

BEACON ROOFING SUPPLY INC
Form 10-Q
August 08, 2008

**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, 2008

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.: 000-50924

BEACON ROOFING SUPPLY, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of
incorporation or organization)

36-4173371

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

**One Lakeland Park Drive,
Peabody, Massachusetts**

(Address of principal executive offices)

01960

(Zip Code)

978-535-7668

(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 is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. (Check one):

Large accelerated filer

Accelerated filer

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Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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 August 1, 2008, there were 44,297,906 outstanding shares of the registrant's common stock, \$.01 par value per share.

BEACON ROOFING SUPPLY, INC.
Form 10-Q
For the Quarter Ended June 30, 2008
INDEX

Part I.	<u>Financial Information</u>	3
Item 1.	<u>Condensed Consolidated Financial Statements (Unaudited)</u>	3
	<u>Consolidated Balance Sheets</u>	3
	<u>Consolidated Statements of Operations</u>	4
	<u>Consolidated Statements of Cash Flows</u>	5
	<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	6
Item 2.	<u>Management's Discussion and Analysis of Financial Condition And Results of Operations</u>	13
	<u>Overview</u>	13
	<u>Results of Operations</u>	14
	<u>Seasonality and Quarterly Fluctuations</u>	19
	<u>Liquidity and Capital Resources</u>	20
	<u>Cautionary Statement</u>	24
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	24
	<u>Interest Rate Risk</u>	24
	<u>Foreign Exchange Risk</u>	25
Item 4.	<u>Controls and Procedures</u>	25
Part II.	<u>Other Information</u>	25
Item 6.	<u>Exhibits</u>	25
Signature Page		26
Index to Exhibits		27

BEACON ROOFING SUPPLY, INC.
PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
Consolidated Balance Sheets

	(Unaudited) June 30, 2008	(Unaudited) June 30, 2007	(Note) September 30, 2007
(Dollars in thousands)			
Assets			
Current assets:			
Cash and cash equivalents	\$ 11,503	\$ 7,232	\$ 6,469
Accounts receivable, less allowance of \$11,113 at June 30, 2008, \$6,695 at June 30, 2007, and \$7,970 at September 30, 2007	276,857	263,688	267,563
Inventories	203,101	192,735	165,848
Prepaid expenses and other assets	38,121	40,452	34,509
Deferred income taxes	17,601	13,578	13,196
Total current assets	547,183	517,685	487,585
Property and equipment, net	58,119	74,010	69,753
Goodwill	354,813	353,781	355,155
Other assets, net	78,465	98,310	94,167
Total assets	\$ 1,038,580	\$ 1,043,786	\$ 1,006,660
Liabilities and stockholders' equity			
Current liabilities:			
Accounts payable	\$ 191,975	\$ 198,115	\$ 183,257
Accrued expenses	87,830	79,373	54,020
Current portion of long-term obligations	16,674	51,225	34,773
Total current liabilities	296,479	328,713	272,050
Senior notes payable, net of current portion	340,375	344,750	343,000
Deferred income taxes	36,516	32,651	36,490
Long-term obligations under equipment financing and other, net of current portion	26,581	23,021	31,270
Commitments and contingencies			
Stockholders' equity:			
Common stock (voting); \$.01 par value; 100,000,000 shares authorized; 44,297,906 issued at June 30, 2008, 44,273,312 at June 30, 2007 and 44,273,312 at September 30, 2007	443	443	443
Undesignated preferred stock; 5,000,000 shares authorized, none issued or outstanding	-	-	-
Additional paid-in capital	215,407	210,333	211,567
Retained earnings	122,013	95,332	106,640
Accumulated other comprehensive income	766	8,543	5,200
Total stockholders' equity	338,629	314,651	323,850
Total liabilities and stockholders' equity	\$ 1,038,580	\$ 1,043,786	\$ 1,006,660

Note: The balance sheet at September 30, 2007

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has been derived from the audited financial statements at that date.

The accompanying Notes are an integral part of the Consolidated Financial Statements

BEACON ROOFING SUPPLY, INC.
Consolidated Statements of Operations

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2008	2007	2008	2007
Unaudited				
(Dollars in thousands, except per share data)				
Net sales	\$ 514,647	\$ 484,870	\$ 1,217,294	\$ 1,152,024
Cost of products sold	394,474	377,036	937,035	886,288
Gross profit	120,173	107,834	280,259	265,736
Operating expenses	83,240	81,183	234,489	222,249
Income from operations	36,933	26,651	45,770	43,487
Interest expense	5,977	7,401	19,714	20,110
Income before income taxes	30,956	19,250	26,056	23,377
Income tax expense	12,692	7,745	10,683	9,406
Net income	\$ 18,264	\$ 11,505	\$ 15,373	\$ 13,971
Net income per share:				
Basic	\$ 0.41	\$ 0.26	\$ 0.35	\$ 0.32
Diluted	\$ 0.41	\$ 0.26	\$ 0.34	\$ 0.31
Weighted average shares used in computing net income per share:				
Basic	44,291,478	44,263,602	44,281,768	44,020,089
Diluted	45,059,653	45,017,314	44,818,107	44,938,812

The accompanying Notes are an integral part of the Consolidated Financial Statements.

