BEACON ROOFING SUPPLY INC
Form 10-Q
August 07, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2012

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	36-4173371
(State or other jurisdiction of	(I.R.S. Employer

incorporation or organization)	Identification No.)
One Lakeland Park Drive,	
Peabody, Massachusetts	01960
(Address of principal executive offices)	(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 x 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 (§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). x 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 x	Accelerated filer ¨
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 x

As of August 1, 2012, there were 47,043,296 outstanding shares of the registrant's common stock, $.01 par value per share.

BEACON ROOFING SUPPLY, INC.

Quarterly Report on Form 10-Q

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BEACON ROOFING SUPPLY, INC.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets

	(Unaudited) June 30, 2012	(Unaudited) June 30, 2011	(Note) September 30, 2011
	(Dollars in thousands)		
Assets			
Current assets:			
Cash and cash equivalents	$31,243	$107,982	$ 143,027
Accounts receivable, less allowances of $14,560 at June 30, 2012, $13,762 at June 30, 2011, and $13,816 at September 30, 2011	279,304	296,208	280,322
Inventories	284,412	269,469	202,474
Prepaid expenses and other assets	58,332	51,711	37,573
Deferred income taxes	14,258	15,418	15,469
Total current assets	667,549	740,788	678,865
Property and equipment, net	52,526	47,326	47,427
Goodwill	425,190	380,788	380,916
Other assets, net	76,822	53,167	49,756
Total assets	$1,222,087	$1,222,069	$ 1,156,964
Liabilities and stockholders' equity			
Current liabilities:			
Accounts payable	$214,865	$240,012	$ 182,523
Accrued expenses	79,450	100,760	69,906
Borrowings under revolving lines of credit	44,900	71	28
Current portion of long-term obligations	15,255	8,852	15,577
Total current liabilities	354,470	349,695	268,034
Senior notes payable, net of current portion	210,938	309,364	301,544
Deferred income taxes	39,941	41,613	38,992
Long-term obligations under equipment financing and other, net of current portion	8,267	11,254	9,967
Commitments and contingencies			

Stockholders' equity:				
Common stock (voting); $.01 par value; 100,000,000 shares authorized; 47,079,268 issued and 46,971,235 outstanding at June 30, 2012, 46,179,790 issued and 46,071,758 outstanding at June 30, 2011, and 46,262,140 issued and 46,154,107 outstanding at September 30, 2011	470	461	462	
Undesignated preferred stock; 5,000,000 shares authorized, none issued or outstanding	-	-	-	
Additional paid-in capital	266,007	245,661	248,260	
Retained earnings	340,784	261,853	293,110	
Accumulated other comprehensive income (loss)	1,210	2,168	(3,405	)
Total stockholders' equity	608,471	510,143	538,427	
Total liabilities and stockholders' equity	$1,222,087	$1,222,069	$ 1,156,964	

Note: The balance sheet at September 30, 2011

has been derived from the audited financial statements at that date

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

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BEACON ROOFING SUPPLY, INC.

Consolidated Statements of Operations

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
Unaudited (Dollars in thousands, except per share data)				
Net sales	$ 560,526	$ 540,747	$ 1,445,537	$ 1,241,861
Cost of products sold	419,790	414,030	1,093,760	955,107
Gross profit	140,736	126,717	351,777	286,754
Operating expenses	89,459	83,585	256,407	230,614
Income from operations	51,277	43,132	95,370	56,140
Interest expense and other financing costs	8,158	3,326	14,717	9,981
Income before income taxes	43,119	39,806	80,653	46,159
Income tax expense	17,704	15,718	32,979	18,196
Net income	$ 25,415	$ 24,088	$ 47,674	$ 27,963
Net income per share:				
Basic	$ 0.54	$ 0.52	$ 1.02	$ 0.61
Diluted	$ 0.53	$ 0.51	$ 1.00	$ 0.60
Weighted average shares used in computing net income per share:				
Basic	46,910,336	45,990,255	46,542,158	45,848,209
Diluted	47,897,609	46,809,289	47,485,574	46,678,582

