilities	3,207	1,046
Accounts payable and checks outstanding	111,741	34,471
Accrued liabilities	(43,016)	10,741
Net cash provided by (used in) operating activities	(32,849)	17,557
Cash flows from investing activities:		
Purchases of property, plant and equipment	(22,672)	(14,331)
Proceeds from sale of property, plant and equipment	923	180
Cash used for acquisitions, net	(3,970)	(5,797)
Net cash used in investing activities	(25,719)	(19,948)
Cash flows from financing activities:		
Borrowings under revolving credit facility	479,000	25,000
Repayments under revolving credit facility	(435,000)	—
Repayments of long-term debt and other loans	(42,189)	(36)
Payments of loan costs	(4,452)	—
Payments of transaction costs	—	(326)
Exercise of stock options	3,430	1,117

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Repurchase of common stock	(1,092)	(986)
Net cash provided by (used in) financing activities	(303)	24,769
Net change in cash and cash equivalents	(58,871)	22,378
Cash and cash equivalents at beginning of period	65,063	17,773
Cash and cash equivalents at end of period	\$6,192	\$40,151

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

BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Basis of Presentation

Builders FirstSource, Inc., a Delaware corporation formed in 1998, is a leading supplier of building materials, manufactured components and construction services to professional contractors, sub-contractors, and consumers. Following our acquisition of ProBuild Holdings LLC (“ProBuild”) in July 2015, the company operates locations in 40 states across the United States. In this quarterly report, references to the “Company,” “we,” “our,” “ours” or “us” refer to Builders FirstSource, Inc. and its consolidated subsidiaries (including ProBuild as of July 31, 2015), unless otherwise stated or the context otherwise requires.

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, 2015 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, 2015 and the unaudited condensed consolidated financial statements included herein should be read in conjunction with the more detailed audited consolidated financial statements for the year ended December 31, 2015 included in our 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 our Form 10-K.

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (“FASB”) issued an update to the existing guidance under the Compensation-Stock Compensation topic. This update simplifies several aspects of accounting for stock compensation including accounting for income taxes, classification of awards as liabilities or equity, forfeitures and classification on the statement of cash flows. This update is effective for public companies for annual and interim reporting periods beginning after December 15, 2016. Early adoption is permitted with adjustments reflected as of the beginning of the fiscal year of adoption. The various aspects of this guidance require prospective, retrospective, or modified retrospective application. We are currently evaluating the impact of this guidance on our financial statements.

In February 2016, the FASB issued an update to the existing guidance under Leases topic. Under the new guidance, lessees will be required to recognize the following for all leases, with the exception of short-term leases, at the commencement date: (1) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. This update requires a modified retrospective transition as of the beginning of the earliest comparative period presented in the financial statements. This update is effective for

public companies for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. We are currently evaluating the impact of this guidance on our financial statements.

In July 2015 the FASB issued an update to the existing guidance under the Inventory topic of the Codification. This update changes the subsequent measurement of inventory from lower of cost or market to lower of cost and net realizable value. This guidance is effective for interim and annual reporting periods beginning after December 15, 2016. Early adoption of this guidance is permitted as of the beginning of an interim or annual reporting period. This guidance requires prospective application. We do not expect the adoption of this guidance to have an impact on our financial statements.

In August 2014, the FASB issued an update to the existing guidance under the Presentation of Financial Statements topic of the Codification. This update requires management to perform interim and annual assessments on whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year of the date the financial statements are issued and to provide related disclosures, if required. This new guidance is effective for the annual period ending after December 15, 2016, and for annual and interim periods thereafter. Early adoption is permitted, but not required. We do not expect the adoption of this guidance to have an impact on our financial statements.

In May 2014, the FASB issued an update to the existing guidance under the Revenue Recognition topic of the Codification which is a comprehensive new revenue recognition model requiring a company to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This new guidance was originally effective for annual reporting periods beginning after December 15, 2016. However, in July 2015 the FASB approved an optional one year deferral of the effective date to annual reporting periods beginning after December 15, 2017. As such, this guidance will be effective for us beginning on January 1, 2018. Early adoption is permitted; however, this guidance cannot be adopted earlier than the original effective date. This guidance allows either full retrospective or modified retrospective methods of adoption. Subsequent to issuance of the original update the FASB issued several updates amending this new guidance. In April 2016, the FASB issued an update clarifying issues related to identifying performance obligations and licensing. In May 2016, the FASB issued an update regarding the assessment of collectability criteria, presentation of sales taxes, measurement of noncash consideration and transition guidance for completed contracts and contract modifications. We are currently evaluating the impact of these updates on our financial statements.

2. Acquisitions

ProBuild Acquisition

On July 31, 2015, we acquired all of the operating affiliates of ProBuild through the purchase of all issued and outstanding equity interests of ProBuild for \$1.63 billion in cash, subject to certain adjustments. The purchase price was funded by the net proceeds received from concurrent financing transactions. Previously headquartered in Denver, Colorado, ProBuild is one of the nation's largest professional building materials suppliers. As a result of the ProBuild acquisition, the Company has a greater diversification of products and services and a significantly improved geographic footprint.