BEACON ROOFING SUPPLY, INC.
Consolidated Statements of Cash Flows

	Nine Months ended June 30,	
	2008	2007
	Unaudited (in thousands)	
Operating activities:		
Net income	\$ 15,373	\$ 13,971
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	25,755	23,321
Stock-based compensation	3,772	3,943
Deferred income taxes	(1,470)	(1,183)
Changes in assets and liabilities, net of the adjustments of businesses acquired:		
Accounts receivable	(9,798)	(19,626)
Inventories	(37,495)	(13,875)
Prepaid expenses and other assets	(1,878)	2,756
Accounts payable and accrued expenses	34,926	43,030
Net cash provided by operating activities	29,185	52,337
Investing activities:		
Purchases of property and equipment, net of sales proceeds	(2,321)	(21,470)
Acquisition of businesses, net of cash acquired	-	(120,154)
Net cash used in investing activities	(2,321)	(141,624)
Financing activities:		
Repayments under revolving lines of credit, net	(17,157)	(185,181)
Net borrowings (repayments) under senior notes payable, and other	(4,472)	279,742
Proceeds from exercise of options	47	1,115
Payment of deferred financing costs	-	(3,047)
Income tax benefit from stock-based compensation deductions in excess of the associated compensation costs	21	2,040
Net cash provided (used) by financing activities	(21,561)	94,669
Effect of exchange rate changes on cash	(269)	3
Net increase in cash and cash equivalents	5,034	5,385
Cash and cash equivalents at beginning of year	6,469	1,847
Cash and cash equivalents at end of period	\$ 11,503	\$ 7,232
Non-cash transactions:		
Conversion of senior notes payable to new senior notes payable	\$ -	\$ 66,839

The accompanying Notes are an integral part of the Consolidated Financial Statements

BEACON ROOFING SUPPLY, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

Beacon Roofing Supply, Inc. (the "Company") prepared the consolidated financial statements following accounting principles generally accepted in the United States (GAAP) for interim financial information and the requirements of the Securities and Exchange Commission (SEC). As permitted under those rules, certain footnotes or other financial information required by GAAP for complete financial statements have been condensed or omitted. The balance sheet as of June 30, 2007 has been presented for a better understanding of the impact of seasonal fluctuations on the Company's financial condition. Certain prior-year amounts have been reclassified to conform to the current-year presentation.

In management's opinion, the financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of the Company's financial position and operating results. The results for the three-month period (third quarter) and the nine-month period ended June 30, 2008 are not necessarily indicative of the results to be expected for the twelve months ending September 30, 2008 ("2008").

The Company's fiscal year ends on the last day in September of each year. Each of the Company's 2008 and 2007 quarters ends or ended on the last day of the respective third calendar month. Both this year's and last year's third quarter had 64 business days, while the nine-month periods ended June 30, 2008 and June 30, 2007 both had 189 business days.

During the first quarter of 2007, the Company refinanced its prior credit facilities and invested the associated excess funds in a money market account, which were classified as cash equivalents. The Company considers all highly liquid investments with maturities of three months or less when purchased to be cash equivalents. Cash and cash equivalents also include unsettled credit card transactions.

You should also read the financial statements and notes included in the Company's 2007 Annual Report on Form 10-K. The accounting policies used in preparing these financial statements are the same as those described in that Annual Report.

Accounting Change

Prior to October 1, 2007, the Company recognized income tax accruals with respect to uncertain tax positions based upon Statement of Financial Accounting Standards ("SFAS") No. 5, "Accounting for Contingencies." Under SFAS No. 5, the Company recorded a liability (including interest and penalties) associated with an uncertain tax position if the liability was both probable and estimable.

Effective October 1, 2007, the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109," which clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes" and requires expanded disclosure with respect to the uncertainty in income taxes. This Interpretation seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes.

The Company is subject to U.S. federal income tax and to income tax of multiple state jurisdictions. The Company is open to tax audits in the various jurisdictions until the respective statutes of limitations expire. The Company is no

longer subject to U.S. federal tax examinations for tax years prior to 2004. For the majority of states, the Company is no longer subject to tax examinations for tax years before 2004. In connection with the adoption of FIN No. 48, the Company analyzed its filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as

BEACON ROOFING SUPPLY, INC.**Notes to Consolidated Financial Statements (Unaudited) (Continued)****1. Basis of Presentation (Continued)**

well as all open tax years in these jurisdictions. There was no material impact on the consolidated financial statements upon adoption of FIN No. 48.

As of October 1, 2007, the total amount of gross unrecognized tax benefits (excluding the federal benefit received from state positions) was \$168,000. Of this total, \$109,000 (net of the federal benefit received from state positions) represents the amount of unrecognized tax benefits that, if recognized, would affect the Company's effective tax rate. The Company's continuing practice is to recognize interest and penalties related to income tax matters in income tax expense in the consolidated statements of operations. There were no significant accrued interest and penalty amounts resulting from such unrecognized tax benefits at October 1, 2007. The Company does not anticipate a significant change in its unrecognized tax benefits during the next twelve months.

