

HUTTIG BUILDING PRODUCTS INC

Form 10-Q

November 02, 2011

[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

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

For the quarterly period ended September 30, 2011

Commission file number 1-14982

**HUTTIG BUILDING PRODUCTS, INC.**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of

43-0334550  
(I.R.S. Employer

Edgar Filing: HUTTIG BUILDING PRODUCTS INC - Form 10-Q

incorporation or organization)

Identification No.)

555 Maryville University Drive

Suite 400

St. Louis, Missouri  
(Address of principal executive offices)

63141  
(Zip code)

(314) 216-2600

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if 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

The number of shares of Common Stock outstanding on September 30, 2011 was 23,648,177 shares.

**Table of Contents**

	<b>Page No.</b>
<b>PART I. FINANCIAL INFORMATION</b>	
<u>Item 1.</u> Financial Statements	
<u>Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2011 and 2010 (unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets as of September 30, 2011, December 31, 2010 and September 30, 2010 (unaudited)</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the three and nine months ended September 30, 2011 and 2010 (unaudited)</u>	6
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	7
<u>Item 2.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	10
<u>Item 4.</u> <u>Controls and Procedures</u>	17
<b>PART II. OTHER INFORMATION</b>	
<u>Item 1.</u> <u>Legal Proceedings</u>	17
<u>Item 5.</u> <u>Other Information</u>	17
<u>Item 6.</u> <u>Exhibits</u>	18
<u>Signatures</u>	19
<u>Exhibit Index</u>	20
<u>EX-10.1</u>	
<u>EX-10.2</u>	
<u>EX-10.3</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	

**Table of Contents**

**HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(unaudited)

(In Millions, Except Share and Per Share Data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net sales	\$ 135.5	\$ 127.2	\$ 365.6	\$ 364.6
Cost of sales	110.5	104.4	298.9	297.9
Gross margin	25.0	22.8	66.7	66.7
Operating expenses	25.4	26.6	74.3	78.6
Goodwill impairment	0.3		0.3	
Operating loss	(0.7)	(3.8)	(7.9)	(11.9)
Interest expense, net	0.7	0.7	2.0	1.5
Loss from continuing operations before income taxes	(1.4)	(4.5)	(9.9)	(13.4)
(Benefit) provision for income taxes		(0.1)		(0.1)
Loss from continuing operations	(1.4)	(4.4)	(9.9)	(13.3)
(Loss) income from discontinued operations, net of taxes	(0.3)	(0.1)	(0.4)	0.7
Net loss	\$ (1.7)	\$ (4.5)	\$ (10.3)	\$ (12.6)
Net loss from continuing operations per share basic and diluted	\$ (0.06)	\$ (0.20)	\$ (0.45)	\$ (0.62)
Net (loss) income from discontinued operations per share basic and diluted	(0.02)	(0.01)	(0.02)	0.03
Net loss per share basic and diluted	\$ (0.08)	\$ (0.21)	\$ (0.47)	\$ (0.59)
Weighted average shares outstanding:				
Basic shares outstanding continuing and discontinued operations	22,211,787	21,592,927	22,140,153	21,529,460
Diluted shares outstanding continuing operations	22,211,787	21,592,927	22,140,153	21,529,460
Diluted shares outstanding discontinued operations	22,211,787	21,592,927	22,140,153	22,152,081

*See notes to condensed consolidated financial statements*

**Table of Contents****HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARY****CONDENSED CONSOLIDATED BALANCE SHEETS****(unaudited)****(In Millions)**

	September 30, 2011	December 31, 2010	September 30, 2010
<b>ASSETS</b>			
<b>CURRENT ASSETS:</b>			
Cash and equivalents	\$ 2.2	\$ 0.8	\$ 1.1
Trade accounts receivable, net	55.2	37.1	51.3
Inventories	53.9	46.2	53.7
Other current assets	3.4	4.3	3.1
<b>Total current assets</b>	<b>114.7</b>	<b>88.4</b>	<b>109.2</b>
<b>PROPERTY, PLANT AND EQUIPMENT</b>			
Land	5.0	4.9	5.4
Building and improvements	25.4	24.4	24.7
Machinery and equipment	29.7	29.1	29.1
Gross property, plant and equipment	60.1	58.4	59.2
Less accumulated depreciation	42.4	40.5	40.0
Property, plant and equipment, net	17.7	17.9	19.2
<b>OTHER ASSETS:</b>			
Goodwill	8.2	8.6	8.6
Other	2.5	3.0	3.1
Deferred income taxes	7.7	8.2	7.8
<b>Total other assets</b>	<b>18.4</b>	<b>19.8</b>	<b>19.5</b>
<b>TOTAL ASSETS</b>	<b>\$ 150.8</b>	<b>\$ 126.1</b>	<b>\$ 147.9</b>