The ProBuild acquisition was accounted for by the acquisition method, and accordingly the results of operations were included in the Company's consolidated financial statements from the acquisition date. The purchase price was allocated to the assets acquired based on estimated fair values at the acquisition date, with the excess of purchase price over the estimated fair value of the net assets acquired recorded as goodwill. All final purchase accounting adjustments related to this acquisition, which primarily reflect the final purchase price allocations and other revisions to the methodology and assumptions associated with the intangible asset valuations, have been recorded as of December 31, 2015. The fair value of acquired intangible assets of \$184.5 million, primarily related to tradenames, customer relationships and lease contract intangibles, was estimated by applying an income approach. That measure is based on significant Level 3 inputs not observable in the market. Key assumptions developed based on the Company's historical experience, future projections and comparable market data include future cash flows, long-term growth rates, royalty rates, attrition rates and discount rates.

We incurred \$6.3 million and \$11.6 million in costs related to the acquisition of ProBuild during the three and six months ended June 30, 2015, respectively. These costs include due diligence costs and transaction costs to complete the acquisition, and were recognized in selling, general and administrative expense in the accompanying condensed consolidated statements of operations and comprehensive income (loss) for the three and six months ended June 30, 2015. We did not incur any acquisition costs related to ProBuild during the three and six months ended June 30, 2016.

The following table summarizes the aggregate fair values of the assets acquired and liabilities assumed at the acquisition date for ProBuild, net of cash (in thousands):

Accounts receivable	\$470,105
Other receivables	34,718
Inventory	411,160
Other current assets	12,101
Property, plant and equipment	658,540
Assets held for sale	10,911
Goodwill	602,690
Intangible assets	184,509
Other assets	2,016
Total assets acquired	2,386,750
Checks outstanding	(32,378)
Current maturities of long term debt and lease obligations	(25,456)
Accounts payable	(339,673)
Accrued liabilities	(210,436)
Other long-term liabilities	(53,703)
Long-term debt and lease obligations, net of current maturities	(262,390)
Total liabilities assumed	(924,036)
Total net assets acquired	\$1,462,714

All of the goodwill and intangible assets recognized from the ProBuild acquisitions are expected to be deductible for tax purposes, with the goodwill recognized from these acquisitions being amortized ratably over a 15 year period. The ProBuild acquisition was treated as an asset purchase for tax purposes.

The operating results of this acquisition have been included in the consolidated statements of operations and comprehensive income (loss) from the acquisition date through June 30, 2016. For the three months ended June 30, 2016, net sales and net income attributable to ProBuild were approximately \$1,189.4 million and \$54.0 million, respectively. For the six months ended June 30, 2016, net sales and net income attributable to ProBuild were approximately \$2,172.1 million and \$62.1 million, respectively. Net income attributable to ProBuild does not include an allocation of the additional interest expense incurred by the Company as a result of the ProBuild acquisition financing transactions.

The following table reflects the unaudited pro forma operating results for the Company for the three and six months ended June 30, 2015 which gives effect to the acquisition of ProBuild as if it had occurred on January 1, 2014. The pro forma results are based on assumptions that the Company believes are reasonable under the circumstances. The pro forma results are not necessarily indicative of future results. The pro forma financial information includes the historical results of the Company and ProBuild adjusted for certain items, which are described below, and does not include the effects of any synergies or cost reduction initiatives related to the acquisition of ProBuild.

Three Months Ended
Six Months Ended

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June 30, June
2015 30, 2015
(Unaudited pro-forma)

(in thousands, except per
share amounts)

Net sales	\$1,627,840	\$2,911,966
Net income (loss)	\$25,162	\$(22,533)
Basic net income (loss) per share	\$0.23	\$(0.21)
Diluted net income (loss) per share	\$0.22	\$(0.21)

Pro forma net income (loss) for the three and six months ended June 30, 2015 reflects adjustments primarily related to depreciation and amortization, the conversion from last-in, first-out to first-in, first out inventory valuation, and interest expense. Pro forma net loss was adjusted to exclude transaction-related expenses of \$7.1 million (\$6.3 million incurred by the Company and \$0.8 million incurred by ProBuild) and \$13.4 million (\$11.6 million incurred by the Company and \$1.8 million incurred by ProBuild) in the three and six months ended June 30, 2015, respectively.

Alaska Truss Acquisition

On May 13, 2016 the Company acquired certain assets and the operations of Alaska Truss Manufacturing, LLC and ATM, LLC (collectively "Alaska Truss") for cash of \$4.0 million and \$1.0 million of other consideration, subject to certain adjustments. Of the total consideration, \$3.4 million was allocated to tangible assets acquired, primarily property, plant and equipment, \$0.8 million was allocated to intangible assets and \$0.8 million was allocated to goodwill. These are preliminary allocations and are subject to adjustment.

Based in Chugiak, Alaska, Alaska Truss supplies roof trusses to both residential and commercial contractors throughout the greater Anchorage area. Acquisition costs related to Alaska Truss were not material in the three or six months ended June 30, 2016. Pro forma results of operations are not presented as this acquisition is not material.

3. Net Income (Loss) per Common Share

Net income (loss) per common share ("EPS") is calculated in accordance with the Earnings per Share topic of the FASB Accounting Standards Codification ("Codification"), 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 shares.