2. Earnings Per Share

The Company calculates basic income per share by dividing net income by the weighted-average number of common shares outstanding. Diluted net income per share includes the dilutive effects of outstanding stock awards.

The following table reflects the calculation of weighted-average shares outstanding for each period presented:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2008	2007	2008	2007
Weighted-average common shares outstanding for basic	44,291,478	44,263,602	44,281,768	44,020,089
Dilutive effect of employee stock options	768,175	753,712	536,339	918,723
Weighted-average shares assuming dilution	45,059,653	45,017,314	44,818,107	44,938,812

3. Stock-Based Compensation

The Company records stock-based compensation under Statement of Financial Accounting Standards ("SFAS") 123R, *Share-Based Payments*, using the modified-prospective transition method. Under this method, compensation expense recognized in 2008 and 2007 included: (a) compensation cost for all unvested share-based awards granted prior to adoption of SFAS 123R, based on the grant date fair value estimated in accordance with SFAS 123, *Accounting For Stock-Based Compensation*, and (b) compensation cost for all subsequent share-based awards granted subsequent to September 24, 2005, based on the grant date fair value estimated in accordance with SFAS 123R. SFAS 123R also requires the Company to estimate forfeitures in calculating the expense related to stock-based compensation.

Compensation cost arising from stock options granted to employees and non-employee directors is recognized as an expense using the straight-line method over the vesting period. As of June 30, 2008, there was \$6.2 million of total unrecognized compensation cost related to stock options. That cost is expected to be recognized over a weighted-average period of 1.9 years. The Company recorded stock-based compensation expense of \$1.2 million (\$0.7 million net of tax) and \$1.3 million (\$0.8 million net of tax) for the three months ended June 30, 2008 and 2007, respectively, and \$3.8 million (\$2.2 million net of tax) and \$3.9 million (\$2.4 million net of tax) for the nine months

ended June 30, 2008 and 2007, respectively.

7

BEACON ROOFING SUPPLY, INC.**Notes to Consolidated Financial Statements (Unaudited) (Continued)****3. Stock-Based Compensation (Continued)**

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants issued in the first three quarters of 2008 and 2007:

	Nine Months Ended June 30,	
	2008	2007
Risk free interest rate	2.76 - 4.08%	4.52 - 4.81%
Expected life	6.0 years	5.0 years
Expected volatility	45%	45%
Expected dividend yield	0%	0%

Expected lives of the options granted and expected volatilities are based on the expected lives and historical volatilities of the options and stocks of comparable public companies and other factors. Estimated cumulative forfeiture rates of 0%-12% were used for expensing the fair value of unvested options during both of the periods above.

The following table summarizes stock options outstanding as of June 30, 2008, as well as activity during the nine months then ended:

	Shares	Weighted-Average Exercise Price	Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (in Millions)
Outstanding at September 30, 2007	3,045,120	\$ 12.15		
Granted	749,023	9.33		
Exercised	(24,594)	1.93		
Forfeited	(118,926)	17.38		
Outstanding at June 30, 2008	3,650,623	\$ 11.47	6.94	\$ 10.8
Vested and expected to vest at June 30, 2008	3,572,070	\$ 11.40	6.89	\$ 10.7
Exercisable at June 30, 2008	2,341,404	\$ 9.66	5.91	\$ 9.8

As of June 30, 2008, there were remaining options to purchase 2,448,825 shares of common stock available for grants under the Company's Amended and Restated 2004 Stock Plan (inclusive of 1,750,000 additional shares approved by stockholders under the plan on February 7, 2008). The weighted-average grant date fair values of stock options granted during the nine months ended June 30, 2008 and 2007 were \$4.54 and \$10.07, respectively. The intrinsic values of stock options exercised during the nine months ended June 30, 2008 and June 30, 2007 were \$0.2 and \$5.7 million, respectively. At June 30, 2008, the Company had \$10.4 million of excess tax benefits available for potential deferred tax write-offs related to option accounting.

BEACON ROOFING SUPPLY, INC.**Notes to Consolidated Financial Statements (Unaudited) (Continued)****4. Comprehensive Income**

Comprehensive income or loss consists of net income or loss and other gains and losses affecting stockholders' equity that, under GAAP, are excluded from net income or loss. For the Company, these currently consist of the following items:

Unaudited (Dollars in thousands, except per share data)	Three Months Ended June 30,		One Months Ended June 30,	
	2008	2007	2008	2007
Net income	\$ 18,264	\$ 11,505	\$ 15,373	\$ 13,971
Foreign currency translation adjustment, net of tax effect	112	2,559	(766)	1,432
Unrealized gain (loss) on financial derivatives, net of tax effect	3,029	1,571	(3,668)	1,175
Comprehensive income	\$ 21,405	\$ 15,635	\$ 10,939	\$ 16,578

