Builders FirstSource, Inc.
Form 10-Q
October 28, 2010

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

**Form 10-Q**

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the quarterly period ended September 30, 2010**

**OR**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the transition period from to**

**Commission File Number 0-51357**

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o *Registrant is not subject to the requirements of Rule 405 of Regulation S-T at this time

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

| Large accelerated filer o | Accelerated filer þ | Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company o |
|---|---|---|---|

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

The number of shares of the issuer s common stock, par value $0.01, outstanding as of October 26, 2010 was 96,871,621.

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

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

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Unaudited) | | | |
| | (In thousands, except per share amounts) | | | |
| Sales | $ 180,394 | $ 188,865 | $ 553,250 | $ 523,923 |
| Cost of sales | 144,865 | 149,473 | 449,555 | 411,808 |
| Gross margin | 35,529 | 39,392 | 103,695 | 112,115 |
| Selling, general and administrative expenses | 47,569 | 49,260 | 148,460 | 151,658 |
| Facility closure costs | 411 | 41 | 420 | 1,190 |
| Asset impairments | 839 | | 839 | 470 |
| Loss from operations | (13,290) | (9,909) | (46,024) | (41,203) |
| Interest expense, net | 6,910 | 5,930 | 24,766 | 19,558 |
| Loss from continuing operations before income taxes | (20,200) | (15,839) | (70,790) | (60,761) |
| Income tax (benefit) expense | (525) | 110 | (995) | 2,358 |
| Loss from continuing operations | (19,675) | (15,949) | (69,795) | (63,119) |
| (Loss) income from discontinued operations (net of income tax benefit of $0 and $0 for the three months and nine months ended in 2010 and 2009, respectively) | (795) | 703 | (1,100) | (5,309) |
| Net loss | $ (20,470) | $ (15,246) | $ (70,895) | $ (68,428) |
| *Basic and diluted net loss per share:* | | | | |
| Loss from continuing operations | $ (0.21) | $ (0.41) | $ (0.77) | $ (1.61) |
| (Loss) income from discontinued operations | (0.01) | 0.02 | (0.01) | (0.14) |
| Net loss | $ (0.22) | $ (0.39) | $ (0.78) | $ (1.75) |
| *Weighted average common shares outstanding:* | | | | |
| Basic and diluted | 94,895 | 39,179 | 90,589 | 39,114 |

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

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

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| | (Unaudited) (In thousands, except per share amounts) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 121,413 | $ 84,098 |
| Trade accounts receivable, less allowances of $3,391 and $4,883 at September 30, 2010 and December 31, 2009, respectively | 67,960 | 60,723 |
| Other receivables | 3,794 | 39,758 |
| Inventories | 58,164 | 48,022 |
| Other current assets | 9,479 | 7,741 |
| Total current assets | 260,810 | 240,342 |
| Property, plant and equipment, net | 60,077 | 64,025 |
| Goodwill | 111,193 | 111,193 |
| Other assets, net | 10,197 | 19,391 |
| Total assets | $ 442,277 | $ 434,951 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 45,627 | $ 39,570 |
| Accrued liabilities | 31,796 | 28,923 |
| Current maturities of long-term debt | 51 | 48 |
| Total current liabilities | 77,474 | 68,541 |
| Long-term debt, net of current maturities | 169,063 | 299,135 |
| Other long-term liabilities | 13,200 | 20,328 |
| Total liabilities | 259,737 | 388,004 |
| Commitments and contingencies (Note 9) | | |
| Stockholders equity: | | |
| Preferred stock, $0.01 par value, 10,000 shares authorized; zero shares issued and outstanding at September 30, 2010 and December 31, 2009, respectively | | |
| Common stock, $0.01 par value, 200,000 shares authorized; 96,872 and 36,347 shares issued and outstanding at September 30, 2010 and December 31, 2009, respectively | 949 | 363 |
| Additional paid-in capital | 354,103 | 150,240 |
| Accumulated deficit | (169,868) | (98,973) |
| Accumulated other comprehensive loss | (2,644) | (4,683) |
| Total stockholders equity | 182,540 | 46,947 |

| | | |
|---|---|---|
| Total liabilities and stockholders equity | $ 442,277 | $ 434,951 |

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

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

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2010 | 2009 |
| | (Unaudited) | |
| | (In thousands) | |
| Cash flows from operating activities: | | |
| Net loss | $ (70,895) | $ (68,428) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 11,668 | 13,882 |
| Asset impairments | 839 | 470 |
| Amortization of deferred loan costs | 5,055 | 3,134 |
| Bad debt expense | 650 | 1,656 |
| Net non-cash (income) expense from discontinued operations | (3) | 732 |
| Stock compensation expense | 3,217 | 2,521 |
| Deferred income taxes | (1,091) | 302 |
| Net gain on sales of assets | (162) | (525) |
| Changes in assets and liabilities: | | |
| Receivables | 28,081 | 42,035 |
| Inventories | (10,142) | 14,080 |
| Other current assets | (1,738) | 58 |
| Other assets and liabilities | 290 | (2,669) |
| Accounts payable | 6,057 | 11,133 |
| Accrued expenses | 4,048 | (8,646) |
| Net cash (used in) provided by operating activities | (24,126) | 9,735 |
| Cash flows from investing activities: | | |
| Purchases of property, plant and equipment | (8,183) | (1,976) |
| Proceeds from sale of property, plant and equipment | 355 | 1,702 |
| Net cash used in investing activities | (7,828) | (274) |
| Cash flows from financing activities: | | |
| Payments under revolving credit facility | | (20,000) |
| Payments of long-term debt and other loans | (105,176) | (32) |
| Proceeds from rights offering | 180,107 | |
| Payment of recapitalization costs | (5,631) | |
| Exercise of stock options | | 123 |
| Repurchase of common stock | (31) | (126) |
| Net cash provided by (used in) financing activities | 69,269 | (20,035) |
| Net change in cash and cash equivalents | 37,315 | (10,574) |
| Cash and cash equivalents at beginning of period | 84,098 | 106,891 |

| | | |
|---|---|---|
| Cash and cash equivalents at end of period | $ 121,413 | $ 96,317 |

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

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

## 1. Basis of Presentation

Builders FirstSource, Inc., a Delaware corporation formed in 1998, is a leading supplier and manufacturer of structural and related building products for residential new construction in the United States. In this quarterly report, references to the company, we, our, ours or us refer to Builders FirstSource, Inc. and its consolidated subsidiarie unless otherwise stated or the context otherwise requires.

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

The condensed consolidated balance sheet as of December 31, 2009 is derived from the audited consolidated financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. This condensed consolidated balance sheet as of December 31, 2009 and the unaudited condensed consolidated financial statements included herein should be read in conjunction with the more detailed audited consolidated financial statements for the years ended December 31, 2009 included in our most recent annual report on Form 10-K. Accounting policies used in the preparation of these unaudited condensed consolidated financial statements are consistent with the accounting policies described in the Notes to Consolidated Financial Statements included in our Form 10-K.

## 2. Net Loss per Common Share

Net loss per common share ( EPS ) is calculated in accordance with the *Earnings per Share* topic of the FASB Accounting Standards Codification ( Codification ), which requires the presentation of basic and diluted EPS. Basic EPS is computed using the weighted average number of common shares outstanding during the period. Diluted EPS is computed using the weighted average number of common shares outstanding during the period, plus the dilutive effect of potential common shares.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Weighted average shares for basic EPS | 94,895 | 39,179 | 90,589 | 39,114 |
| Dilutive effect of stock options | | | | |
| Weighted average shares for diluted EPS | 94,895 | 39,179 | 90,589 | 39,114 |

In connection with our common stock rights offering, as discussed in Note 4, we offered all shareholders the right to purchase additional shares at an offering price of $3.50 per share. At the inception of our rights offering the offering price was lower than the fair value of our common stock, thus creating a bonus element which requires us to retroactively adjust the weighted average shares for basic EPS for all periods prior to the closing of the transaction. Therefore, we increased the number of weighted average common shares used in computing basic and diluted EPS for 2009 using an adjustment factor of 1.09.