Our restricted stock shares include rights to receive dividends that are not subject to the risk of forfeiture even if the underlying restricted stock shares on which the dividends were paid do not vest. In accordance with the Earnings per Share topic of the Codification, unvested share-based payment awards that contain non-forfeitable rights to dividends are deemed participating securities and should be considered in the calculation of basic EPS. Since the restricted stock shares do not include an obligation to share in losses, they will be included in our basic EPS calculation in periods of net income and excluded from our basic EPS calculation in periods of net loss. Accordingly, there were 13,000 restricted stock shares included in our calculation of basic EPS for the three months ended June 30, 2015 as we generated net income. There were 13,000 restricted stock shares excluded from our calculation of basic EPS for the six months ended June 30, 2015 as we generated a net loss. There were no outstanding restricted stock shares as of June 30, 2016.

For the purpose of computing diluted EPS, weighted average shares outstanding have been adjusted for common shares underlying 4.3 million options and 2.2 million restricted stock units ("RSUs") for the three months and six months ended June 30, 2016. There were no outstanding warrants as of June 30, 2016 as all of the remaining stock warrants were exercised in the second quarter of 2015.

Weighted average shares outstanding have been adjusted for common shares underlying 6.2 million options and 1.5 million RSUs for the three months ended June 30, 2015. Incremental shares attributable to average warrants outstanding during the second quarter of 2015 were not included in the computation of diluted EPS for the three months ended June 30, 2015 as their effect was anti-dilutive. Options to purchase 6.2 million shares of common stock, 1.5 million RSUs, and the incremental shares attributable to average warrants outstanding during the first six months of 2015 were not included in the computation of diluted EPS for the six months ended June 30, 2015 because their effect was anti-dilutive.

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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		Six Months Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Weighted average shares for basic EPS	110,339	99,163	110,133	98,677
Dilutive effect of options and RSUs	3,165	3,815	2,789	—
Weighted average shares for diluted EPS	113,504	102,978	112,922	98,677

4. Debt

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

	June 30,	December 31,
	2016	2015
2021 notes	\$582,596	\$ 350,000
2023 notes	417,608	700,000
2015 facility	104,000	60,000
2015 term loan	595,875	598,625
Lease finance obligations	269,303	280,909
Capital lease obligations	9,480	8,159
	1,978,862	1,997,693
Unamortized debt discount and debt issuance costs	(40,499)	(46,022)
	1,938,363	1,951,671
Less: current maturities of long-term debt and lease obligations	28,540	29,153
Long-term debt and lease obligations, net of current maturities	\$ 1,909,823	\$ 1,922,518

Note Exchange Transactions

On February 12, 2016, we completed separate privately negotiated note exchange transactions in which \$218.6 million in aggregate principal amount of our 10.75% senior unsecured notes due 2023 (“2023 notes”) was exchanged for \$207.6 million in aggregate principal amount of our 7.625% senior secured notes due 2021 (“2021 notes”). On February 29, 2016, we completed additional separate privately negotiated note exchange transactions in which \$63.8 million in aggregate principal amount of our 2023 notes was exchanged for \$60.0 million in aggregate principal amount of our 2021 notes. The 2021 notes were issued under the existing indenture dated as of May 29, 2013.

The note exchange transactions were considered to be debt extinguishments. As such, we recognized a net gain of \$7.8 million which was recorded as an offset to interest expense in the accompanying condensed consolidated statements of operations and comprehensive income (loss) in the first quarter of 2016. Of this \$7.8 million gain, \$14.8 million was attributable to the reduction in outstanding principal which was partially offset by the write-off of \$7.0 million of unamortized debt issuance costs associated with the 2023 notes which were extinguished in the exchange transactions.

In connection with issuance of the 2021 notes in the exchange transactions, we incurred \$4.9 million of various third-party fees and expenses. These costs have been recorded as a reduction to long-term debt and are being amortized over the remaining term of the 2021 notes using the effective interest method.

Note Redemption Transaction

In May 2016 the Company exercised its contractual right to redeem \$35.0 million in aggregate principal amount of 2021 notes at a price of 103.0%, plus accrued and unpaid interest. The redemption transaction was considered to be a debt extinguishment. As such, we recognized a loss of \$1.7 million which was recorded as a component of interest expense in the accompanying condensed consolidated statements of operations and comprehensive income (loss) in the second quarter of 2016. Of this \$1.7 million loss, \$1.0 million was attributable to the payment of the redemption

premium and \$0.7 million was attributable to the write-off of unamortized debt issuance costs associated with the redeemed notes.

2015 Facility Borrowings

As of June 30, 2016, we have \$104.0 million in borrowings outstanding under our \$800.0 million senior secured revolving credit facility (“2015 facility”). During the first six months of 2016, we borrowed \$479.0 million, primarily related to the note redemption transaction described above, and repaid \$435.0 million at a weighted average interest rate of 2.5%.

Fair Value

The only financial instrument which was measured at fair value on a recurring basis was our warrants. However, in April 2015, the remaining 0.7 million of outstanding, detachable warrants were exercised. The warrants were considered to be derivative financial instruments and were classified as liabilities.

The table below presents the effect of our derivative financial instrument on the condensed consolidated statements of operations and comprehensive income (loss) (in thousands):

		Amount of Loss	
		Recognized in Income Three Months Ended	Recognized in Income Six Months Ended
Derivative Not Designated	Location of Loss	June 30,	June 30,
as Hedging Instrument	Recognized in Income	201 6 15	201 6 15
Warrants	Interest expense, net	\$—\$4,730	\$—\$4,563

We used the income approach to value our warrants by using the Black-Scholes option-pricing model. Using this model, the risk-free interest rate was based on the U.S. Treasury yield curve in effect on the valuation date. The expected life was based on the period of time until the expiration of the warrants. Expected volatility was based on the historical volatility of our common stock over the most recent period equal to the expected life of the warrants. The expected dividend yield was based on our history of not paying regular dividends in the past.