5. Acquisitions***North Coast Commercial Roofing Systems, Inc.***

On April 2, 2007, the Company purchased 100% of the outstanding stock of North Coast Commercial Roofing Systems, Inc. and certain of its subsidiaries and affiliates (together "North Coast"), a Twinsburg, Ohio-based distributor of commercial roofing systems and related accessories, with 16 locations in eight U.S. states at the time of the acquisition. North Coast has branches in Ohio, Illinois, Indiana, Kentucky, Michigan, New York, Pennsylvania and West Virginia. This purchase was funded with cash on hand along with funds borrowed under the Company's U.S. revolving line of credit. North Coast had net sales of \$235 million (unaudited) for the year ended June 30, 2006. A total of \$8.1 million of cash remains in escrow at June 30, 2008 for post-closing indemnification claims, with \$3.6 million included in other current assets and accrued expenses and \$4.5 million included in other long-term assets and liabilities. The Company has included the results of operations for North Coast from the date of acquisition and applied purchase accounting, which, along with certain purchase price adjustments, resulted in recorded goodwill of \$62.3 million as per below (in 000's). The Company finalized the purchase accounting in the second quarter of 2008.

Accounts receivable	\$ 31,706
Inventories	13,349
Prepaid expenses and other	982
Property and equipment	4,150
Deferred taxes	(10,400)
Accounts payable and accrued expenses	(19,189)
Net assets	20,598
Non-compete	3,300
Customer relationships	29,550
Goodwill	62,282

Purchase price	\$ 115,730
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9

BEACON ROOFING SUPPLY, INC.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

5. Acquisitions (Continued)

Other Recent Acquisitions

On May 18, 2007, the Company purchased certain assets of Wholesale Roofing Supply ("WRS"), a single location distributor of residential and commercial roofing products located in Knoxville, Tennessee.

6. Debt

The Company currently has the following credit facilities:

- a senior secured credit facility in the U.S.;
- a Canadian senior secured credit facility; and
- two equipment financing facilities.

Senior Secured Credit Facilities

On November 2, 2006, the Company entered into an amended and restated seven-year \$500 million U.S. senior secured credit facility and a C\$15 million senior secured Canadian credit facility with GE Antares Capital ("GE Antares") and a syndicate of other lenders (combined, the "Credit Facility"). The Credit Facility consists of a U.S. revolving credit facility of \$150 million, which includes a sub-facility of \$20 million for letters of credit, and an initial \$350 million term loan (the "Term Loan"). The Credit Facility also includes a C\$15 million senior secured revolving credit facility provided by GE Canada Finance Holding Company. As of June 30, 2008, the Company was in compliance with the covenants under the Credit Facility. Substantially all of the Company's assets, including the capital stock and assets of wholly-owned subsidiaries, secure obligations under the Credit Facility.

Equipment Financing Facilities

The Company has two equipment financing facilities that allow for the financing of purchased transportation and material handling equipment totaling \$32.9 million with \$7.5 million of remaining availability as of June 30, 2008. There was \$25.4 million of equipment financing loans outstanding at June 30, 2008, with fixed interest rates ranging from 5.5% to 7.4%.

BEACON ROOFING SUPPLY, INC.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

7. Foreign Sales

Foreign (Canadian) sales totaled \$68.6 and \$69.4 million in the nine months ended June 30, 2008 and June 30, 2007, respectively.

8. Financial Derivatives

The Company uses derivative financial instruments for hedging and non-trading purposes to manage its exposure to changes in interest rates. Use of derivative financial instruments in hedging programs subjects the Company to certain risks, such as market and credit risks. Market risk represents the possibility that the value of the derivative instrument will change. In a hedging relationship, the change in the value of the derivative is offset to a great extent by the change in the value of the underlying hedged item. Credit risk related to derivatives represents the possibility that the counterparty will not fulfill the terms of the contract. The notional, or contractual, amount of the Company's derivative financial instruments is used to measure interest to be paid or received and does not represent the Company's exposure due to credit risk. The Company's current derivative instruments are with counterparties rated very highly by nationally recognized credit rating agencies.

The Company is using interest rate derivative instruments to manage the risk of interest rate changes by converting a portion of its variable-rate borrowings into fixed-rate borrowings. There were interest rate derivative instruments outstanding in a total notional amount of \$300 million at June 30, 2008, which consisted of: a) interest rate swaps totaling \$200 million, expiring in April 2010, with a fixed rate of 4.97%; b) a \$50 million interest rate collar expiring in April 2010 with a floor rate of 3.99% and a cap rate of 5.75%; and c) a \$50 million interest rate collar expiring in April 2010 with a floor rate of 3.75% and a cap rate of 6.00%. The combined fair market value of the agreements resulted in a recorded liability of approximately \$8.2 million at June 30, 2008, which was determined based on current interest rates and expected future trends. The Company entered into

BEACON ROOFING SUPPLY, INC.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

8. Financial Derivatives (Continued)

these instruments during the second quarter of 2007 and cancelled the prior interest rate derivative instruments that had notional amounts totaling \$150 million. The current derivative instruments are designated as cash flow hedges, for which the Company records the effective portions of changes in their fair value, net of tax, in other comprehensive income (Note 4). Any ineffective portion of the hedges is recognized in earnings, of which there has been none to date. The prior derivative instruments were not designated as hedges and therefore changes in their fair values were recorded in interest expense.