Our restricted stock shares include rights to receive dividends that are not subject to the risk of forfeiture even if the underlying restricted stock shares on which the dividends were paid do not vest. In accordance with the *Earnings per Share* topic of the Codification, unvested share-based payment awards that contain non-forfeitable rights to dividends are deemed participating securities and should be considered in the calculation of basic EPS. Since the restricted stock shares do not include an obligation to share in

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losses, they will be included in our basic EPS calculation in periods of net income and excluded from our basic EPS calculation in periods of net loss. Accordingly, there were 2.0 million and 157,000 restricted stock shares excluded from the computations of basic EPS for the three and nine months ended September 30, 2010 and 2009, respectively, because we generated a net loss. For the purpose of computing diluted EPS, options to purchase 6.1 million and 2.6 million shares of common stock were not included in the computations of diluted EPS for the three and nine months ended September 30, 2010 and 2009, respectively, because their effect was anti-dilutive.

**3. Receivables**

Trade accounts receivable consisted of the following (in thousands):

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Trade receivables | $ 71,351 | $ 65,606 |
| Less: allowance for returns and doubtful accounts | 3,391 | 4,883 |
| Trade accounts receivable, net | $ 67,960 | $ 60,723 |

Other receivables consisted of the following (in thousands):

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Income tax receivables | $ 181 | $ 33,819 |
| Other | 3,613 | 5,939 |
| Other receivables | $ 3,794 | $ 39,758 |

**4. Debt**

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

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Revolving credit facility | $ 20,000 | $ 20,000 |
| Floating rate notes: | | |
| 2012 notes | 5,249 | 275,000 |
| 2016 notes | 139,718 | |
| Other | 4,147 | 4,183 |
| | 169,114 | 299,183 |
| Less: current portion of long-term debt | 51 | 48 |
| Total long-term debt, net of current maturities | $ 169,063 | $ 299,135 |

On January 21, 2010, we completed a common stock rights offering and debt exchange for our Second Priority Senior Secured Floating Rate Notes due 2012 ( 2012 notes ). As part of these transactions, we raised $180.1 million of new equity capital through the issuance of 51,459,184 shares of common stock in the rights offering at a subscription price of $3.50 per share. We used $105.1 million of the proceeds from the rights offering to repurchase a portion of the 2012 notes in the debt exchange. We used a portion of the remaining $75.0 million of proceeds to pay the

expenses of the rights offering and the debt exchange and will use the remainder for general corporate purposes.

In the debt exchange, holders of the 2012 notes exchanged, at par, $269.8 million aggregate principal amount of 2012 notes for (i) $139.7 million aggregate principal amount of Second Priority Senior Secured Floating Rate Notes due 2016 ( 2016 notes ), (ii) $105.1 million in cash from the proceeds of the rights offering, and (iii) 7,112,244 shares of our common stock. As a result of the debt exchange, we reduced our indebtedness by $130.0 million and extended the maturity of $139.7 million of indebtedness until 2016. There was no gain or loss recognized on the extinguishment of the 2012 notes since the notes were exchanged at par value for cash and common stock which had a closing price on the transaction date that was equal to the exchange price of $3.50 per share.

The $139.7 million in aggregate principal amount of new second priority senior secured floating rate notes mature on February 15, 2016. Interest accrues on the floating rate notes at a rate of 3-month LIBOR (subject to a 3.0% floor) plus 10.0%. LIBOR is reset at the beginning of each quarterly period. Interest on the floating rate notes is payable quarterly in arrears. At any time we can redeem some or all of the notes at a redemption price equal to par plus a specified premium that declines ratably to par. In the event of a change in control, we may be required to offer to purchase the notes at a purchase price equal to 101% of the principal, plus accrued and unpaid interest. The resale of these notes was registered under the Securities Act.

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The notes are jointly and severally guaranteed by all of our subsidiaries and collateralized by a pledge of common stock of certain of our subsidiaries and by a second priority lien on substantially all tangible and intangible property and interests in property and proceeds thereof now owned or hereafter acquired by us and substantially all of our subsidiaries. All of the subsidiaries are wholly-owned and domiciled in the United States. The parent company has no independent assets or operations, and the guarantees are full and unconditional. The indenture covering the 2016 notes contains certain restrictive covenants, which, among other things, relate to the payment of dividends, incurrence of indebtedness, repurchase of common stock or other distributions, asset sales and investments. At September 30, 2010, we were not in violation of any covenants.

In connection with our rights offering and debt exchange, we incurred approximately $9.4 million of various third-party fees and expenses. Of the total costs incurred, $0.5 million, net of insurance recoveries, related to the settlement of the consolidated class and derivative action lawsuit involving our initial recapitalization plans and $2.6 million related primarily to expenses of the special committee formed to review and respond to the recapitalization proposal. Primarily all of these costs were incurred and expensed in 2009 as a component of selling, general and administrative expenses. The remaining $6.3 million of costs incurred were considered to be directly related to the issuance of the common stock and the 2016 notes in the rights offering and debt exchange. These costs were allocated to the debt and equity based on their relative fair value to the total consideration issued in the transaction. Accordingly, $3.7 million was allocated to the rights offering and recorded as a reduction to additional paid-in capital in the first quarter of 2010. The remaining $2.6 million of costs were allocated to the 2016 notes and expensed primarily in the first quarter of 2010 as a component of interest expense, net, in the condensed consolidated statement of operations. The debt exchange was considered to be a modification, and therefore, any third-party costs were expensed as incurred. In addition, $1.6 million of unamortized debt issue costs related to the 2012 notes that were extinguished as part of the transaction was expensed in the first quarter and also included in interest expense, net, in the condensed consolidated statement of operations. The remaining $1.9 million of unamortized debt issue costs will be amortized over the term of the outstanding floating rate notes.

During the first quarter of 2009, we reduced the borrowing capacity under our 2007 Senior Secured Credit Agreement (the 2007 Agreement ) from $350 million to $250 million, as we did not expect our borrowing base to support borrowings in excess of $250 million at any point during the remaining life of this credit facility. This reduction also allowed us to reduce our interest expense related to commitment fees. Also as a result of this reduction, we expensed approximately $1.2 million of deferred financing costs in the first quarter of 2009, as a component of interest expense, net, in the condensed consolidated statement of operations.

Loans under the 2007 Agreement are collateralized by substantially all of our assets, primarily accounts receivable and inventory, and are guaranteed by us and certain of our subsidiaries. Our net borrowing availability in excess of the $35 million liquidity covenant at September 30, 2010 was $4.2 million. The 2007 Agreement has certain restrictive covenants, which, among other things, relate to the payment of dividends, incurrence of indebtedness, and asset sales. The 2007 Agreement also has a fixed charge coverage ratio of 1:1 that is triggered if our available borrowing capacity, as determined under the borrowing base formula, is less than $35 million. The calculation allows cash on deposit with the agent to be included as eligible borrowing base. At September 30, 2010, we were not required to have any cash on deposit with the agent since there was no short-fall in the calculation of the $35 million minimum liquidity covenant. Based on our 2010 forecast, we will not meet the fixed charge coverage ratio, but we anticipate that we will not fall below the $35 million minimum liquidity covenant in 2010 including the use of cash on deposit with the agent; therefore, we will not trigger the fixed charge coverage ratio requirement. The fixed charge coverage ratio is defined as the ratio of earnings before interest expenses, income taxes, depreciation and amortization expenses minus capital expenditures, cash taxes paid, dividends, distributions and share repurchases or redemptions to the sum of scheduled principal payments and interest expense on a trailing twelve month basis from the trigger date.