These techniques incorporated Level 1 and Level 2 inputs. Significant inputs to the derivative valuation for the warrants were observable in the active markets and are classified as Level 2 in the hierarchy.

We have elected to report the value of our 2021 notes, 2023 notes, and the \$600.0 million term loan credit agreement (“2015 term loan”) at amortized cost. The fair values of the 2021 notes, the 2023 notes and the 2015 term loan at June 30, 2016 were approximately \$617.6 million, \$458.3 million and \$595.1 million, respectively, and were determined using Level 2 inputs based on market prices.

5. Employee Stock-Based Compensation

Time Based Restricted Stock Unit Grants

In the first quarter of 2016, our board of directors granted 625,000 RSUs to employees and eligible directors under our 2007 and 2014 Incentive Plans for which vesting is based on continuous employment over the requisite service period. 530,000 of the RSUs vest at 33% per year at each anniversary of the grant date over the next three years, 63,000 RSUs vest at 25% per year at each anniversary of the grant date over the next four years and 32,000 RSUs vest 100% at the first anniversary of the grant date. The weighted average grant date fair value for these RSUs was \$10.52 per share, which was based on the closing stock price on the grant dates.

Performance and Service Condition Based Restricted Stock Unit Grants

In the first quarter of 2016, our board of directors granted 265,000 RSUs to employees under our 2014 Incentive Plan, which vest if the compound annual growth rate of the Company's total sales in 2018 over 2015 exceeds a composite annual growth rate based on single-family housing starts, multi-family housing starts, and growth in repair and remodeling sales over the same period. Assuming continued employment and if the performance vesting condition is achieved, these awards will cliff vest on the third anniversary of the grant date. The weighted average grant date fair value for these RSUs was \$10.96 per share, which was based on the closing stock price on the grant dates.

Market and Service Condition Based Restricted Stock Unit Grants

In the first quarter of 2016, our board of directors granted 265,000 RSUs to employees under our 2014 Incentive Plan for which vesting is contingent upon the Company's total shareholder return exceeding that of the Company's peer group over a three year measurement period. Assuming continued employment and if the market vesting condition is met, these awards will cliff vest on the third anniversary of the grant date. The weighted average grant date fair value for these RSUs was \$7.58 per share, which was determined using the Monte Carlo simulation model using the following weighted average assumptions:

Expected volatility (company)	53.6%
Expected volatility (peer group median)	17.3%
Correlation between the company and peer group median	0.47
Expected dividend yield	0.00%
Risk-free rate	1.29%

The expected volatilities are based on the historical volatilities of our common stock and the common stocks of the constituents of the Company's peer group over the most recent period equal to the measurement period. The expected dividend yield is based on our history of not paying regular dividends in the past and our 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 measurement period.

Stock Option Grant

In the first quarter of 2016, our board of directors granted 63,000 stock options to employees under our 2014 Incentive Plan. All the awards vest at 25% per year at each anniversary of the grant date over four years. The exercise price for the options was \$6.59 per share, which was the closing stock price on the grant date. The weighted average grant date fair value of the options was \$3.71 and was determined using the Black-Scholes option-pricing model with the following weighted average assumptions:

Expected life	6.0 years
Expected volatility	60.88%
Expected dividend yield	0.00%
Risk-free rate	1.41%

The expected life represents the period of time the options are expected to be outstanding. We used the simplified method for determining the expected life assumption due to limited historical exercise experience on our stock options. The expected volatility is based on the historical volatility of our common stock over the most recent period equal to the expected life of the option. The expected dividend yield is based on our history of not paying regular dividends in the past and our 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.

6. Income Taxes

We evaluate our deferred tax assets on a quarterly basis to determine whether a valuation allowance is required. In accordance with the Income Taxes topic of the Codification we assess whether it is more likely than not that some or all of our deferred tax assets will not be realized. Significant judgment is required in estimating valuation allowances for deferred tax assets and in making this determination, we consider all available positive and negative evidence and make certain assumptions. The realization of a deferred tax asset ultimately depends on the existence of sufficient taxable income in the applicable carryback or carryforward periods. We consider nature, frequency, and severity of current and cumulative losses, as well as historical and forecasted financial results, the overall business environment, our industry's historic cyclicalities, the reversal of existing deferred tax liabilities, and tax planning strategies in our assessment. Changes in our estimates of future taxable income and tax planning strategies will affect our estimate of the realization of the tax benefits of these tax carryforwards. To the extent we generate sufficient taxable income in the future to fully utilize the tax benefits of the net deferred tax assets on which a valuation allowance was recorded;

our effective tax rate may decrease as the valuation allowance is reversed.

We recorded a full valuation allowance in 2008 due to our cumulative three year loss position at that time, compounded by the negative industry-wide business trends and outlook. At December 31, 2015, we reported a valuation allowance of \$136.5 million against our deferred income tax assets, representing a full valuation allowance against our net deferred income tax assets.

Historically weak housing market conditions have contributed to our cumulative loss position for the past several years. As of March 31, 2016, we had a cumulative unadjusted loss for the three year period. Further, considering the historical ProBuild results on a proforma basis, including debt, we also had a cumulative three year loss position.