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,	
	2012	2011
	Unaudited (in thousands)	
Operating activities:		
Net income	$ 47,674	$ 27,963
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	17,795	18,795
Stock-based compensation	5,651	4,511
Adjustment of liability for contingent consideration	250	-
Certain interest expense and other financing costs	5,171	-
Gain on sale of assets	(899)	(641)
Deferred income taxes	254	(1,638)
Changes in assets and liabilities, net of the effects of businesses acquired:		
Accounts receivable	19,790	(49,541)
Inventories	(62,081)	(99,642)
Prepaid expenses and other assets	(19,393)	(6,258)
Accounts payable and accrued expenses	21,116	144,170
Net cash provided by operating activities	35,328	37,719
Investing activities:		
Purchases of property and equipment	(12,242)	(9,859)
Acquisition of businesses	(94,481)	(34,848)
Proceeds from sales of assets	996	1,408
Net cash used by investing activities	(105,727)	(43,299)
Financing activities:		
Borrowings (repayments) under revolving lines of credit, net	44,872	(7)
Repayments under senior notes payable and other, net	(93,693)	(8,787)
Deferred financing costs	(5,088)	-
Proceeds from exercises of options	11,084	4,365
Income tax benefit from stock-based compensation deductions in excess of the associated compensation costs	1,020	652
Net cash used by financing activities	(41,805)	(3,777)
Effect of exchange rate changes on cash	420	203
Net decrease in cash and cash equivalents	(111,784)	(9,154)
Cash and cash equivalents at beginning of year	143,027	117,136
Cash and cash equivalents at end of period	$ 31,243	$ 107,982

Cash paid during the year for:		
Interest	$ 9,524	$ 10,124
Income taxes, net of refunds	37,132	4,145

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

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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 the 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 have been condensed or omitted. The balance sheet as of June 30, 2011 has been presented for a better understanding of the impact of seasonal fluctuations on the Company's financial condition.

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 (year-to-date) ended June 30, 2012 are not necessarily indicative of the results to be expected for the twelve months ending September 30, 2012 (fiscal year 2012 or “2012”).

The nine-month periods ended June 30, 2012 and June 30, 2011 had 188 and 190 business days, respectively, while the three-month periods ended June 30, 2012 and June 30, 2011 each had 64 days.

You should also read the financial statements and notes included in the Company's fiscal year 2011 (“2011”) 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.

Adoption of Recent Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards No. 2011-08, *Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment,* which permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Previous guidance under Topic 350 required an entity to test goodwill for impairment, on at least an annual basis, by

comparing the fair value of a reporting unit with its carrying amount, including goodwill (step one). If the fair value of a reporting unit is less than its carrying amount, then the second step of the test must be performed to measure the amount of the impairment loss, if any. Under the amendments in this Update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. This Update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued. The Company early adopted this Update at the end of 2011 for its goodwill impairment testing for 2011.

In December 2010, the FASB issued Accounting Standards No. 2010-29, an amendment to *Business Combinations (Topic 805) – Disclosure of Supplementary Pro Forma Information for Business Combinations*, which specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments in this Update also expand the supplemental pro forma disclosures under Topic 805 to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The Update is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The Company's adoption of this Update in 2012 did not have an impact on the financial statements.

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

In December 2010, the FASB issued Accounting Standards No. 2010-28 an amendment to *Intangibles-Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts* (a consensus of the FASB Emerging Issues Task Force). The new guidance modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with the existing guidance and examples in paragraph 350-20-35-30, which require that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The amendment is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. The Company's adoption of this amendment in 2012 did not have an impact on the financial statements.

2. Income 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,	
	2012	2011	2012	2011
Weighted-average common shares outstanding for basic	46,910,336	45,990,255	46,542,158	45,848,209
Dilutive effect of stock options and restricted stock awards	987,273	819,034	943,416	830,373
Weighted-average shares assuming dilution	47,897,609	46,809,289	47,485,574	46,678,582

3. Stock-Based Compensation

The Company accounts for employee and non-employee director stock-based compensation using the fair value method of accounting. Compensation cost arising from stock options and restricted stock awards granted to employees

and non-employee directors is recognized using the straight-line method over the vesting period, which represents the requisite service or performance period. In calculating the expense related to stock-based compensation, the Company estimates option forfeitures and projects the number of restricted shares and units that are expected to vest based on the related performance measures.