In the first quarter of 2008, we entered into three interest rate swap agreements with notional amounts of $100 million, $50 million, and $50 million. We entered into these interest rate swaps in order to mitigate a portion of the interest rate risk that we were exposed to in the normal course of business on our floating rate notes. The swap agreements, effective May 15, 2008, were for a term of three years. In conjunction with our debt exchange and resulting reduction in outstanding floating rate notes to $145.0 million, we paid $1.7 million in December 2009 to

cancel and settle one of our $50 million swaps that had a fixed rate of 2.99%. Under the remaining $100 million and $50 million swap agreements, we are paying fixed rates of 3.25% and 3.17%, respectively, and receiving a variable rate at 90 day LIBOR. In December 2009, we de-designated the remaining $150 million of our swaps.

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The tables below present the effect of our interest rate swap derivatives on the condensed consolidated statements of operations for the three and nine months ended September 30, 2010 and 2009 (in thousands):

| Derivatives Designated as Hedging Instruments | Amount of Loss Recognized in OCI* | | | | Location of Loss Reclassified from OCI into Income | Amount of Loss Reclassified from OCI Into Income* | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Three Months Ended September 30, | | Nine Months Ended September 30, | | | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| | 2010 | 2009 | 2010 | 2009 | | 2010 | 2009 | 2010 | 2009 |
| Interest rate swaps | $ | $ (1,770) | $ | $ (2,617) | Interest expense, net | $ | $ (1,276) | $ | $ (3,068) |

| Derivatives Not Designated as Hedging Instruments | Location of Loss Recognized in Income | Amount of Loss Recognized in Income* | | | |
|---|---|---|---|---|---|
| | | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| | | 2010 | 2009 | 2010 | 2009 |
| Interest rate swaps | Interest expense, net | $ (1,004) | $ | $ (3,275) | $ |

* Net of tax

When our interest rate swap agreements are in a net asset position, we are exposed to credit losses in the event of non-performance by counterparties. The amount of such credit exposure is limited to the unrealized gains on our swaps. We have not experienced any credit loss as a result of counterparty nonperformance in the past. To manage credit risks, we generally select counterparties who are part of our banking syndicate and settle on a net basis. We perform a quarterly assessment of our counterparty credit risk, including a review of credit ratings, credit default swap rates, and potential nonperformance of the counterparty. Since the counterparty is part of the bank syndicate, we also would have the ability to net amounts owed to us against any outstanding borrowings under the 2007 Agreement, thereby reducing the credit risk.

When interest rate swap agreements are in a net liability position, we are required to establish a reserve against our borrowing base equal to 110% of the fair value of the interest rate swaps on the last day of the month. This reserve effectively reduces our available borrowing capacity under the 2007 Agreement. At September 30, 2010, the reserve for the swaps was $3.6 million. The swaps are also collateralized in a manner similar to the loans under the 2007 Agreement. In the event of default, or if we or the counterparty fail to be part of the 2007 Agreement, an early termination event would be triggered which could require us to settle the swaps on the termination date at the then fair market value.

The *Fair Value Measurements and Disclosures* topic of the Codification provides a framework for measuring the fair value of assets and liabilities and establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The fair value hierarchy can be summarized as follows:

Level 1 unadjusted quoted prices for identical assets or liabilities in active markets accessible by us

Level 2 inputs that are observable in the marketplace other than those inputs classified as Level 1

Level 3 inputs that are unobservable in the marketplace and significant to the valuation

If a financial instrument uses inputs that fall in different levels of the hierarchy, the instrument will be categorized based upon the lowest level of input that is significant to the fair value calculation.

The only financial instruments measured at fair value on a recurring basis are our interest rate swaps. We do not trade in swaps or hold them for speculative purposes, therefore, the retail market that exists for swaps would be the most advantageous market for our interest rate swaps. As such, we use the market approach to value our interest rate swaps by obtaining a quote from the counterparty

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that is based on a discounted cash flow analysis which incorporates information obtained from third-party market sources and is adjusted for company specific credit risk. We validate the fair value quote obtained from the counterparty by using an independent, third-party discounted cash flow analysis which also utilizes market information. These discounted cash flow techniques incorporate Level 1 and Level 2 inputs. In addition to the term and notional amount inputs, the valuation also factors in discount rate, forward yield curves, and credit risk. Significant inputs to the derivative valuation for interest rate swaps are observable in the active markets and are classified as Level 2 in the hierarchy.

The following fair value hierarchy table presents information about the Company s financial instruments measured at fair value on a recurring basis using significant other observable inputs (Level 2) (in thousands):

| | Carrying Value As of September 30, 2010 | Fair Value Measurement as of September 30, 2010 | Carrying Value As of December 31, 2009 | Fair Value Measurement as of December 31, 2009 |
|---|---|---|---|---|
| Interest rate swaps (included in Total liabilities) | $ 3,247 | $ 3,247 | $ 5,314 | $ 5,314 |

We have elected to continue to report the value of our floating rate notes at amortized cost. The floating rate notes are registered and publicly traded. The carrying value of the floating rate notes at September 30, 2010 approximated fair value. The carrying value of amounts outstanding under the 2007 Agreement also approximated fair value.

**5. Comprehensive Loss**

The following table presents the components of comprehensive loss for the three and nine months ended September 30, 2010 and 2009 (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Net loss | $ (20,470) | $ (15,246) | $ (70,895) | $ (68,428) |
| Other comprehensive income (loss) change related to interest rate swap agreements, net of related tax effect | 592 | (494) | 2,039 | 451 |
| Total comprehensive loss | $ (19,878) | $ (15,740) | $ (68,856) | $ (67,977) |

**6. Employee Stock-based Compensation**

In January 2010, our shareholders approved an amendment to our 2007 Incentive Plan ( 2007 Plan ) which increased the number of shares of common stock that may be granted pursuant to awards under the 2007 Plan from 2.5 million shares to 7.0 million shares. On February 3, 2010, our board of directors granted 3,945,000 stock options and 1,800,000 shares of restricted stock to employees under our 2007 Plan. All the awards vest in one-third installments on the second, third and fourth anniversaries of the grant date. The grant date fair value for the restricted stock and the exercise price for the options was $3.19 per share, which was the closing stock price on the grant date. The grant date fair value of the options was $2.54 and was determined using the following assumptions:

| | |
|---|---|
| Expected life | 6 years |
| Expected volatility | 99.28% |
| Expected dividend yield | 0.00% |
| Risk-free rate | 2.97% |

**7. Facility Closure Costs**

During the third quarter of 2010, we idled six facilities: two distribution facilities in South Carolina, two manufacturing facilities in Florida, and two manufacturing facilities in Maryland. We recognized $0.4 million in facility closure costs which are related to employee severance and termination benefits for these idled facilities and revisions to sub-rental incomes estimates on other closed facilities. In situations where multiple facilities serve the same market we may temporarily close, or idle, facilities with plans to reopen these facilities once demand returns to the market. Should conditions in our markets worsen, or recovery take significantly longer than forecasted, we may temporarily idle or permanently close additional facilities, at which time we may incur additional facility closure costs or asset impairment charges. Future non-cash impairment charges would have the effect of decreasing our earnings or increasing our losses in such period, but would not impact our current outstanding debt obligations or compliance with covenants contained in the related debt agreements.