*See notes to condensed consolidated financial statements*

**Table of Contents****HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARY****CONDENSED CONSOLIDATED BALANCE SHEETS****(unaudited)****(In Millions, Except Share and Per Share Data)**

	September 30, 2011	December 31, 2010	September 30, 2010
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>			
<b>CURRENT LIABILITIES:</b>			
Current maturities of long-term debt	\$ 0.1	\$ 0.2	\$ 0.2
Trade accounts payable	38.2	26.1	32.9
Deferred income taxes	7.7	8.2	7.8
Accrued compensation	2.4	2.3	3.3
Other accrued liabilities	12.8	13.2	12.2
Total current liabilities	61.2	50.0	56.4
<b>NON-CURRENT LIABILITIES:</b>			
Long-term debt, less current maturities	65.4	41.9	51.1
Other non-current liabilities	1.4	1.6	1.6
Total non-current liabilities	66.8	43.5	52.7
<b>SHAREHOLDERS EQUITY</b>			
Preferred shares; \$.01 par (5,000,000 shares authorized)			
Common shares; \$.01 par (50,000,000 shares authorized: 23,648,177; 22,847,760; and 22,847,760 shares issued at September 30, 2011, December 31, 2010 and September 30, 2010, respectively)	0.2	0.2	0.2
Additional paid-in capital	39.4	39.0	38.9
Accumulated deficit	(16.8)	(6.6)	(0.3)
Total shareholders equity	22.8	32.6	38.8
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>	<b>\$ 150.8</b>	<b>\$ 126.1</b>	<b>\$ 147.9</b>

*See notes to condensed consolidated financial statements*

**Table of Contents****HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARY****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited)****(In Millions)**

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>Cash Flows From Operating Activities:</b>				
Net loss	\$ (1.7)	\$ (4.5)	\$ (10.3)	\$ (12.6)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:				
Net (income) loss from discontinued operations			0.4	(0.7)
Depreciation and amortization	0.8	1.1	2.4	3.0
Stock based compensation	0.1	0.2	0.4	0.6
Goodwill impairment	0.3		0.3	
Other adjustments		(0.4)		(0.6)
Changes in operating assets and liabilities:				
Trade accounts receivable	1.2	6.3	(18.1)	(9.5)
Inventories	6.1	7.8	(7.7)	(8.6)
Trade accounts payable	(6.1)	(10.6)	12.1	7.0
Other		2.0	0.2	6.3
Total cash provided by (used in) operating activities	1.0	2.0	(20.3)	(15.1)
<b>Cash Flows From Investing Activities:</b>				
Capital expenditures	(0.3)	(0.2)	(1.8)	(0.7)
Proceeds from disposition of capital assets				1.3
Total cash (used in) provided by investing activities	(0.3)	(0.2)	(1.8)	0.6
<b>Cash Flows From Financing Activities:</b>				
(Payments) borrowings of debt, net	(1.5)	(2.5)	23.5	14.4
Debt issuance costs		(0.1)		(0.1)
Total cash (used in) provided by financing activities	(1.5)	(2.6)	23.5	14.3
Net (decrease) increase in cash and equivalents	(0.8)	(0.8)	1.4	(0.2)
Cash and equivalents, beginning of period	3.0	1.9	0.8	1.3
Cash and equivalents, end of period	\$ 2.2	\$ 1.1	\$ 2.2	\$ 1.1
<b>Supplemental Disclosure of Cash Flow Information:</b>				
Interest paid	\$ 0.7	\$ 0.4	\$ 1.6	\$ 1.0
Income taxes (paid) refunded			(0.1)	3.0
Capital lease obligations financed				0.2
Debt issuance costs financed		1.2		1.2

*See notes to condensed consolidated financial statements*





**Table of Contents****HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)****1. BASIS OF PRESENTATION**

The unaudited interim condensed consolidated financial statements of Huttig Building Products, Inc. and Subsidiary (the Company or Huttig) were prepared in accordance with U.S. generally accepted accounting principles and reflect all adjustments (including normal recurring accruals) which, in the opinion of management, are considered necessary for the fair presentation of the results for the periods presented. These statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

The condensed consolidated results of operations and resulting cash flows for the interim periods presented are not necessarily indicative of the results that might be expected for the full year. Due to the seasonal nature of Huttig's business, operating profitability is usually lower in the Company's first and fourth quarters than in the second and third quarters.