The Company recorded stock-based compensation expense of $1.9 million ($1.1 million net of tax) and $1.5 million ($0.9 million net of tax) in the three months ended June 30, 2012 and 2011, respectively, and $5.7 million ($3.4 million net of tax) and $4.5 million ($2.7 million net of tax) in the nine months ended June 30, 2012 and 2011, respectively. At June 30, 2012, the Company had $17.4 million of excess tax benefits available for potential deferred tax write-offs related to previously recognized stock-based compensation.

The amended and restated Beacon Roofing Supply, Inc. 2004 Stock Plan (the "Plan") provides for grants of stock options and restricted stock awards of up to 7,800,000 shares of common stock to key employees and directors. As of June 30, 2012, there were 2,120,649 shares of common stock available for awards under the Plan.

Stock options

As of June 30, 2012, there was $7.8 million of total unrecognized compensation cost related to unvested stock options. That cost is expected to be recognized over a weighted-average period of 2.2 years. Except under certain conditions, the options are subject to continued employment and vest in one-third increments over a three-year period following the grant dates.

The fair values of the options were estimated on the dates of grants using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Nine Months Ended June 30, 2012	2011
Risk-free interest rate	0.94 %	1.51 %
Expected life in years	6.5	7.0
Expected volatility	47.00%	48.00%
Dividend yield	0.00 %	0.00 %

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

Expected lives of the options granted are based primarily on historical activity, while expected volatilities are based on historical volatilities of the Company's stock and consideration of comparable public companies' stock. Estimated forfeiture rates vary by grant and range up to 8.0% as of June 30, 2012.

The following table summarizes stock options outstanding as of June 30, 2012, as well as activity during the nine months then ended:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in Years)	Aggregate Intrinsic Value (in Millions)
Outstanding at September 30, 2011	3,895,583	$ 15.06		
Granted	789,332	18.78		
Exercised	(817,128)	13.56		
Canceled	(91,376)	16.49		
Outstanding at June 30, 2012	3,776,411	$ 16.12	6.5	$ 34.4
Vested or Expected to Vest at June 30, 2012	3,673,337	$ 16.10	6.5	$ 33.6
Exercisable at June 30, 2012	2,333,394	$ 15.52	5.1	$ 22.7

The aggregate intrinsic values above include only in-the-money options. The weighted-average grant date fair values of stock options granted during the nine months ended June 30, 2012 and June 30, 2011 were $8.78 and $7.82, respectively. The intrinsic values of stock options exercised were $8.2 and $3.8 million during the nine months ended June 30, 2012 and June 30, 2011, respectively.

Restricted stock awards

As of June 30, 2012, there was $3.3 million of total unrecognized compensation cost related to unvested restricted stock awards. That cost is expected to be recognized over a weighted-average period of 2.1 years.

The total fair values of the restricted stock awards were determined based upon the number of shares or units and the closing prices of the Company's common stock on the dates of the grants. The restricted stock awards granted to management are subject to continued employment, except under certain conditions, and will vest if the Company attains a targeted rate of return on invested capital at the end of a three-year period. The actual number of shares or units that will vest can range from 0% to 125% of the management grants depending upon actual Company performance below or above the target level and the Company estimates that performance in determining the projected number of shares or units that will vest and the related compensation cost. The restricted stock awards granted to non-employee directors are also subject to continued service, vest at the end of one year (except under certain conditions) and the underlying common shares will not be distributed until six months after the director separates from the Company.

The following table summarizes restricted shares and units outstanding as of June 30, 2012, as well as the activity during the nine months then ended:

	Number of Shares/Units	Weighted-Average Grant Price	Weighted-Average Remaining Contractual Life (in Years)	Aggregate Intrinsic Value (in Millions)
Outstanding at September 30, 2011	135,009	$ 16.70		
Granted	144,050	$ 20.08		
Lapse of restrictions	-			
Canceled	-			
Outstanding at June 30, 2012	279,059	$ 18.45	2.1	$ 7.0
Vested or Expected to Vest at June 30, 2012	279,059	$ 18.45	2.1	$ 7.0
Exercisable at June 30, 2012	-		-	-

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

4. Comprehensive Income

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
(Dollars in thousands)	2012	2011	2012	2011
Net income	$ 25,415	$ 24,088	$ 47,674	$ 27,963
Foreign currency translation adjustment	(2,051)	233	2,695	3,451
Tax effect	-	(92)	-	(1,437)
Foreign currency translation adjustment, net	(2,051)	141	2,695	2,014
Unrealized gain(loss) on financial derivatives	820	(267)	3,123	2,802
Tax effect	(324)	106	(1,203)	(1,009)
Unrealized gain(loss) on financial derivatives, net (Note 7)	496	(161)	1,920	1,793
Comprehensive income	$ 23,860	$ 24,068	$ 52,289	$ 31,770