In the second quarter of 2016 we moved from a cumulative loss position over the previous three years to a cumulative income position for the first time since we established the full valuation allowance in 2008. While this is positive evidence, we have concluded as of June 30, 2016 that it remains necessary to record a full valuation allowance against our net federal and some state deferred tax assets based upon our history of losses since establishing the valuation allowance nine years ago. As of June 30, 2016, we are currently projecting taxable income in certain states where we do not have any carryover net operating losses and as such, management determined that there was sufficient positive evidence to conclude that it is more likely than not that the valuation allowance should be reduced for the deferred tax assets related to these states. We continue to evaluate our cumulative income position and income trend, as well as our future projections of sustained profitability. We evaluate whether this profitability is a trend, which may constitute sufficient positive evidence to support a full or partial reversal of our valuation allowance. If this profitability trend continues for the remainder of 2016 and the forecasted future, we anticipate that we may reverse substantially all of our valuation allowance as early as the second half of 2016.

As of December 31, 2015 we had \$414.6 million of state operating loss carry-forwards, which included \$2.6 million of state tax credit carry-forwards expiring at various dates through 2035. In addition, at December 31, 2015 we also had \$281.2 million of federal net operating loss carry-forwards that will expire at various dates through 2035.

We recorded reductions to the valuation allowance of \$16.0 million and \$10.9 million for the three and six months ended June 30, 2016, respectively against our net deferred tax assets as we generated income during those periods. We recorded a reduction to the valuation allowance of \$1.3 million for the three months ended June 30, 2015 against our net deferred tax assets as we generated income during that period. We recorded an increase to the valuation allowance of \$1.8 million for the six months ended June 30, 2015 against our net deferred tax assets as we generated a net operating loss during that period. Our effective tax rate was 12.4% and 41.2% for the three and six months ended June 30, 2016, respectively. Our effective tax rate was (5.9%) and 0.1% for the three and six months ended June 30, 2015, respectively. We have historically calculated the provision for income taxes during interim reporting periods by applying an estimate of the annual effective tax rate for the full fiscal year to “ordinary” income or loss (pretax income or loss excluding unusual or infrequently occurring discrete items) for the reporting period. We have used a discrete effective tax rate method to calculate income tax expense for the three and six months ended June 30, 2016 as we determined that due to higher tax expense in 2016, primarily relating to deferred tax expense arising from amortization of goodwill, that even a small level of volatility in projections would result in significant fluctuations in the estimated annualized effective tax rate.

Section 382 of the Internal Revenue Code imposes annual limitations on the utilization of net operating loss (“NOL”) carryforwards, other tax carryforwards, and certain built-in losses upon an ownership change as defined under that section. In general terms, an ownership change may result from transactions that increase the aggregate ownership of certain stockholders in the Company’s stock by more than 50 percentage points over a three year testing period (“Section 382 Ownership Change”). If the Company were to experience a Section 382 Ownership Change, an annual limitation would be imposed on certain of the Company’s tax attributes, including NOL and capital loss carryforwards, and certain other losses, credits, deductions or tax basis.

We base our estimate of deferred tax assets and liabilities on current tax laws and rates. In certain cases, we also base our estimate on business plan forecasts and other expectations about future outcomes. Changes in existing tax laws or rates could affect our actual tax results, and future business results may affect the amount of our deferred tax liabilities or the valuation of our deferred tax assets over time. Due to uncertainties in the estimation process, particularly with respect to changes in facts and circumstances in future reporting periods, as well as the residential homebuilding industry’s cyclicity and sensitivity to changes in economic conditions, it is possible that actual results could differ from the estimates used in previous analyses.

Accounting for deferred taxes is based upon estimates of future results. Differences between the anticipated and actual outcomes of these future results could have a material impact on our consolidated results of operations or financial position.

7. Commitments and Contingencies

We are a party to various legal proceedings in the ordinary course of business. Although the ultimate disposition of these proceedings cannot be predicted with certainty, management believes the outcome of any claim that is pending or threatened, either individually or on a combined basis, will not have a material adverse effect on our consolidated financial position, cash flows or results of operations. However, there can be no assurances that future costs related to

legal proceedings would not be material to our results of operations or liquidity for a particular period.

8. Segment and Product Information

We offer an integrated solution to our customers providing manufacturing, supply, and installation of a full range of structural and related building products. We provide a wide variety of building products and services directly to homebuilder customers. We manufacture floor trusses, roof trusses, wall panels, stairs, millwork, windows, and doors. We also provide a full range of construction services. These product and service offerings are distributed across approximately 399 locations operating in 40 states across the United States, which have been reorganized into nine geographical regions following the ProBuild acquisition. Centralized financial and operational oversight, including resource allocation and assessment of performance on an income (loss) before income taxes basis, is performed by our CEO, whom we have determined to be our chief operating decision maker (“CODM”).

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As a result of the reorganization following the ProBuild acquisition, the Company has nine operating segments aligned with its nine geographical regions (Regions 1 through 9). While all of our operating segments have products, distribution methods and customers of a similar nature, certain of our operating segments have been aggregated due to also containing similar economic characteristics, resulting in the following composition of reportable segments:

- Regions 1 and 2 have been aggregated to form the “Northeast” reportable segment
- Regions 3 and 5 have been aggregated to form the “Southeast” reportable segment
- Regions 4 and 6 have been aggregated to form the “South” reportable segment
- Region 7, 8 and 9 have been aggregated to form the “West” reportable segment, which was acquired entirely through the ProBuild acquisition.