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**8. Income Taxes**

In accordance with the *Income Taxes* topic of the Codification, we evaluate our deferred tax assets quarterly to determine if a valuation allowance is required. The *Income Taxes* topic requires that companies assess whether valuation allowances should be established based on the consideration of all available evidence. During the three and nine months ended September 30, 2010, we recorded valuation allowances of $7.2 and $25.9 million against the net deferred tax assets generated from the net losses during the periods related to our continuing operations. During the three months ended September 30, 2009, we recorded a valuation allowance of $6.0 million against the net deferred tax assets generated from the net loss during the period, of which $6.2 million related to continuing operations. During the nine months ended September 30, 2009, we recorded a valuation allowance of $27.4 million against the net deferred tax assets generated from the net loss during the period, of which $25.0 million related to continuing operations and $2.4 million related to discontinued operations.

To the extent we generate sufficient taxable income in the future to fully utilize the tax benefits of the net deferred tax assets on which a valuation allowance is recorded, our effective tax rate may decrease as the valuation allowance is reversed. However, to the extent we generate future operating losses, we would be required to increase the valuation allowance on our net deferred tax assets and our income tax expense will be adversely affected.

**9. Commitments and Contingencies**

In the third quarter of 2010, we received $1.2 million from a litigation settlement. This settlement was recorded as a reduction of selling, general and administrative expenses in the accompanying condensed consolidated statement of operations for the three and nine months ended September 30, 2010.

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

**10. Segment and Product Information**

We have three regional operating segments Atlantic, Southeast and Central with centralized financial and operational oversight. We believe that these operating segments meet the aggregation criteria prescribed in the *Segment Reporting* topic of the Codification, and thus have one reportable segment.

Sales by product category for the three and nine month periods ended September 30, 2010 and 2009 were as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Prefabricated components | $ 36,283 | $ 36,479 | $ 109,434 | $ 100,559 |
| Windows & doors | 40,923 | 44,728 | 124,308 | 127,658 |
| Lumber & lumber sheet goods | 50,053 | 46,611 | 160,640 | 125,018 |
| Millwork | 19,605 | 20,545 | 59,180 | 55,883 |
| Other building products & services | 33,530 | 40,502 | 99,688 | 114,805 |
| Total sales | $ 180,394 | $ 188,865 | $ 553,250 | $ 523,923 |

**11. Recent Accounting Pronouncements**

In January 2010, the FASB issued guidance under the *Fair Value Measurements and Disclosures* topic of the Codification which requires, in both interim as well as annual financial statements, for assets and liabilities that are measured at fair value on a recurring basis, disclosures regarding the valuation techniques and inputs used to develop those measurements. It also requires separate disclosures of significant amounts transferred in and out of Level 1 and Level 2 fair value measurements and a description of the reasons for the transfers. We have adopted these provisions and included all required disclosures.

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In October 2009, the FASB issued guidance under the *Multiple Element Revenue Arrangements* topic of the Codification which requires separation of the consideration received in such arrangements by establishing a selling price hierarchy for determining the selling price of a deliverable, which will be based on available information in the following order: vendor-specific objective evidence, third-party evidence, or estimated selling price. It also eliminates the residual method of allocation, requires that the consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method, which allocates any discount in the arrangement to each deliverable on the basis of each deliverable s selling price, and requires that a vendor determine its best estimate of selling price in a manner that is consistent with that used to determine the price to sell the deliverable on a standalone basis. These changes become effective for us on January 1, 2011. We are currently reviewing the impact of these changes on our financial statements, but we do not expect these changes to have a material impact on our financial position or results of operations.

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

The following discussion of our financial condition and results of operations should be read in conjunction with the Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and notes thereto for the year ended December 31, 2009 included in our most recent annual report on Form 10-K. The following discussion and analysis should also be read in conjunction with the unaudited condensed consolidated financial statements appearing elsewhere in this report. In this quarterly report on Form 10-Q, references to the company, we, our, ours or us refer to Builders FirstSource, Inc. and its consolidated subsidiarie unless otherwise stated or the context otherwise requires.

***Cautionary Statement***

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

**COMPANY OVERVIEW**

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

We group our building products into five product categories:

*Prefabricated Components.* Our prefabricated components consist of wood floor and roof trusses, steel roof trusses, wall panels, stairs, and engineered wood.

*Windows & Doors.* Our windows & doors category is comprised of the manufacturing, assembly, and distribution of windows and the assembly and distribution of interior and exterior door units.

*Lumber & Lumber Sheet Goods.* Lumber & lumber sheet goods include dimensional lumber, plywood, and OSB products used in on-site house framing.

*Millwork.* Millwork includes interior trim, exterior trim, columns and posts that we distribute, as well as custom exterior features that we manufacture under the Synboard® brand name.

*Other building products & services.* Other building products & services are comprised of products such as cabinets, gypsum, roofing and insulation and services such as turn-key framing, shell construction, design assistance, and professional installation spanning all of our product categories.

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

*Homebuilding Industry.* Our business is driven primarily by the residential new construction market, which is in turn dependent upon a number of factors, including interest rates, consumer confidence, foreclosure rates, and the health of the economy and

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mortgage markets. Over the past four years, many homebuilders significantly decreased their starts because of the economic recession, lower demand and an excess of home inventory. Although housing starts increased during the first half of 2010, mainly due to the federal tax credit for first-time homebuyers, we experienced a decline in the current quarter and do not expect building activity to improve for the remainder of 2010. Due to the housing downturn and continued pricing pressures within the industry, we have experienced, and may continue to experience, significant pressure on our gross margins. However, we still believe there are several meaningful trends that indicate U.S. housing demand will likely recover in the long term. These trends include relatively low interest rates, the aging of housing stock, and normal population growth due to birthrate exceeding death rate. We believe that the current downturn in the housing industry, though prolonged and severe, is likely a trough in the cyclical nature of the residential construction industry.

*Targeting Large Production Homebuilders.* In recent years, the homebuilding industry has undergone significant consolidation, with the larger homebuilders substantially increasing their market share. We expect that trend to continue during this housing correction due to the better liquidity positions of the larger homebuilders relative to the smaller, less capitalized homebuilders. Our focus is on maintaining relationships and market share with these customers while balancing the competitive pressures we are facing with our profitability expectations. Our sales to the Builder 100, the country s largest 100 homebuilders, increased 20.5% during the nine months ended September 30, 2010 compared to the same period of the prior year, which is higher than the 11.7% overall increase in housing starts within our markets during the same time period. We expect that our ability to maintain strong relationships with the largest builders will be vital to our ability to grow and expand into new markets as well as maintain our current market share through the downturn. Additionally, during the downturn, we will continue to expand our custom homebuilder base, but this growth may be limited by our tight credit standards.

*Expand into Multi-Family and Light Commercial Business.* We have diversified, and will continue to attempt to diversify our customer base and grow our sales by further expanding into multi-family and light commercial business. While we primarily serve the single family new home construction market, we have entered the multi-family and/or light commercial market in certain regions. Our Shelby, Alabama location gives us the ability to manufacture steel roof trusses often used in multi-family and light commercial construction.