5. Acquisitions

In June 2012, the Company purchased certain assets of Cassady Pierce Company (“Cassady Pierce”), a distributor of residential and commercial roofing products and related accessories headquartered in Pittsburgh, Pa. Cassady Pierce has six locations in the Pittsburgh area and recent annual sales of approximately $52 million. The purchase price allocation has not yet been completed.

In November 2011, the Company purchased all of the stock of Fowler & Peth, Inc., a distributor of residential and commercial roofing products and related accessories that has five branches in Colorado, two in Wyoming and one in Nebraska, with recent annual sales of approximately $60 million. The purchase price of $36.7 million resulted in goodwill of $14.9 million. The purchase price allocation remains preliminary. The Company and the selling stockholders mutually agreed to file a Section 338 election with the Internal Revenue Service to treat the transaction

for tax purposes as an asset purchase.

In October 2011, the Company purchased all of the stock of The Roofing Connection, a distributor of mostly residential roofing products and related accessories with one location in Dartmouth, Nova Scotia, a suburb of Halifax.

In May 2011, the Company purchased all of the stock of Enercon Products ("Enercon") for $39.8 million, including an earn-out amount of $4.9 million discussed herein. The purchase allocation resulted in goodwill of $17.1 million. Enercon is a roofing distributor with six locations in Western Canada. Headquartered within its branch in Edmonton, Enercon also has branches in Calgary, Regina and Saskatoon and two branches in Vancouver and generated annual sales of approximately $45 million in 2010. The purchase price included an additional payout of up to C$5.5 million if certain earn-out targets (based on defined EBITDA) were met for the twelve-month period ending in May 2012. A liability of $4.9 million for the earned portion of this contingent consideration is included in accrued expenses in the consolidated balance sheet at June 30, 2012. This payout was made in July 2012 and included payment of $1.3 million in excess of the March 31, 2012 liability. This additional expense was recorded in the third quarter of 2012, following a $1.0 million reduction in the liability earlier this year, resulting in a net expense of $0.3 million for the nine months ended June 30, 2012. Both adjustments were included in operating expenses. These adjustments do not affect taxable income and therefore were treated as permanent differences for income tax reporting purposes.

A total of $4.2 million associated with the above acquisitions remained in escrow at June 30, 2012, primarily for post-closing indemnification claims. Of this total, $1.7 million is included in prepaid expenses and other and accrued expenses and $2.5 million is included in other long-term assets and liabilities.

6. Debt

The Company currently has the following credit facilities:

- a senior secured credit facility in the U.S.;
- a senior secured credit facility in Canada; and
- an equipment financing facility.

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Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

Senior Secured Credit Facility

On April 5, 2012, the Company entered into a five-year senior secured credit facility that includes a $550 million U.S. credit facility and a C$15 million ($15.1 million) Canadian credit facility with Wells Fargo Bank, National Association, and a syndicate of other lenders (combined, the “Credit Facility”). The $550 million U.S credit facility consists of a revolving credit facility of $325 million (the “U.S. Revolver”), which includes a sub-facility of $20 million for letters of credit, and a $225 million term loan (the “Term Loan”). Substantially all of the Company's assets, including the capital stock and assets of wholly-owned subsidiaries, secure obligations under the Credit Facility. The term loan has required amortization of 5% per year that is payable in quarterly installments, with the balance due on June 30, 2017. The Company may increase the Credit Facility by up to $200 million under certain conditions. There was $44.9 and $222.2 million outstanding under the U.S. Revolver and Term Loan, respectively, at June 30, 2012.

Borrowings under the Credit Facility carry interest at a margin above the LIBOR (London Interbank Offered Rate). The margin is 1.75% per annum and can range from 1.50% to 2.50% per annum depending upon the Company’s Consolidated Total Leverage Ratio, as defined in the Credit Facility. Initial unused commitment fees on the revolving credit facilities are 0.375% per annum. The unused commitment fees can range from 0.35% to 0.50% per annum, again depending upon the Company's Consolidated Total Leverage Ratio.