In addition to our reportable segments, our consolidated results include corporate overhead, other various operating activities that are not internally allocated to a geographical region nor separately reported to the CODM, and certain reconciling items primarily related to allocations of corporate overhead and rent expense, which have collectively been presented as “All Other”. The accounting policies of the segments are consistent with those referenced in Note 1, except for noted reconciling items.

The following tables present Net sales, income (loss) before income taxes and certain other measures for the reportable segments, reconciled to consolidated total continuing operations, for the periods indicated (in thousands):

Three months ended June 30, 2016				
				Income (loss)
		Depreciation & Amortization	Interest	before income taxes
Reportable segments	Net Sales			
Northeast	\$325,765	\$ 5,406	\$4,608	\$12,460
Southeast	364,954	3,180	4,833	11,652
South	430,893	5,938	5,707	18,982
West	523,537	9,798	7,106	28,407
Total reportable segments	1,645,149	24,322	22,254	71,501
All other	32,151	6,236	20,548	(37,881)
Total consolidated	\$1,677,300	\$ 30,558	\$42,802	\$33,620

Six months ended June 30, 2016				
				Income (loss)
		Depreciation & Amortization	Interest	before income taxes
Reportable segments	Net Sales			
Northeast	\$583,785	\$ 10,889	\$8,758	\$15,082

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Southeast	676,074	6,414	9,247	17,485
South	840,222	12,146	10,961	33,981
West	909,797	19,517	13,238	26,998
Total reportable segments	3,009,878	48,966	42,204	93,546
All other	64,537	12,383	35,823	(72,371)
Total consolidated	\$3,074,415	\$ 61,349	\$78,027	\$21,175

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Three months ended June 30, 2015				
				Income (loss)
		Depreciation & Amortization	Interest	before income taxes
Reportable segments	Net Sales			
Northeast	\$68,424	\$ 284	\$857	\$4,288
Southeast	193,525	787	3,255	5,078
South	169,226	1,632	2,461	4,568
West				
Total reportable segments	431,175	2,703	6,573	13,934
All other	30,346	927	6,000	(10,557)
Total consolidated	\$461,521	\$ 3,630	\$ 12,573	\$3,377

Six months ended June 30, 2015				
				Income (loss)
		Depreciation & Amortization	Interest	before income taxes
Reportable segments	Net Sales			
Northeast	\$111,909	\$ 527	\$1,709	\$3,637
Southeast	340,994	1,472	6,245	3,382
South	321,957	3,087	4,834	7,222
West				
Total reportable segments	774,860	5,086	12,788	14,241
All other	57,647	1,696	7,392	(17,738)
Total consolidated	\$832,507	\$ 6,782	\$20,180	\$(3,497)

Asset information by segment is not reported internally or otherwise reviewed by the CODM nor does the Company earn revenues or have long-lived assets located in foreign countries. The Company's net sales by product category for the periods indicated were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2016	2015	June 30, 2016	2015
Lumber & lumber sheet goods	\$557,314	\$140,302	\$1,016,221	\$254,608

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Windows, doors & millwork	342,589	137,959	649,380	253,416
Manufactured products	291,110	102,639	531,859	181,480
Gypsum, roofing & insulation	139,769	13,021	251,781	23,408
Siding, metal & concrete products	149,471	11,253	268,395	20,278
Other building products & services	197,047	56,347	356,779	99,317
Net sales	\$1,677,300	\$461,521	\$3,074,415	\$832,507

In the above presentation of the Company's Net sales by product category, prior periods have been revised to reflect a categorization of the Company's install material sales within the respective product categories. Install labor sales are reflected in the "Other building products & services" category. The revised presentation of the Company's prior quarterly periods is as follows (in thousands):

	Three Months Ended			
	March 31,	December 31,	September 30,	March 31,
	2016	2015	2015	2015
Lumber & lumber sheet goods	\$ 458,907	\$446,133	\$407,642	\$ 114,306
Windows, doors & millwork	306,791	308,423	276,095	115,457
Manufactured products	240,749	232,762	227,175	78,841
Gypsum, roofing & insulation	112,012	131,213	110,451	10,387
Siding, metal & concrete products	118,924	131,962	112,636	9,025
Other building products & services	159,731	205,362	142,064	42,970
Net Sales	\$ 1,397,114	\$1,455,855	\$1,276,063	\$370,986

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

The following discussion of our financial condition and results of operations should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and notes thereto for the year ended December 31, 2015 included in our most recent annual report on Form 10-K. The following discussion and analysis should also be read in conjunction with the unaudited condensed consolidated financial statements appearing elsewhere in this report. In this quarterly report on Form 10-Q, references to the "company," "we," "our," "ours" or "us" refer to Builders FirstSource, Inc. and its consolidated subsidiaries, including ProBuild Holdings LLC ("ProBuild"), as of July 31, 2015, unless otherwise stated or the context otherwise requires.