*Use of Prefabricated Components.* Prior to the housing downturn, homebuilders were increasingly using prefabricated components in order to realize increased efficiency and improved quality. Shortening cycle time from start to completion was a key imperative of the homebuilders during periods of strong consumer demand. With the housing downturn, that trend decelerated as cycle time had less relevance. Customers who traditionally used prefabricated components, for the most part, still do. However, the conversion of customers to this product offering has slowed. We will continue to monitor our manufacturing capacity to ensure we are operating efficiently given the current market conditions.

*Economic Conditions.* Economic changes both nationally and locally in our markets impact our financial performance. The building products supply industry is highly dependent upon new home construction and subject to cyclical market changes. Our operations are subject to fluctuations arising from changes in supply and demand, national economic conditions, labor costs, competition, government regulation, trade policies and other factors that affect the homebuilding industry such as demographic trends, interest rates, single-family housing starts, employment levels, consumer confidence, and the availability of credit to homebuilders, contractors, and homeowners. During 2007, the mortgage markets experienced substantial disruption due to increased defaults, primarily as a result of credit quality deterioration. The disruption resulted in reduced availability of mortgages for potential homebuyers due to an illiquid credit market and more restrictive standards to qualify for mortgages. During 2008, the conditions in the credit markets worsened and the economy fell into a recession. The credit markets and financial services industry experienced a significant crisis characterized by the bankruptcy or failure of various financial institutions and severe limitations on credit availability. As a result, the credit

markets became highly illiquid as financial and lending institutions limited credit to conserve cash and protect their balance sheets. These economic conditions continued, to a lesser extent, into 2009 and 2010. As the housing industry is dependent upon potential homebuyers access to mortgage financing and homebuilders access to commercial credit, it is likely that the housing industry will not fully recover until conditions in the credit markets substantially improve.

*Cost of Materials.* Prices of wood products, which are subject to cyclical market fluctuations, may adversely impact operating income when prices rapidly rise or fall within a relatively short period of time. We purchase certain materials, including lumber products, which are then sold to customers as well as used as direct production inputs for our manufactured and prefabricated products. Short-term changes in the cost of these materials, some of which are subject to significant fluctuations, are sometimes passed on to our customers, but our pricing quotation periods may limit our ability to pass on such price changes. We may also be limited in our ability to pass on increases on in-bound freight costs on our products due to the price of fuel. Our inability to pass on material and freight price increases to our customers could adversely impact our operating results.

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*Controlling Expenses.* Another important aspect of our strategy is controlling costs and enhancing our status as a low-cost building materials supplier in the markets we serve. We pay close attention to managing our working capital and operating expenses. We have a best practices operating philosophy, which encourages increasing efficiency, lowering costs, improving working capital, and maximizing profitability and cash flow. We constantly analyze our workforce productivity to achieve the optimum, cost-efficient labor mix for our facilities. Further, we pay careful attention to our logistics function and its effect on our shipping and handling costs.

**CURRENT OPERATING CONDITIONS AND OUTLOOK**

We experienced reduced building activity and declining sales during the third quarter of 2010 as compared to the second quarter of 2010. This was due in part to continued difficult economic conditions coupled with the expiration of the federal income tax credit for first-time homebuyers in the second quarter. The annualized rate for U.S. single-family starts decreased to 452,000 as of September 2010, down 10.8% from one year ago. For the current quarter, actual U.S. single-family housing starts were 119,600, down 13.5% from the same quarter last year, and the number of single-family units under construction fell 12.8%. The South Region, as defined by the U.S. Census Bureau and which encompasses our entire geographic footprint, experienced similar trends as actual single-family housing starts for the third quarter of 2010 decreased to 59,400, down 13.7% from the third quarter of 2009, and single-family units under construction were down 5.9% over the same period.

While pricing in the commodity markets has stabilized since the second quarter of 2010, we continue to experience the same competitive pricing conditions that we have been faced with in recent years. This pressure, especially on our non-commodity products, contributed to our gross margins declining 1.2 percentage points compared to the third quarter of 2009. From an operating expense perspective, we continued to focus on our cost containment initiatives. During the quarter, we temporarily idled four manufacturing facilities, two in Maryland and two in Florida, and two distribution centers in South Carolina, in order reduce operating expenses and excess capacity. Most of the customer demand from these idled facilities will be serviced by other existing locations within the market. Should conditions in our markets worsen or recovery take significantly longer than forecasted, we may incur additional facility closure costs or asset impairment charges. Future non-cash impairment charges would have the effect of decreasing our earnings or increasing our losses in such period, but would not impact our current outstanding debt obligations or compliance with covenants contained in the related debt agreements.

Current market conditions remain difficult and we expect this environment to persist into 2011. Through these challenging conditions, we remain focused on our strategy of conserving liquidity while monitoring, and adjusting as necessary, physical capacity and staffing levels. We ended the third quarter with approximately $126 million in available liquidity, which included $121.4 million in available cash and $4.2 million of net borrowing availability under our revolver. Our use of cash through September is consistent with forecast, and we believe seasonal reductions in working capital will partially offset our use of cash over the remainder of the year.

We still believe that the long-term outlook for the housing industry is positive due to the growth in the underlying demographics. However, currently there remains a significant amount of uncertainty in the macro-economic factors that drive our business. We plan to continue managing our business in the same manner we have used over the past several years and will do so until greater clarity returns to the homebuilding sector.

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**SEASONALITY AND OTHER FACTORS**

Our first and fourth quarters have historically been, and are expected to continue to be, adversely affected by weather patterns in some of our markets, causing reduced construction activity. In addition, quarterly results historically have reflected, and are expected to continue to reflect, fluctuations from period to period arising from the following:

The volatility of lumber prices;

The cyclical nature of the homebuilding industry;

General economic conditions in the markets in which we compete;

The pricing policies of our competitors;

The production schedules of our customers; and

The effects of weather.

The composition and level of working capital typically change during periods of increasing sales as we carry more inventory and receivables. Working capital levels typically increase in the second and third quarters of the year due to higher sales during the peak residential construction season. These increases have in the past resulted in negative operating cash flows during this peak season, which generally have been financed through available cash. Collection of receivables and reduction in inventory levels following the peak building and construction season have in the past helped to partially offset this negative cash flow. We have also from time to time utilized our credit facility to cover working capital needs.

**RESULTS OF OPERATIONS**

The following table sets forth, for the three and nine months ended September 30, 2010 and 2009, the percentage relationship to sales of certain costs, expenses and income items:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2010** | **2009** | **2010** | **2009** |
| Sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of sales | 80.3% | 79.1% | 81.3% | 78.6% |
| Gross margin | 19.7% | 20.9% | 18.7% | 21.4% |
| Selling, general and administrative expenses | 26.4% | 26.1% | 26.8% | 28.9% |
| Facility closure costs | 0.2% | 0.0% | 0.1% | 0.2% |
| Asset impairments | 0.5% | 0.0% | 0.2% | 0.1% |
| Loss from operations | (7.4)% | (5.2)% | (8.4)% | (7.8)% |
| Interest expense, net | 3.8% | 3.1% | 4.5% | 3.7% |
| Income tax (benefit) expense | (0.3)% | 0.0% | (0.2)% | 0.5% |
| Loss from continuing operations | (10.9)% | (8.3)% | (12.7)% | (12.0)% |
| Income (loss) from discontinued operations, net of tax | (0.4)% | 0.3% | (0.2)% | (1.0)% |
| Net loss | (11.3)% | (8.0)% | (12.9)% | (13.0)% |

***Three Months Ended September 30, 2010 Compared with the Three Months Ended September 30, 2009***

*Sales.* Sales for the three months ended September 30, 2010 were $180.4 million, a 4.5% decrease from sales of $188.9 million for the three months ended September 30, 2009. For the three months ended September 30, 2010, actual U.S. single-family housing starts decreased 13.5% compared to the same period a year ago, while the number of single-family units under construction declined 12.8% over this same time period. In the South Region, actual U.S. single-family housing starts decreased 13.7% during the third quarter of 2010 compared to the same quarter a year ago, while single-family units under construction in the region were down 5.9% over the same period. For the quarter, our sales to the Builder 100 decreased by 13.4% over the same time period last year. Market prices for lumber and lumber sheet goods were on average 4.5% higher than the same period a year ago. Commodity sales increased by

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approximately $3.5 million, or 7.4%, quarter over quarter. This increase was offset by a decline in sales relating to our windows and doors category of approximately $3.8 million, and a sales decline of approximately $7.0 million in our other building products and services category as a result of a reduction in installed services and multi-family construction.