The Company paid off the outstanding debt of $304.0 million under the Prior Credit Facility (see below) with the proceeds of $225 million from the Credit Facility and from cash on hand. In the third quarter of 2012, the Company recorded a charge of approximately $1.2 million ($0.7 million net of tax), included in interest expense and other financing costs, associated with this transaction. In addition, this transaction impacted the effectiveness of the Company’s interest rate swaps (Note 7) existing as of the refinancing date and therefore the fair value ($4.9 million at the time of the refinancing) was recognized in interest expense and other financing costs and subsequent changes in the fair value of those swaps are also being recognized in interest expense and other financing costs. Financial covenants under the Credit Facility are comprised of a Consolidated Total Leverage Ratio and Consolidated Interest Coverage Ratio, as defined in the Credit Facility.

Prior Senior Secured Credit Facility

The Company’s prior credit facility was comprised of a 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 that was scheduled to mature in September 2013 (combined, the "Prior Credit Facility"). The Prior Credit Facility consisted of a U.S. revolving credit facility providing up to $150 million, which included a sub-facility

of $20 million for letters of credit, and a term loan with an initial principal amount of $350 million. The Credit Facility also included a C$15 million senior secured revolving credit facility provided by GE Canada Finance Holding Company.

The amounts outstanding under the Prior Credit Facility were paid off in early April 2012 in connection with the closing of the Credit Facility (see above) and there was an associated net reduction of approximately $79 million in the Company's outstanding term debt from cash on hand. Substantially all of the Company's assets, including the capital stock and assets of wholly-owned subsidiaries secured obligations under the Prior Credit Facility.

Equipment Financing Facilities

As of June 30, 2012, there was a total of $8.3 million outstanding under prior equipment financing facilities, with fixed interest rates ranging from 3.6% to 7.1% and payments due through March 2016. No further amounts can be drawn on the prior facilities. The Company's current facility provides financing for up to $5.5 million of purchased transportation and material handling equipment through August 15, 2012 at an interest rate approximately 2.75% above the 3-year term swap rate at the time of the advances. No amounts were outstanding under the current facility at June 30, 2012.

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

7. Financial Instruments

Financial Derivatives

The Company uses derivative financial instruments to manage its exposure related to fluctuating cash flows from 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 large financial counterparties rated highly by nationally recognized credit rating agencies.

The Company uses interest rate derivative instruments to manage the risk related to fluctuating cash flows from interest rate changes by converting a portion of its variable-rate borrowings into fixed-rate borrowings. As of June 30, 2012, the following interest rate derivative instruments were outstanding: a) a $100 million interest rate swap with interest payments at a fixed rate of 2.72%; b) a $50 million interest rate swap with interest payments at a fixed rate of 3.12%; and c) a $50 million interest rate swap with interest payments at a fixed rate of 3.11%. These interest rate swaps were designated as cash flow hedges until the refinancing (Note 6) and expire in April 2013. On April 9, 2012, the Company entered into a new interest rate derivative instrument consisting of a $213.8 million interest rate swap with interest payments at a fixed rate of 1.38%, commencing on June 28, 2013. This new interest rate swap was designated as a cash flow hedge and amortizes at $2.8 million per quarter beginning on June 28, 2013 and expires on June 30, 2017.

For derivative instruments designated as cash flow hedges, the Company records the effective portions of changes in their fair value, net of taxes, in other comprehensive income (Note 4). The effectiveness of the hedges is periodically assessed by the Company during the lives of the hedges by 1) comparing the current terms of the hedges with the related hedged debt to assure they continue to coincide and 2) through an evaluation of the ability of the counterparties to the hedges to honor their obligations under the hedges. Any ineffective portions of the hedges are recognized in earnings through interest expense and other financing costs. The Company’s refinancing transaction on April 5, 2012, resulted in hedge ineffectiveness on the derivative instruments that expire in April 2013, as the underlying term debt being hedged was repaid before the expiration of the derivative instruments. This resulted in a $4.9 million charge to interest expense and other financing costs in the third quarter of 2012 for the fair value of the derivative instruments previously recorded as a component of comprehensive loss. Subsequent changes in the fair value of those swaps are also being recognized in interest expense and other financing costs and there was a decline of $1.2 million in the fair

value of the ineffective swaps in the third quarter of 2012 that was recognized as a reduction to interest expense and other financing costs.