**2. COMPREHENSIVE INCOME**

Comprehensive income refers to net income adjusted by gains and losses that in conformity with U.S. GAAP are excluded from net income. Other comprehensive items are amounts that are included in stockholders' equity in the condensed consolidated balance sheets. Comprehensive net loss is equal to net loss, respectively, for all periods presented.

**3. DEBT**

Debt consisted of the following (in millions):

	September 30, 2011	December 31, 2010	September 30, 2010
Revolving credit facility	\$ 65.3	\$ 41.7	\$ 50.9
Other obligations	0.2	0.4	0.4
<b>Total debt</b>	<b>65.5</b>	<b>42.1</b>	<b>51.3</b>
Less current portion	0.1	0.2	0.2
<b>Long-term debt</b>	<b>\$ 65.4</b>	<b>\$ 41.9</b>	<b>\$ 51.1</b>

**Credit Agreement** The Company has a \$120.0 million asset based senior secured revolving credit facility (credit facility). In October 2011, the Company amended its credit facility to, among other things, amend the cash dominion threshold. Borrowing availability under the credit facility is based on eligible accounts receivable, inventory and real estate. The real estate component of the borrowing base amortizes monthly over ten years on a straight-line basis. Borrowings under the credit facility are collateralized by substantially all of the Company's assets and are subject to certain operating limitations applicable to a loan of this type, which, among other things, place limitations on indebtedness, liens, investments, mergers and acquisitions, dispositions of assets, cash dividends and transactions with affiliates. The entire unpaid balance under the credit facility is due and payable on September 3, 2014, the maturity date of the credit agreement.

At September 30, 2011, under the credit facility, the Company had revolving credit borrowings of \$65.3 million outstanding at a weighted average interest rate of 3.07%, letters of credit outstanding totaling \$5.2 million, primarily for health and workers' compensation insurance, and \$29.6 million of additional committed borrowing capacity. The Company pays an unused commitment fee in the range of 0.30% to 0.375% per annum. In addition, the Company had \$0.2 million of capital lease and other obligations outstanding at September 30, 2011.

The sole financial covenant in the credit facility is the fixed charge coverage ratio (FCCR) that must be tested by the Company if the excess borrowing availability falls below a range of \$10.0 million to \$15.0 million depending on the Company's borrowing base and must also be tested

## Edgar Filing: HUTTIG BUILDING PRODUCTS INC - Form 10-Q

on a pro forma basis prior to consummation of certain significant business transactions outside the Company's ordinary course of business, as defined in the agreement. The FCCR is 1.25:1.00. At September 30, 2011, the FCCR testing threshold was \$11.9 million and the Company had \$29.6 million of excess availability. In addition to the sole financial covenant, the credit facility, as amended, gives the lenders the right to dominion of the Company's bank accounts should excess borrowing availability fall below \$5.0 million over the FCCR testing threshold, or \$16.9 million at September 30, 2011. This right does not change the Company's ability to borrow on the credit facility in any manner nor does it make the underlying debt callable by the lender, however, under ASC 470, Debt, if the excess availability were to fall below the dominion threshold, the Company would be required to reclassify long-term debt to current debt on its balance sheet.

---

**Table of Contents**

The Company believes that cash generated from its operations and funds available under the credit facility will provide sufficient funds to meet its currently anticipated short-term and long-term liquidity and capital expenditure requirements. In the first nine months of 2011, the minimum FCCR was not required to be tested as excess borrowing availability was greater than the minimum threshold. However, if availability would have fallen below that threshold, the Company would not have met the minimum FCCR. If the Company was unable to maintain excess borrowing availability of more than the applicable amount in the range of \$10.0 million to \$15.0 million and was also unable to comply with this financial covenant, its lenders would have the right, but not the obligation, to terminate the loan commitments and accelerate the repayment of the entire amount outstanding under the credit facility. The lenders could also foreclose on the Company's assets that secure the credit facility. In that event, the Company would be forced to seek alternative sources of financing, which may not be available on terms acceptable to it, or at all.