The following table shows sales classified by product category (dollars in millions):

| | Three Months Ended September 30, | | | | |
|---|---|---|---|---|---|
| | 2010 | | 2009 | | |
| | Sales | % of Sales | Sales | % of Sales | % Change |
| Prefabricated components | $ 36.3 | 20.1% | $ 36.5 | 19.3% | (0.5)% |
| Windows & doors | 40.9 | 22.7% | 44.7 | 23.7% | (8.5)% |
| Lumber & lumber sheet goods | 50.1 | 27.7% | 46.6 | 24.7% | 7.4% |
| Millwork | 19.6 | 10.9% | 20.6 | 10.9% | (4.6)% |
| Other building products & services | 33.5 | 18.6% | 40.5 | 21.4% | (17.2)% |
| Total sales | $ 180.4 | 100.0% | $ 188.9 | 100.0% | (4.5)% |

*Gross Margin.* Gross margin decreased $3.9 million to $35.5 million. Our gross margin percentage decreased from 20.9% in the third quarter of 2009 to 19.7% in the current quarter, a 1.2 percentage point decline. Our gross margin decrease was primarily due to competitive pricing pressure on non-commodity products.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses decreased $1.7 million, or 3.4%. Included as a reduction to these expenses is a $1.2 million litigation settlement we received in the current quarter. As a percentage of total sales, however, these expenses, excluding stock-based compensation expense and the litigation settlement, increased from 25.8% in 2009 to 26.4% in 2010. Our salaries and benefits expense, excluding stock compensation expense, was $28.5 million, or 15.8% of total sales, compared to $28.4 million, or 15.0% of total sales in the third quarter of 2009. Our office general and administrative expense, excluding the litigation settlement, decreased $0.5 million quarter over quarter and as a percentage of total sales, down to 2.7% in 2010 from 2.9% in 2009. Occupancy expenses decreased $0.1 million, or 2.6%, while bad debt expense increased $0.3 million from last year. Delivery expenses decreased $0.8 million due to lower equipment lease expense. We continue to monitor our operating cost structure closely and make adjustments as necessary.

*Asset Impairments.* Asset impairments was $0.8 million in the third quarter of 2010. The continued downturn in the macroeconomic factors that drive our business and the unfavorable economic conditions that exist caused us to revise our expectations and assess the recoverability of our long-lived assets in certain markets during the third quarter of 2010. Based upon the results of our assessments, we determined that the carrying amounts of certain assets exceeded their estimated fair values and recorded approximately $0.7 million of asset impairment charges. The remaining $0.1 million of the asset impairment charges related to land we have held for sale. There were no asset impairment charges recorded in the third quarter of 2009.

*Interest Expense, Net.* Interest expense was $6.9 million in the third quarter of 2010, an increase of $1.0 million from the third quarter of 2009. The increase was primarily due to higher interest rates during the current quarter and partially offset by lower average debt balances.

*Income Tax (Benefit) Expense.* We recorded an income tax benefit of $0.5 million during the quarter compared to $0.1 million of expense in the third quarter of 2009. We recorded an after-tax, non-cash valuation allowance of $7.2 million and $6.2 million, in 2010 and 2009, respectively, related to our net deferred tax assets. Absent this valuation allowance, our tax benefit rate would have been 38.4% and 38.5% in 2010 and 2009, respectively.

***Nine Months Ended September 30, 2010 Compared with the Nine Months Ended September 30, 2009***

*Sales.* Sales for the nine months ended September 30, 2010 were $553.3 million, a 5.6% increase from sales of $523.9 million for the nine months ended September 30, 2009. For the nine months ended September 30, 2010, actual U.S. single-family housing starts increased 10.5%, however, single-family units under construction declined

approximately 12% over the same period. In the South Region, actual U.S. single-family housing starts increased 11.7% in 2010 compared to a year ago, while single-family units under construction in the region were down 5.6% over the same period. At the same time, we increased our sales to the Builder 100 by 20.5% over the same period last year. Market prices for lumber and lumber sheet goods were on average approximately 35% higher than the same period a year ago. Commodity and manufactured product sales increased by $44.5 million, or 19.7%, year over year

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partly due to volume and partly due to price inflation. This increase was partially offset by a decline in sales of other building products and services of approximately $15.1 million for the nine months ended September 30, 2010 compared to the same time period last year.

The following table shows sales classified by product category (dollars in millions):

| | Nine Months Ended September 30, | | | | |
|---|---|---|---|---|---|
| | 2010 | | 2009 | | |
| | Sales | % of Sales | Sales | % of Sales | % Change |
| Prefabricated components | $ 109.5 | 19.8% | $ 100.6 | 19.2% | 8.8% |
| Windows & doors | 124.3 | 22.5% | 127.6 | 24.4% | (2.6)% |
| Lumber & lumber sheet goods | 160.6 | 29.0% | 125.0 | 23.9% | 28.5% |
| Millwork | 59.2 | 10.7% | 55.9 | 10.6% | 5.9% |
| Other building products & services | 99.7 | 18.0% | 114.8 | 21.9% | (13.2)% |
| Total sales | $ 553.3 | 100.0% | $ 523.9 | 100.0% | 5.6% |

*Gross Margin.* Gross margin decreased $8.4 million to $103.7 million. Our gross margin percentage decreased from 21.4% in the first nine months of 2009 to 18.7% in the current period, a 2.7 percentage point decline. Our gross margin percentage decreased 3.1 percentage points due to price, slightly offset by an increase in sales volume and a shift in sales mix. Our gross margins were negatively impacted by the volatile commodity prices during the first six months of the current year and intense pricing pressure we continue to experience.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses decreased $3.2 million, or 2.1%. Included as a reduction to these expenses is a $1.2 million litigation settlement we received in the current quarter. As a percentage of total sales these expenses, excluding stock-based compensation expense and the litigation settlement, decreased from 28.5% in 2009 to 26.5% in 2010. Our salaries and benefits expense, excluding stock compensation expense, was $86.4 million, or 15.6% of total sales, compared to $85.5 million, or 16.3% of total sales in the first nine months of 2009. Our office general and administrative expense, excluding the litigation settlement, decreased $0.7 million year over year, down to 2.7% of total sales in 2010 from 3.0% in 2009. Occupancy expenses decreased $1.3 million, or 8.5%, and our bad debt expense decreased $1.0 million. Delivery expenses were consistent with last year.