9. Recent Accounting Pronouncements

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an Amendment of FASB Statement No. 133," which requires enhanced disclosures about an entity's derivative and hedging activities. In addition to disclosing the fair values of derivative instruments and their gains and losses in a tabular format, entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. SFAS No. 161 does not change the accounting for derivative instruments.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations" ("SFAS 141R") and SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51" ("SFAS 160"). These new standards will significantly change the accounting for and reporting of business combination transactions and noncontrolling (minority) interests in consolidated financial statements. SFAS 141R and SFAS 160 are required to be adopted simultaneously and are effective for the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited. The Company believes the adoption of SFAS 141R will have a significant impact on the accounting for future acquisitions. The adoption of SFAS 160 is not expected to have a material impact on the financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115" ("SFAS 159"). SFAS 159 permits companies to measure many financial instruments and certain other items at fair value at specified election dates. SFAS 159 will be effective for the Company in the fiscal year beginning October 1, 2008. The Company has not completed assessing the impact that the adoption of SFAS 159 will have on its consolidated financial statements, although the impact is not currently expected to be material.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"), which addresses how fair value should be measured when required for recognition or disclosure purposes under GAAP. It also establishes a fair value hierarchy and will require expanded disclosures on fair value measurements where applicable. SFAS 157 is effective for the Company in the fiscal year beginning October 1, 2008. The Company has not completed assessing the impact that SFAS 157 will have on its consolidated financial statements, although the impact is not currently expected to be material.

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

You should read the following discussion in conjunction with Management's Discussion and Analysis included in our 2007 Annual Report on Form 10-K. Unless otherwise specifically indicated, all references to "2008" and "YTD 2008" refer to the three months (third quarter) and nine months (year-to-date) ended June 30, 2008, respectively, of our fiscal year ending September 30, 2008, and all references to "2007" and "YTD 2007" refer to the three months (third quarter) and nine months (year-to-date) ended June 30, 2007, respectively, of our fiscal year ended September 30, 2007. Certain tabular information may not foot due to rounding.

Overview

We are one of the largest distributors of residential and non-residential roofing materials in the United States and Canada. We are also a distributor of other complementary building products, including siding, windows, specialty lumber products and waterproofing systems for residential and non-residential building exteriors. We purchase products from a large number of manufacturers and then distribute these goods to a customer base consisting of contractors and, to a lesser extent, general contractors, retailers and building materials suppliers.

We distribute up to 10,000 SKUs through 176 branches in the United States and Canada. We had 2,503 employees as of June 30, 2008, including our sales and marketing team of 956 employees.

In fiscal year 2007, approximately 94% of our net sales were in the United States. We stock one of the most extensive assortments of high-quality branded products in the industry, enabling us to deliver products to our customers on a timely basis.

Execution of the operating plan at each of our branches drives our financial results. Revenues are impacted by the relative strength of the residential and non-residential roofing markets we serve. We allow each of our branches to develop its own marketing plan and mix of products based upon its local market. We differentiate ourselves from the competition by providing customer services, including job site delivery, tapered insulation layouts and design and metal fabrication, and by providing credit. We consider customer relations and our employees' knowledge of roofing and exterior building materials to be very important to our ability to increase customer loyalty and maintain customer satisfaction. We invest significant resources in training our employees in sales techniques, management skills and product knowledge. Although we consider these attributes important drivers of our business, we continually pay close attention to controlling operating costs.

Our growth strategy includes both internal growth (opening branches, growing sales with existing customers, adding new customers and introducing new products) and acquisition growth. Our main acquisition strategy is to target market leaders in geographic areas that we do not service. Our April 2007 acquisition of North Coast Commercial Roofing Systems, Inc. ("North Coast") is one example of this approach. North Coast is a distributor of commercial roofing systems and related accessories that operated 16 branches in eight states in the Midwest and Northeast. North Coast had minimal branch overlap with our existing operations at the time of the acquisition. In addition, we also acquire smaller companies to supplement branch openings within existing markets. Our August 2006 acquisition of Roof Depot, Inc. ("Roof Depot"), which operated two branches and was integrated into our Midwest region, is one example of such an acquisition.

Results of Operations

The following table shows, for the periods indicated, information derived from our consolidated statements of operations expressed as a percentage of net sales for the periods presented. Percentages may not foot due to rounding.

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2008	2007	2008	2007
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	76.6	77.8	77.0	76.9
Gross profit	23.4	22.2	23.0	23.1
Operating expenses	16.2	16.7	19.3	19.3
Income from operations	7.2	5.5	3.8	3.8
Interest expense	(1.2)	(1.5)	(1.6)	(1.7)
Income before income taxes	6.0	4.0	2.1	2.0
Income tax expense	(2.5)	(1.6)	(0.9)	(0.8)
Net income	3.5%	2.4%	1.3%	1.2%

In managing our business, we consider all growth, including the opening of new branches, to be internal (organic) growth unless it results from an acquisition. When we refer to growth in existing markets or internal growth in our discussion and analysis of financial condition and results of operations, we include growth from existing and newly opened branches but exclude growth from acquired branches until they have been under our ownership for at least four full fiscal quarters at the start of the fiscal reporting period. At June 30, 2008, we had a total of 177 branches in operation. Acquired markets for the quarter ended June 30, 2008 include only the one branch at Wholesale Roofing Supply. For YTD 2008, 160 of the 177 branches, along with two branches closed in October 2007 and February 2008, respectively, were included in our existing market calculations. The other 17 branches were excluded because they were acquired in fiscal 2007. Percentages in the tables below may not foot due to rounding.