The Company records any differences paid or received on its interest rate hedges as adjustments to interest expense. The table below presents the combined fair values of the interest rate derivative instruments:

		Unrealized Losses			
Instrument	Location on Balance Sheet	June 30, 2012	June 30, 2011	September 30, 2011	Fair Value Hierarchy
		(Dollars in thousands)			
Designated interest rate swaps (effective)	Accrued expenses	$4,112	$ 8,281	$ 7,235	Level 2
Non-designated interest rate swaps (ineffective)	Accrued expenses	3,715	-	-	Level 2
		$7,827	$ 8,281	$ 7,235	

The fair values of the interest rate hedges were determined through the use of pricing models, which utilize verifiable inputs such as market interest rates that are observable at commonly quoted intervals (generally referred to as the "LIBOR Curve") for the full terms of the hedge agreements. These values reflect a Level 2 measurement under the applicable fair value hierarchy.

The table below presents the amounts of gain (loss) on the interest rate derivative instruments recognized in other comprehensive income (OCI):

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

	Three Months Ended June 30,		Nine Months Ended June 30,	
(Dollars in thousands)	2012	2011	2012	2011
Amount of Gain (Loss) Recognized in OCI (net of tax)				
Designated interest rate swaps	$ (2,488)	$ (161)	$ (1,064)	$ 1,793
Non-designated interest rate swaps (reclassified from accumulated OCI)	2,984	-	2,984	-
	$ 496	$ (161)	$ 1,920	$ 1,793

The table below presents the amounts of gain (loss) on the interest rate derivative instruments recognized in interest expense and other financing costs:

	Three Months Ended June 30,		Nine Months Ended June 30,	
(Dollars in thousands)	2012	2011	2012	2011
Amount of Gain (Loss) Recognized in Interest Expense				
Designated interest rate swaps	$ -	$ -	$ -	$ -
Non-designated interest rate swaps	1,138	-	1,138	-
Non-designated interest rate swaps (reclassified from accumulated OCI)	(4,932)	-	(4,932)	-
	$ (3,794)	$ -	$ (3,794)	$ -

Cash and 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. As of June 30, 2012, the cash equivalents were mostly comprised of money market funds, which invest primarily in commercial paper or bonds with a rating of A-1 or better, and bank certificates of deposit. The carrying values of the cash equivalents for the periods presented equaled the fair values, which were determined under Level 1 of the Fair Value Hierarchy.

8. Foreign Net Revenue

Foreign (Canadian) net revenue totaled $112.5 and $85.6 million in the nine months ended June 30, 2012 and 2011, respectively.

9. Recent Accounting Pronouncements

In July 2012, the FASB issued Accounting Standards No. 2012-02, *Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment,* which permits an entity the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Subtopic 350-30. An entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. The Company does not currently expect the adoption of this Update to have a significant impact on the financial statements.

In December 2011, the FASB issued Accounting Standards No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities,* which requires an entity to disclose certain information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. An entity is required to apply the amendments in this Update for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The Company does not expect the adoption of this Update to have an impact on the financial statements.

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income,* which provides an entity with the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In a single continuous statement, the entity is required to present the components of net income and total net income, the components of other comprehensive income and a total for other comprehensive income, along with the total of comprehensive income in that statement. In the two-statement approach, an entity is required to present components of net income and total net income in the statement of net income. The statement of other comprehensive income should immediately follow the statement of net income and include the components of other comprehensive income and a total for other comprehensive income, along with a total for comprehensive income. These changes apply to both annual and interim financial statements. The amendments in ASU 2011-05 should be applied retrospectively. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, however Accounting Standards No. 2011-12, issued by the FASB in December 2011, has deferred the effective date of the portions of this Update that relate to the presentation of reclassification adjustments. Early adoption is permitted. The Company does not currently expect the adoption of ASU 2011-05 to have a significant impact on its financial position and results of operations.

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs,* which changes the wording used to describe the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011, and should be applied prospectively. Early adoption is not permitted. The Company does not currently expect the adoption of this standard to have a significant impact on the financial statements.

10. Subsequent Events

On July 2, 2012, the Company announced it acquired certain assets of Structural Materials, Co. ("Structural"), a distributor of residential and commercial roofing products and related accessories headquartered in Santa Ana, CA. Structural has six locations in Los Angeles and Orange Counties and in the surrounding areas, with total annual sales of approximately $81 million in 2011.