*Asset Impairments.* Asset impairments was $0.8 million for the nine months ended September 30, 2010. The continued downturn in the macroeconomic factors that drive our business and the unfavorable economic conditions that exist caused us to revise our expectations and assess the recoverability of our long-lived assets in certain markets during the third quarter of 2010. Based upon the results of our assessments, we determined that the carrying amounts of certain assets exceeded their estimated fair values and recorded approximately $0.7 million of asset impairment charges. The remaining $0.1 million of the asset impairment charges related to land we have held for sale. We also recorded an $0.5 million asset impairment charge related to land we have held for sale during the nine months ended September 30, 2009.

*Interest Expense, Net.* Interest expense was $24.8 million in 2010, an increase of $5.2 million. The increase was primarily due to the write-off of $1.6 million of unamortized debt issuance costs related to long-term debt repaid and $2.5 million of costs incurred related to our recapitalization transaction in the first quarter of 2010. The remaining difference was due to higher interest rates during the current year and partially offset by lower average debt balances and $1.2 million of debt issuance cost write-offs in the first quarter of 2009 related to the capacity reduction of our revolving credit facility.

*Income Tax (Benefit) Expense.* We recorded an income tax benefit of $1.0 million for the first nine months of 2010 compared to $2.4 million of expense for 2009. We recorded an after-tax, non-cash valuation allowance of $25.9 million and $25.0 million, in 2010 and 2009, respectively, related to our net deferred tax assets. Absent this valuation allowance, our tax benefit rate would have been 38.1% and 37.3% in 2010 and 2009, respectively.

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**LIQUIDITY AND CAPITAL RESOURCES**

Availability under our $250 million revolving credit facility is determined by a borrowing base. The following table shows our borrowing base, excess availability, borrowing availability and fixed charge coverage ratio as of September 30, 2010 and December 31, 2009 (in millions):

| | As of | |
|---|---|---|
| | **September 30, 2010** | **December 31, 2009** |
| Accounts Receivable Availability | $ 52.4 | $ 42.3 |
| Inventory Availability | 24.3 | 18.7 |
| Equipment Availability | 3.2 | 4.1 |
| Gross Availability | 79.9 | 65.1 |
| Less: | | |
| Agent Reserves | (4.8) | (8.5) |
| Borrowing Base | 75.1 | 56.6 |
| Plus: | | |
| Qualified Cash | | 15.7 |
| Less: | | |
| Outstanding Borrowings | (20.0) | (20.0) |
| Letters of Credit | (15.9) | (17.3) |
| Excess Availability | $ 39.2 | $ 35.0 |
| Less: | | |
| Minimum Liquidity Requirement | (35.0) | (35.0) |
| Borrowing Availability | $ 4.2 | $ |
| Actual Fixed Charge Coverage Ratio | -1.99x | -1.68x |
| Required Fixed Charge Coverage Ratio* | 1.00x | 1.00x |

* Required only if excess availability falls below $35 million.

Our borrowing base consists of trade accounts receivable, inventory and fixed assets, which meet specific criteria contained within the credit agreement, minus agent specified reserves. Our net borrowing base availability at September 30, 2010 was $4.2 million, and as such, we were not required to have any cash on deposit with the agent to meet the $35 million excess availability requirement contained within the revolving senior secured credit agreement. Excess availability is the sum of borrowing base plus qualified cash, defined as cash on deposit with the agent subject to a control agreement, minus outstanding borrowings and letters of credit. This amount must equal or exceed $35 million at the monthly reporting dates or we are required to meet a fixed charge coverage ratio of 1 to 1, which we currently would not meet.

Future declines in our borrowing base, if any, could compel us to either repay outstanding borrowings under the senior secured revolving credit facility or increase our cash on deposit with the agent in order to meet the excess availability requirement. At September 30, 2010, we had $121.4 million of unencumbered cash that can be used to either repay the $35.9 million currently funded under the facility or support any shortfall in the net borrowing base availability. At September 30, 2010, we were not in violation of any covenants or restrictions imposed by any of our debt agreements.

At September 30, 2010, we had $121.4 million of usable cash and $4.2 million of net borrowing base availability, which we believe is sufficient to meet our anticipated needs, including contractual obligations, for the next twelve months. We do not expect working capital or our credit facility to be a significant source of funds for the next twelve months. Based upon current economic conditions, we do not expect building activity to be as strong for the remainder of 2010 as had originally been anticipated, though we still believe our liquidity at year-end will range from $100-$110 million. Our projected cash use is subject to change, and will be influenced by actual housing activity over the next twelve months, commodity prices, gross margins, as well as customer and supplier responses to our changing liquidity position. Additional cash could be used if we choose to pursue strategic acquisition opportunities that may become available. Since the housing downturn began, we have continued our focus on preserving our liquidity. Our action plan, which consists of generating new business, reducing physical capacity, adjusting staffing levels, implementing cost containment programs, managing credit tightly and, most importantly, conserving cash has allowed us to mitigate the effects of the difficult industry conditions. We will continue to execute this strategy as long as these conditions persist.

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In January 2010, we completed our rights offering and debt exchange which reduced our indebtedness by $130.0 million and extended the maturity of $139.7 million of indebtedness until 2016. In addition, we received net proceeds of approximately $65 million, after paying for expenses related to the transaction (See Note 4).

***Consolidated Cash Flows***

Cash used in operating activities was $24.1 million for the nine months ended September 30, 2010 compared to cash provided by operating activities of $9.7 million for the nine months ended September 30, 2009. This includes federal income tax refunds of $33.8 million and $31.8 million received in the second quarters of 2010 and 2009, respectively. The increase in cash used was primarily driven by an increase in working capital of $7.4 million during the first nine months of 2010 compared to a decrease in working capital of $26.9 million during the same period last year. The change in working capital is the result of improved sales, higher commodity prices, and increased inventory levels.

During the nine months ended September 30, 2010 and 2009, cash used in investing activities was $7.8 million and $0.3 million, respectively. Capital expenditures increased $6.2 million as we continued buying out expiring vehicle and equipment leases. In addition, proceeds from the sale of assets decreased $1.3 million as the company actively sold off excess equipment in the prior year.

For the nine months ended September 30, 2010, cash provided by financing activities was $69.3 million, primarily due to the net proceeds received upon completion of our rights offering and debt exchange in the first quarter of 2010. For the nine months ended September 30, 2009, cash used in financing activities was $20.0 million, the result of a $20.0 million pay down of the revolving credit facility.

**RECENT ACCOUNTING PRONOUNCEMENTS**

In January 2010, the FASB issued guidance under the *Fair Value Measurements and Disclosures* topic of the Codification which requires, in both interim as well as annual financial statements, for assets and liabilities that are measured at fair value on a recurring basis, disclosures regarding the valuation techniques and inputs used to develop those measurements. It also requires separate disclosures of significant amounts transferred in and out of Level 1 and Level 2 fair value measurements and a description of the reasons for the transfers. We have adopted these provisions and included all required disclosures.

In October 2009, the FASB issued guidance under the *Multiple Element Revenue Arrangements* topic of the Codification which requires separation of the consideration received in such arrangements by establishing a selling price hierarchy for determining the selling price of a deliverable, which will be based on available information in the following order: vendor-specific objective evidence, third-party evidence, or estimated selling price. It also eliminates the residual method of allocation, requires that the consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method, which allocates any discount in the arrangement to each deliverable on the basis of each deliverable s selling price, and requires that a vendor determine its best estimate of selling price in a manner that is consistent with that used to determine the price to sell the deliverable on a standalone basis. These changes become effective for us on January 1, 2011. We are currently reviewing the impact of these changes on our financial statements, but we do not expect these changes to have a material impact on our financial position or results of operations.