Three Months Ended June 30, 2008 ("2008") Compared to the Three Months Ended June 30, 2007 ("2007")

Existing and Acquired Markets

For the Three Months Ended
(Dollars in thousands)

	Existing Markets		Acquired Markets		Consolidated	
	June 30, 2008	2007	June 30, 2008	2007	June 30, 2008	2007
Net Sales	\$ 512,491	\$ 483,979	\$ 2,156	\$ 891	\$ 514,647	\$ 484,870
Gross Profit	119,541	107,629	632	205	120,173	107,834
Gross Margin	23.3%	22.2%	29.3%	23.0%	23.4%	22.2%
Operating Expenses	82,875	81,031	365	152	83,240	81,183
	16.2%	16.7%	16.9%	17.1%	16.2%	16.7%

Operating
Expenses as a %
of Net Sales

Operating Income	\$	36,666	\$	26,598	\$	267	\$	53	\$	36,933	\$	26,651
Operating Margin		7.2%		5.5%		12.4%		5.9%		7.2%		5.5%

Net Sales

Consolidated net sales increased \$29.8 million, or 6.1%, to \$514.6 million in 2008 from \$484.9 million in 2007. Both this year's and last year's third quarter had 64 business days. Existing market sales increased \$28.5 million or 5.9%, while acquired markets contributed an increase of \$1.3 million. We attribute the existing market sales increase primarily to the following factors:

- a rapid rise in prices, especially in residential roofing products;
 - strong re-roofing activity in storm-affected regions; and
 - continued strength in non-residential roofing activity in most markets;
- partially offset by the negative impact of:
- continued weakness in new residential roofing activity in most markets; and
 - weak complementary product sales in certain markets where we have had historically higher levels of new residential construction.

We did not open or close any branches in our existing markets during the third quarter of 2008, but opened one branch in existing markets during the third quarter of 2007. For 2008, our acquired markets had combined product group sales of \$1.9 and \$0.2 million in residential roofing products and non-residential roofing products, respectively, while the product group sales for our existing markets were as follows:

Existing Markets

For the Three Months Ended

	June 30, 2008		June 30, 2007		Change	
	Sales	Mix	Sales	Mix		
	(dollars in thousands)					
Residential roofing products	\$ 221,510	43.2%	\$ 197,139	40.7%	\$ 24,371	12.4%
Non-residential roofing products	209,999	41.0%	195,587	40.4%	14,412	7.4
Complementary building products	80,982	15.8%	91,253	18.9%	(10,271)	-11.3
	\$ 512,491	100.0%	\$ 483,979	100.0%	\$ 28,512	5.9%

Note: Total 2008 existing market sales of \$512.5 million plus 2008 sales from acquired markets of \$2.1 million equal \$514.6 million of total 2008 sales. Total 2007 existing market sales of \$484.0 million plus 2007 sales from acquired markets of \$0.9 million equal \$484.9 million of total 2007 sales. We believe the existing market information is useful to investors because it helps explain organic growth or decline.

Gross Profit

For the Three Months Ended

	June 30, 2008		June 30, 2007		Change
	(dollars in millions)				
Gross profit	\$ 120.2	\$ 107.8	\$ 12.4		11.5%
Existing Markets	119.5	107.6	11.9		11.1%

Gross margin	23.4%	22.2%	1.2%
Existing Markets	23.3%	22.2%	1.1%

Our existing markets' gross profit increased \$11.9 million or 11.1% in 2008, while our acquired markets' gross profit increased \$0.4 million. Our overall gross margin increased to 23.4% from 22.2%, while our existing markets' gross margin increased to 23.3% in 2008 from 22.2% in 2007. These increases were mostly in residential roofing products and resulted principally from the pass-through of increases in shingle prices as we were notified of price increases from our vendors. However, our cost of goods sold did not increase at the same time or rate due to favorable buying programs and the lower cost inventory on hand before the price increases. Our existing market gross margin in non-residential roofing and complementary products, excluding vendor incentives, which represents our invoiced gross margin, was relatively consistent with 2007. If price increases do not continue in the future, existing market gross margins could decrease somewhat from current levels. The gross margin increases were also helped somewhat by an increase of residential roofing products in our product sales mix, which have substantially higher gross margins than the more competitive non-residential market.