Cautionary Statement

Statements in this report which are not purely historical facts or which necessarily depend upon future events, including statements regarding our anticipations, beliefs, expectations, hopes, intentions or strategies for the future, may be forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. All forward-looking statements in this report are based upon information available to us on the date of this report. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Any forward-looking statements made in this report involve risks and uncertainties that could cause actual events or results to differ materially from the events or results described in the forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements. In addition, oral statements made by our directors, officers and employees to the investor and analyst communities, media representatives and others, depending upon their nature, may also constitute forward-looking statements. As with the forward-looking statements included in this report, these forward-looking statements are by nature inherently uncertain, and actual results may differ materially as a result of many factors. Further information regarding the risk factors that could affect our financial and other results are included as Item 1A of our annual report on Form 10-K.

COMPANY OVERVIEW

We are a leading supplier of building materials, manufactured components and construction services to professional contractors, sub-contractors, and consumers. Following our acquisition of ProBuild in July 2015, the Company operates 399 locations in 40 states across the United States. Given the span and depth of our geographical reach, our locations are organized into nine geographical regions (Regions 1 through 9), which are also our operating segments, further aggregated into four reportable segments: Northeast, Southeast, South and West. All of our segments have similar customers, products and services, and distribution methods. Our financial statements contain additional information regarding segment performance which is discussed in Note 8 to the condensed consolidated financial statements included in Item 1 of this quarterly report on Form 10-Q.

We offer an integrated solution to our customers providing manufacturing, supply and installation of a full range of structural and related building products. Our manufactured products include our factory-built roof and floor trusses, wall panels and stairs, vinyl windows, custom millwork and trim, as well as engineered wood that we design, cut, and assemble for each home. We also assemble interior and exterior doors into pre-hung units. Additionally, we supply our customers with a broad offering of professional grade building products not manufactured by us, such as dimensional lumber and lumber sheet goods and various window, door and millwork lines. Our full range of construction-related services includes professional installation, turn-key framing and shell construction, and spans all our product categories.

We group our building products into six product categories:

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- Lumber & Lumber Sheet Goods. Lumber & lumber sheet goods include dimensional lumber, plywood, and OSB products used in on-site house framing.
- Windows, Door & Millwork. Windows & doors are comprised of the manufacturing, assembly, and distribution of windows and the assembly and distribution of interior and exterior door units. Millwork includes interior trim, exterior trim, columns and posts that we distribute, as well as custom exterior features that we manufacture under the Synboard[®] brand name.
- Manufactured Products. Manufactured products consist of wood floor and roof trusses, steel roof trusses, wall panels, stairs, and engineered wood.
- Gypsum, Roofing & Insulation. Gypsum, roofing, & insulation include wallboard, metal studs and trims, ceilings, joint treatment and finishes, stucco and exteriors.

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- Siding, Metal, and Concrete. Siding, metal, and concrete includes vinyl, composite, and wood siding, other exteriors, and cement.
- Other Building Products & Services. Other building products & services are comprised of products such as cabinets and hardware as well as services such as turn-key framing, shell construction, design assistance, and professional installation spanning the majority of our product categories.

Our operating results are dependent on the following trends, events and uncertainties, some of which are beyond our control:

- Homebuilding Industry. Our business is driven primarily by both the residential new construction market and the residential repair and remodel market, which are in turn dependent upon a number of factors, including demographic trends, interest rates, consumer confidence, employment rates, foreclosure rates, and the health of the economy and mortgage markets. During the housing downturn, which began in 2006, many homebuilders significantly decreased their housing starts because of lower demand and an excess of home inventory. The housing industry started to strengthen in 2011. According to the U.S. Census Bureau, the annualized rate for U.S. single-family housing starts was 778,000 as of June 30, 2016. However, single-family housing starts remain well below the historical average (from 1959 through 2015) of 1.0 million per year. Due to the lower levels of housing starts and increased competition for homebuilder business, we have and will continue to experience pressure on our gross margins. In addition to these factors, there has been a recent trend of consolidation within the building products supply industry. However, our industry remains highly fragmented and competitive and we will continue to face significant competition from local and regional suppliers. We still believe there are several meaningful trends that indicate U.S. housing demand will likely recover further in the long term and that the downturn in the housing industry was likely a trough in the cyclical nature of the residential construction industry. These trends include relatively low interest rates, the aging of housing stock, and normal population growth due to immigration and birthrate exceeding death rate. Industry forecasters, including the National Association of Homebuilders (“NAHB”), expect to see continued improvement in housing demand over the next few years.
- Targeting Large Production Homebuilders. Over the past ten years, the homebuilding industry has undergone consolidation, and the larger homebuilders have increased their market share. We expect that trend to continue as larger homebuilders have better liquidity and land positions relative to the smaller, less capitalized homebuilders. Our focus is on maintaining relationships and market share with these customers while balancing the competitive pressures we are facing in servicing large homebuilders with certain profitability expectations. We expect that our ability to maintain strong relationships with the largest builders will be vital to our ability to expand into new markets as well as grow our market share. Additionally, we have been successful in expanding our custom homebuilder customer base while maintaining acceptable credit standards.
- Repair and remodel end market. Following the acquisition of ProBuild, the repair and remodel end market now comprises a larger portion of our business. Although it is influenced by housing starts to a lesser degree than the homebuilding market, the repair and remodel end market is still dependent upon some of the same factors as the homebuilding market, including demographic trends, interest rates, consumer confidence, employment rates, foreclosure rates, and the health of the economy and home financing markets. We expect that our ability to remain competitive in this space as well as grow our market share will depend on our continued ability to provide a high level of customer service coupled with a broad product offering.
- Use of Prefabricated Components. Prior to the housing downturn, homebuilders were increasingly using prefabricated components in order to realize increased efficiency and improved quality. Shortening cycle time from start to completion was a key imperative of the homebuilders during periods of strong consumer demand. During the housing downturn, that trend decelerated as cycle time had less relevance. Customers who traditionally used prefabricated components, for the most part, still do. However, the conversion of customers to this product offering slowed during the downturn. We are now seeing the demand for prefabricated components increase as the residential new construction market continues to strengthen and the availability of skilled construction labor remains limited.