**Item 3.** ***Quantitative and Qualitative Disclosures About Market Risk***

We experience changes in interest expense when market interest rates change. Changes in our debt could also increase these risks. We utilize interest rate swap contracts to fix interest rates on a portion of our outstanding long-term debt balances. Based on debt outstanding and interest rate swap contracts in place at September 30, 2010, a 1.0% increase in interest rates would result in approximately $0.2 million of additional interest expense annually.

We purchase certain materials, including lumber products, which are then sold to customers as well as used as direct production inputs for our manufactured products that we deliver. Short-term changes in the cost of these materials, some of which are subject to significant fluctuations, are sometimes, but not always, passed on to our customers. Our delayed ability to pass on material price increases to our customers can adversely impact our operating results.

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**Item 4.** ***Controls and Procedures***

*Controls Evaluation and Related CEO and CFO Certifications.* Our management, with the participation of our principal executive officer ( CEO ) and principal financial officer ( CFO ), conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this quarterly report. The controls evaluation was conducted by our Disclosure Committee, comprised of senior representatives from our finance, accounting, internal audit, and legal departments under the supervision of our CEO and CFO.

Certifications of our CEO and our CFO, which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended ( Exchange Act ), are attached as exhibits to this quarterly report. This Controls and Procedures section includes the information concerning the controls evaluation referred to in the certifications, and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

*Limitations on the Effectiveness of Controls.* We do not expect that our disclosure controls and procedures will prevent all errors and all fraud. A system of controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the system are met. Because of the limitations in all such systems, no evaluation can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Furthermore, the design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how unlikely. Because of these inherent limitations in a cost-effective system of controls and procedures, misstatements or omissions due to error or fraud may occur and not be detected.

*Scope of the Controls Evaluation.* The evaluation of our disclosure controls and procedures included a review of their objectives and design, the Company s implementation of the controls and procedures and the effect of the controls and procedures on the information generated for use in this quarterly report. In the course of the evaluation, we sought to identify whether we had any data errors, control problems or acts of fraud and to confirm that appropriate corrective action, including process improvements, were being undertaken if needed. This type of evaluation is performed on a quarterly basis so that conclusions concerning the effectiveness of our disclosure controls and procedures can be reported in our quarterly reports on Form 10-Q. Many of the components of our disclosure controls and procedures are also evaluated by our internal audit department, our legal department and by personnel in our finance organization. The overall goals of these various evaluation activities are to monitor our disclosure controls and procedures on an ongoing basis and to maintain them as dynamic systems that change as conditions warrant.

*Conclusions Regarding Disclosure Controls.* Based on the required evaluation of our disclosure controls and procedures, our CEO and CFO have concluded that, as of September 30, 2010, we maintain disclosure controls and procedures that are effective in providing reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

*Changes in Internal Control Over Financial Reporting.* During the period covered by this report, there have been no changes in our internal control over financial reporting identified in connection with the evaluation described above that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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## PART II OTHER INFORMATION

**Item 1.** ***Legal Proceedings***

We are involved in various claims and lawsuits incidental to the conduct of our business in the ordinary course. We carry insurance coverage in such amounts in excess of our self-insured retention as we believe to be reasonable under the circumstances and that may or may not cover any or all of our liabilities in respect of claims and lawsuits. We do not believe that the ultimate resolution of these matters will have a material adverse impact on our consolidated financial position, cash flows or results of operations.

Although our business and facilities are subject to federal, state and local environmental regulation, environmental regulation does not have a material impact on our operations. We believe that our facilities are in material compliance with such laws and regulations. As owners and lessees of real property, we can be held liable for the investigation or remediation of contamination on such properties, in some circumstances without regard to whether we knew of or were responsible for such contamination. Our current expenditures with respect to environmental investigation and remediation at our facilities are minimal, although no assurance can be provided that more significant remediation may not be required in the future as a result of spills or releases of petroleum products or hazardous substances or the discovery of unknown environmental conditions.

**Item 1A.** ***Risk Factors***

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part 1, Item 1A. Risk Factors in our annual report on Form 10-K for the year ended December 31, 2009, which could materially affect our business, financial condition or future results. The risks described in our annual report on Form 10-K are not the only risks facing our company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**Item 2.** ***Unregistered Sales of Equity Securities and Use of Proceeds***

***Unregistered Sales of Equity Securities***

(a) None

***Use of Proceeds***

(b) Not applicable

***Company Stock Repurchases***

(c) None

**Item 3.** ***Defaults Upon Senior Securities***

(a) None

(b) None

**Item 4.** ***Reserved***

**Item 5.** ***Other Information***

(a) None

(b) None

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**Item 6.** ***Exhibits***

| Exhibit Number | Description |
|---|---|
| 3.1 | Amended and Restated Certificate of Incorporation of Builders FirstSource, Inc. (incorporated by reference to Exhibit 3.1 to Amendment No. 4 to the Registration Statement of the Company on Form S-1, filed with the Securities and Exchange Commission on June 6, 2005, File Number 333-122788) |
| 3.2 | Amended and Restated By-Laws of Builders FirstSource, Inc. (incorporated by reference to Exhibit 3.2 to the Company s Current Report on Form 8-K, filed with the Securities and Exchange Commission on March 5, 2007, File Number 0-51357) |
| 4.1 | Registration Rights Agreement, dated as of January 21, 2010, among Builders FirstSource, Inc., JLL Partners Fund V, L.P., and Warburg Pincus Private Equity IX, L.P. (incorporated by reference to Exhibit 10.2 to the Company s Current Report on Form 8-K, filed with the Securities Exchange Commission on January 22, 2010, File Number 0-51357) |
| 4.2 | Indenture, dated as of February 11, 2005, among Builders FirstSource, Inc., the Guarantors party thereto, and Wilmington Trust Company, as Trustee (incorporated by reference to Exhibit 4.1 to Amendment No. 1 to the Registration Statement of the Company on Form S-1, filed with the Securities and Exchange Commission on April 27, 2005, File Number 333-122788) |
| 4.3 | Supplemental Indenture, dated as of January 8, 2010, among Builders FirstSource, Inc., the Guarantors party thereto, and Wilmington Trust Company, as Trustee (incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K, filed with the Securities Exchange Commission on January 14, 2010, File Number 0-51357) |
| 4.4 | Indenture, dated as of January 21, 2010, among Builders FirstSource, Inc., the Guarantors party thereto, and Wilmington Trust Company, as Trustee (incorporated by reference to Exhibit 4.1 to the Company s Current Report on Form 8-K, filed with the Securities Exchange Commission on January 22, 2010, File Number 0-51357) |
| 31.1* | Written statement pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, signed by Floyd F. Sherman as Chief Executive Officer |
| 31.2* | Written statement pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, signed by M. Chad Crow as Chief Financial Officer |
| 32.1** | Written statement pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, signed by Floyd F. Sherman as Chief Executive Officer and M. Chad Crow as Chief Financial Officer |

* Filed herewith.

** Builders FirstSource, Inc. is furnishing, but not filing, the written

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|---|---|
| | statement pursuant to Title 18 United States Code 1350, as added by Section 906 of the Sarbanes-Oxley Act of 2002, of Floyd F. Sherman, our Chief Executive Officer, and M. Chad Crow, our Chief Financial Officer. |

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**SIGNATURES**

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

**BUILDERS FIRSTSOURCE, INC.**

/s/ FLOYD F. SHERMAN
Floyd F. Sherman
Chief Executive Officer
(Principal Executive Officer)

October 28, 2010

/s/ M. CHAD CROW
M. Chad Crow
Senior Vice President Chief Financial Officer (Principal Financial Officer)

October 28, 2010

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