Operating Expenses**For the Three Months Ended**

	June 30, 2008	June 30, 2007	Change	
	(dollars in millions)			
Operating expenses	\$ 83.2	\$ 81.2	\$ 2.0	2.5%
Existing Markets	82.9	81.0	1.9	2.3%
Operating expenses as a % of sales	16.2%	16.7%		-0.5%
Existing Markets	16.2%	16.7%		-0.5%

Our existing markets' operating expenses increased by \$1.9 million or 2.3% to \$82.9 million in 2008 from \$81.0 million in 2007, while our acquired markets' operating expenses increased \$0.2 million. The following factors were the leading causes of our higher existing market operating expenses:

- payroll and related costs increased by \$1.6 million primarily from higher incentive-based pay accruals, partially offset by a lower headcount and favorable medical insurance claims; and
- an increase of \$1.9 million in selling expenses due primarily to higher transportation expenses resulting from significantly higher petroleum costs;

partially offset by:

- savings of \$0.4 million in other expenses from cost-reduction initiatives; and
- reduced depreciation and amortization of \$1.2 million due to lower amortization amounts of intangible assets and somewhat from substantially lower capital expenditures in 2008.

Existing markets' operating expenses as a percentage of net sales decreased to 16.2% in 2008 from 16.7% in 2007 as we were able to control our variable costs and leverage our fixed costs. Overall operating expenses decreased to 16.2% of net sales from 16.7% due to the same factors. In 2008, we expensed a total of \$3.7 million for the amortization of intangible assets recorded under purchase accounting in our existing markets compared to \$4.5 million in 2007.

Interest Expense

Interest expense decreased \$1.4 million to \$6.0 million in 2008 from \$7.4 million in 2007. This decrease was primarily due to a paydown of debt and a decline in average interest rates since 2007, which affected the unhedged portion of our variable-rate debt.

Income Taxes

Income tax expense of \$12.7 million was recorded in 2008, an effective tax rate of 41.0%, compared to \$7.7 million in 2007, an effective tax rate of 40.2%. The slight increase in the effective rate reflects changes in allocations of taxable income and losses among the states in which we are located.

Nine Months Ended June 30, 2008 ("YTD 2008") Compared to the Nine Months Ended June 30, 2007 ("YTD 2007")**Existing and Acquired Markets****For the Nine Months Ended
(Dollars in thousands)**

	Existing Markets		Acquired Markets		Consolidated	
	June 30,		June 30,		June 30,	
	2008	2007	2008	2007	2008	2007
Net Sales	\$ 1,030,976	\$ 1,081,633	\$ 186,318	\$ 70,391	\$ 1,217,294	\$ 1,152,024
Gross Profit	249,239	254,904	31,020	10,832	280,259	265,736
Gross Margin	24.2%	23.6%	16.6%	15.4%	23.0%	23.1%
Operating Expenses	205,104	212,242	29,385	10,007	234,489	222,249
Operating Expenses as a % of Net Sales	19.9%	19.6%	15.8%	14.2%	19.3%	19.3%
Operating Income	\$ 44,135	\$ 42,662	\$ 1,635	\$ 825	\$ 45,770	\$ 43,487
Operating Margin	4.3%	3.9%	0.9%	1.2%	3.8%	3.8%

Net Sales

Consolidated net sales increased \$65.3 million, or 5.7%, to \$1.22 billion in YTD 2008 from \$1.15 billion in YTD 2007. Both this year and last year had 189 business days. Existing market sales declined \$50.7 million or 4.7%, while acquired markets contributed an increase of \$115.9 million. We attribute the existing market sales decline primarily to a decline in new residential construction and somewhat from weaker residential re-roofing and remodeling activity, partially offset by the recent favorable factors we discussed for the third quarter.

We opened one new branch and closed two branches in our existing markets during YTD 2008, while we opened seven new branches and closed two branches in existing markets in YTD 2007. For YTD 2008, our acquired markets had combined product group sales of \$14.3, \$165.7 and \$6.3 million in residential roofing products, non-residential roofing products and complementary building products, respectively, while the product group sales for our existing markets were as follows:

Existing Markets

For the Nine Months Ended

	June 30, 2008		June 30, 2007		Change	
	Sales	Mix	Sales	Mix		
	(dollars in thousands)					
Residential roofing products	\$ 480,978	46.7%	\$ 498,996	46.1%	\$ (18,018)	-3.6%
Non-residential roofing products	334,953	32.5%	330,040	30.5%	4,913	1.5
Complementary building products	215,045	20.9%	252,597	23.4%	(37,552)	-14.9
	\$ 1,030,976	100.0%	\$ 1,081,633	100.0%	\$ (50,657)	-4.7%

Note: Total YTD 2008 existing market sales of \$1,031.0 million plus YTD 2008 sales from acquired markets of \$186.3 million equal \$1,217.3 million of total YTD 2008 sales. Total YTD 2007 existing market sales of \$1,081.6 million plus YTD 2007 sales from acquired markets of \$70.4 million equal \$1,152.0 million of total YTD 2007 sales. We believe the existing market information is useful to investors because it helps explain organic growth or decline.