- **Economic Conditions.** Economic changes both nationally and locally in our markets impact our financial performance. The building products supply industry is highly dependent upon new home construction and subject to cyclical market changes. Our operations are subject to fluctuations arising from changes in supply and demand, national and local economic conditions, labor costs and availability, competition, government regulation, trade policies and other factors that affect the homebuilding industry such as demographic trends, interest rates, single-family housing starts, employment levels, consumer confidence, and the availability of credit to homebuilders, contractors, and homeowners. Beginning in 2007, the mortgage markets experienced substantial disruption due to increased defaults. This resulted in a stricter regulatory environment and reduced availability of mortgages for potential homebuyers due to an illiquid credit market and tighter standards to qualify for mortgages. Mortgage financing and commercial credit for smaller homebuilders continue to be constrained, although there have been recent signs of easing. As the housing industry is dependent upon the economy as well as potential homebuyers' access to mortgage financing and homebuilders' access to commercial credit, it is likely that the housing industry will not fully recover to the historical average until conditions in the economy and the credit markets further improve.
- **Cost of Materials.** Prices of wood products, which are subject to cyclical market fluctuations, may adversely impact operating income when prices rapidly rise or fall within a relatively short period of time. We purchase certain materials, including lumber products, which are then sold to customers as well as used as direct production inputs for our manufactured and prefabricated products. Short-term changes in the cost of these materials, some of which are subject to significant fluctuations, are sometimes passed on to our customers, but our pricing quotation periods may limit our ability to pass on such price changes. We may also be limited in our ability to pass on increases on in-bound freight costs on our products. Our inability to pass on material price increases to our customers could adversely impact our operating results.
 - **Controlling Expenses.** Another important aspect of our strategy is controlling costs and enhancing our status as a low-cost building materials supplier in the markets we serve. We pay close attention to managing our working capital and operating expenses. Further, we pay careful attention to our logistics function and its effect on our shipping and handling costs.
- **Multi-Family and Light Commercial Business.** Our primary focus has been, and continues to be, on single-family residential new construction and the repair and remodel end market. However, we will continue to identify opportunities for profitable growth in the multi-family and light commercial markets.
- **Successful integration of the ProBuild business:** The acquisition of ProBuild has substantially increased the scale of our company. Successfully integrating ProBuild will be critical to achieving our future objectives. Combining our two companies may be more difficult, costly, or time consuming than expected, which could result in the acquisition not achieving its intended results, including the expected operational synergies and cost savings. In addition, as a result of the ProBuild acquisition we have substantially increased indebtedness. Reduction of our outstanding debt will be a key imperative as we work to achieve the intended results of the acquisition.

RECENT DEVELOPMENTS

On February 12, 2016, we completed separate privately negotiated note exchange transactions in which \$218.6 million in aggregate principal amount of our 10.75% senior unsecured notes due 2023 ("2023 notes") was exchanged for \$207.6 million in aggregate principal amount of our 7.625% senior secured notes due 2021 ("2021 notes"). On February 29, 2016, we completed additional separate privately negotiated note exchange transactions in which \$63.8 million in aggregate principal amount of our 2023 notes was exchanged for \$60.0 million in aggregate principal amount of our 2021 notes. The 2021 notes were issued under the existing indenture dated as of May 29, 2013. These transactions resulted in a \$7.8 million net gain on debt extinguishment, reducing interest expense in the first quarter of 2016.

In May 2016, the Company exercised its contractual right to redeem \$35.0 million in aggregate principal amount of 2021 notes at a price of 103.0%. This transaction resulted in a \$1.7 million loss on debt extinguishment, which increased interest expense in the second quarter of 2016.

These transactions allowed the Company to reduce its long-term debt by approximately \$14.8 million and reduce its annual cash interest expense by approximately \$11.8 million.

CURRENT OPERATING CONDITIONS AND OUTLOOK

Though the level of housing starts remains below the historical average, the homebuilding industry has shown improvement since 2011. For the second quarter of 2016, actual U.S. single-family housing starts were 220,300, a 7.3% increase compared to the second quarter of 2015. U.S. single-family units under construction increased 16.2% during the second quarter of 2016 compared to the same quarter a year ago. While the housing industry has strengthened over the past few years, the limited availability of credit to

smaller homebuilders and potential homebuyers, the high demand for skilled construction labor and the slow economic recovery, among other factors, have hampered a stronger recovery. A composite of third party sources, including the NAHB, are forecasting 809,000 U.S single family housing starts for 2016, which is an increase of 13.2% from 2015. In addition, the Home Improvement Research Institute (“HIRI”) is forecasting sales in the repair and remodel end market to increase approximately 4.7% in 2016 compared to 2015.

Our net sales for the second quarter of 2016 were up 263% over the same period last year largely due to the acquisition of ProBuild. Our gross margin percentage increased by 0.9% during the second quarter of 2016 compared to the second quarter of 2015. Our gross margin percentage increased primarily due