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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 2011 Annual Report on Form 10-K. Unless otherwise specifically indicated, all references to "2012" and "YTD 2012" refer to the three months (third quarter) and nine months (year-to-date) ended June 30, 2012, respectively, of our fiscal year ending September 30, 2012, and all references to "2011" and "YTD 2011" refer to the three months (third quarter) and nine months (year-to-date) ended June 30, 2011, respectively, of our fiscal year ended September 30, 2011. Certain tabular information may not foot due to rounding and certain reclassifications are made to prior year sales by product line to conform to the current year presentation.

Overview

We are one of the largest distributors of residential and non-residential roofing materials in the United States and Canada. We also distribute 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 currently distribute up to 10,000 SKUs through 200 branches in the United States and Canada. We had 2,550 employees as of June 30, 2012, including our sales and marketing team of 1058 employees (which includes branch management).

In fiscal year 2011, approximately 92% 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 May 2011 acquisition of Enercon is one example of this approach. Enercon is a roofing distributor with six locations in Western Canada. Headquartered within its branch in Edmonton, Enercon also has branches in Calgary, Regina and Saskatoon and two branches in Vancouver, with no branch overlap with our existing operations. In addition, we also acquire companies to supplement branch openings within existing markets. Our November 2011 acquisition of Fowler & Peth, a roofing distributor with eight locations in Colorado, Wyoming, and Nebraska, which we integrated into our Shelter Distribution region in the Midwest, is an example of such an acquisition.

Results of Operations

The following table presents, 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,			
	2012		2011		2012		2011	
Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of products sold	74.9		76.6		75.7		76.9	
Gross profit	25.1		23.4		24.3		23.1	
Operating expenses	16.0		15.5		17.7		18.6	
Income (loss) from operations	9.1		8.0		6.6		4.5	
Interest expense	(1.5	)	(0.6	)	(1.0	)	(0.8	)
Income (loss) before income taxes	7.7		7.4		5.6		3.7	
Income tax (expense) benefit	(3.2	)	(2.9	)	(2.3	)	(1.5	)
Net income (loss)	4.5	%	4.5	%	3.3	%	2.3	%

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, 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. When we refer to regions, we are referring to our geographic regions. At June 30, 2012, we had a total of 200 branches in operation. For 2012 and YTD 2012, 179 branches were included in our existing market calculations and 21 branches were excluded because they were acquired after the start of last year’s third quarter. Acquired markets for 2012 and YTD 2012 included Enercon, The Roofing Connection, Fowler & Peth, and Cassady Pierce (See Note 5 to the Condensed Consolidated Financial Statements). When we refer to our net product costs, we are referring to our invoice cost less the impact of short-term buying programs (also referred to as “special buys” given the manner in which they are offered).

Three Months Ended June 30, 2012 ("2012") Compared to the Three Months Ended June 30, 2011 ("2011")

Existing and Acquired Markets

	Existing Markets June 30,		Acquired Markets June 30,		Consolidated June 30,	
	2012	2011	2012	2011	2012	2011
	(dollars in thousands)					
Net Sales	$525,203	$533,001	$35,323	$7,746	$560,526	$540,747
Gross Profit	130,947	124,693	9,789	2,024	140,736	126,717
Gross Margin	24.9 %	23.4 %	27.7 %	26.1 %	25.1 %	23.4 %
Operating Expenses	80,630	81,904	8,829	1,681	89,459	83,585
Operating Expenses as a % of Net Sales	15.4 %	15.4 %	25.0 %	21.7 %	16.0 %	15.5 %
Operating Income	$50,317	$42,789	$960	$343	$51,277	$43,132
Operating Margin	9.6 %	8.0 %	2.7 %	4.4 %	9.1 %	8.0 %

Net Sales

Consolidated net sales increased $19.8 million, or 3.7%, to $560.5 million in 2012 from $540.7 million in 2011. Existing market sales decreased $7.8 million or 1.5%, while acquired market sales increased $27.6 million to $35.3 million. There were 64 business days in both 2012 and 2011. We believe our 2012 existing market sales were influenced primarily by the following factors:

- lower non-residential roofing activity, partially offset by increases in non-residential selling prices;
- lower remodeling and repair activity that affected our complementary product sales;