Gross Profit

For the Nine Months Ended

	June 30,	June 30,	Change	
	2008	2007		
	(dollars in millions)			
Gross Profit	\$ 280.3	\$ 265.7	\$ 14.6	5.5%
Existing Markets	249.24	254.90	(5.66)	-2.2%
Gross Margin	23.0%	23.1%	-0.1%	
Existing Markets	24.2%	23.6%	0.6%	

Our existing markets' gross profit declined \$5.7 million or 2.2% in YTD 2008, while our acquired markets' gross profit increased \$20.2 million. Existing markets' gross margin increased to 24.2% in YTD 2008 from 23.6% in YTD 2007. The existing market increase was caused by the factors we discussed for the quarter combined with higher calendar year-end vendor rebates offered by some of our vendors, partially offset by a negative impact from increased competitive conditions, mainly in our non-residential product group. Our overall gross margin decreased to 23.0% from 23.1% due primarily to the same factors and an increased sales mix of the traditionally lower gross margin non-residential roofing, mainly due to the addition of North Coast which sells mostly non-residential roofing.

Operating Expenses**For the Nine Months Ended**

	June 30, 2008	June 30, 2007	Change	
	(dollars in millions)			
Operating Expenses	\$ 234.5	\$ 222.2	\$ 12.3	5.5%
Existing Markets	\$ 205.1	\$ 212.2	\$ (7.1)	-3.4%
Operating Expenses as a % of Sales	19.3%	19.3%		0.0%
Existing Markets	19.9%	19.6%		0.3%

Our existing markets' operating expenses declined by \$7.1 million or 3.4% to \$205.1 million in YTD 2008 from \$212.2 million in YTD 2007, while our acquired markets' operating expenses increased \$19.4 million. The following factors were the leading causes of our lower existing market operating expenses:

- payroll and related costs decreased by \$5.9 million primarily from a lower headcount;
- savings of \$2.8 million in general and administrative expenses from cost-saving measures and allocations to our acquired markets; and
- reduced depreciation and amortization of \$1.4 million due to lower amortization amounts of intangible assets and somewhat from substantially lower capital expenditures in YTD 2008;

partially offset by:

- An increase in selling expenses of \$1.2 million resulting primarily from higher petroleum costs; and
- a \$1.8 million increase in our provision for bad debts as we increased our accounts receivable allowance due primarily to the first- half business slowdown.

Existing markets' operating expenses as a percentage of net sales increased slightly to 19.9% from 19.6%, primarily due to the lower existing market sales and the relatively fixed nature of our operating expenses. Overall operating expenses were consistent at 19.3% of net sales in YTD 2008 and YTD 2007, due to the same factors offset by the inclusion of North Coast, which had lower operating costs as a percentage of sales in YTD 2008. In YTD 2008, we expensed a total of \$11.3 million for the amortization of intangible assets recorded under purchase accounting, including \$4.9 million in our acquired markets, compared to a total of \$9.7 million in YTD 2007.

Interest Expense

Interest expense decreased \$0.4 million to \$19.7 million in YTD 2008 from \$20.1 million in YTD 2007. We were able to pay down our debt since June 2007 and there was a decline in average interest rates during YTD 2008, which affected the unhedged portion of our variable-rate debt.

Income Taxes

Income tax expense of \$10.7 million was recorded in YTD 2008, an effective tax rate of 41.0%, compared to income tax expense of \$9.4 million in YTD 2007, an effective tax rate of 40.2%. The increase in the effective rate reflects changes in allocations of taxable income and losses among the states in which we are located.

Seasonality and Quarterly Fluctuations

In general, sales and net income are highest during our first, third and fourth fiscal quarters, which represent the peak months of construction and reroofing, especially in our branches in the northeastern U.S. and in Canada. Our sales are substantially lower during the second quarter, when we historically have incurred low net income levels or net losses.

We generally experience an increase in inventory, accounts receivable and accounts payable during the first, third and fourth quarters of the year as a result of the seasonality of our business. Our peak borrowing level generally occurs during the third quarter, primarily because dated accounts payable offered by our suppliers typically are payable in April, May and June, while our peak accounts receivable collections typically occur from June through November.

We generally experience a slowing of collections of our accounts receivable during our second quarter, mainly due to the inability of some of our customers to conduct their businesses effectively in inclement weather in certain of our regions. We continue to attempt to collect those receivables, which require payment under our standard terms. We do not provide any concessions to our customers during this quarter of the year, although we may take advantage of seasonal incentives from our vendors. Also during the second quarter, we generally experience our lowest availability under our senior secured credit facilities, which are asset-based lending facilities.

Certain Quarterly Financial Data

The following table sets forth certain unaudited quarterly data for fiscal years 2008 and 2007 which, in the opinion of management, reflect all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of this data. Results of any one or more quarters are not necessarily indicative of results for an entire fiscal year or of continuing trends. Totals may not foot due to rounding.

	Fiscal year 2008			Fiscal year 2007			
	Qtr 1	Qtr 2	Qtr 3	Qtr 1	Qtr 2	Qtr 3	Qtr 4
	(dollars in millions, except per share data)						
	(unaudited)						
Net sales	\$ 398.4	\$ 304.3	\$ 514.6	\$ 380.2	\$ 286.9	\$ 484.9	\$ 493.8
Gross profit	91.7	68.4	120.2	91.7	66.2	107.8	108.2
Income (loss) from operations	15.8	(6.9)	36.9	21.1	(4.2)	26.7	26.3
Net income (loss)	\$ 5.2	\$ (8.1)	\$ 18.3	\$ 8.8	\$ (6.3)	\$ 11.5	\$ 11.3