**4. CONTINGENCIES**

The Company carries insurance policies on insurable risks with coverage and other terms that it believes to be appropriate. The Company generally has self-insured retention limits and has obtained fully insured layers of coverage above such self-insured retention limits. Accruals for self-insurance losses are made based on claims experience. Liabilities for existing and unreported claims are accrued for when it is probable that future costs will be incurred and can be reasonably estimated.

In 1995, Huttig was identified as a potentially responsible party in connection with the clean up of contamination at a formerly owned property in Montana that was used for the manufacture of wood windows. Huttig is voluntarily remediating this property under the oversight of and in cooperation with the Montana Department of Environmental Quality ( Montana DEQ ) and is complying with a 1995 unilateral administrative order of the Montana DEQ to complete a remedial investigation and feasibility study. The remedial investigation was completed and approved in 1998 by the Montana DEQ, which has issued its final risk assessment of this property. In March 2003, the Montana DEQ approved Huttig's work plan for conducting a feasibility study to evaluate alternatives for cleanup. In July 2004, the Company submitted the feasibility study report, which evaluated several potential remedies, including continuation and enhancement of remedial measures already in place and operating. Huttig also submitted plans for testing a newer technology that could effectively remediate the site. The Montana DEQ approved these plans and a pilot test of the remediation technology was completed in July 2007. The Montana DEQ is in the process of reviewing the results of the pilot test. After evaluating the results of the pilot test, the Montana DEQ will comment on the feasibility study report and its recommended remedy, and then will select a final remedy, publish a record of decision and negotiate with Huttig for an administrative order of consent on the implementation of the final remedy. Huttig spent less than \$0.4 million on remediation costs at this site for the nine months ended September 30, 2011 and 2010. The annual level of future remediation expenditures is difficult to estimate because of the uncertainty relating to the final remedy to be selected by the Montana DEQ. As of September 30, 2011, the Company has accrued \$0.7 million in Other non-current liabilities for future costs of remediating this site, which management believes represents a reasonable estimate, based on current facts and circumstances, of the currently expected costs of remediation. Until the Montana DEQ selects a final remedy, however, management cannot estimate the top of the range of loss or cost to Huttig of the final remediation order.

In addition, some of the Company's current and former distribution centers are located in areas of current or former industrial activity where environmental contamination may have occurred, and for which it, among others, could be held responsible. The Company currently believes that there are no material environmental liabilities at any of its distribution center locations.

In October 2011, one of the Company's vehicles was involved in an accident resulting in two fatalities. As of the date of the filing of this report, the Company's investigation into the scope of its liability, if any, in connection with the accident is in the preliminary stages. In addition, as of the date of the filing of this report, to the Company's knowledge, no lawsuits have been filed against the Company relating to the accident, and no claims otherwise have been overtly asserted against the Company. In the event that the Company were to incur any liability as a result of the accident, the Company believes that its financial exposure, if any, would be covered by the Company's insurance policies and limited by the underlying deductibles on those policies.

## **Table of Contents**

The Company accrues expenses for contingencies when it is probable that an asset has been impaired or a liability has been incurred and management can reasonably estimate the expense. Contingencies for which the Company has made accruals include environmental, product liability and other legal matters. It is possible, however, that future results of operations for any particular quarter or annual period and the Company's financial condition could be materially affected by changes in assumptions or other circumstances related to these matters.

### **5. BASIC AND DILUTED SHARES**

For the nine months ended September 30, 2011 and 2010, all outstanding stock options and all non-vested restricted shares/units were anti-dilutive and, therefore, were not included in the computations of diluted income per share amounts for continuing operations; however, in the nine months ended September 30, 2010, 622,621 shares were dilutive and included for discontinued operations. At September 30, 2011, the Company had 210,625 stock options and an aggregate of 1,705,487 shares of restricted stock and restricted stock units outstanding.

### **6. BRANCH CLOSURES AND OTHER SEVERANCE**

The Company had \$0.6 million, \$0.9 million and \$0.9 million in accruals related to remaining building lease obligations that will be paid out over the terms of the various leases at closed facilities through 2015 recorded in the caption "Other accrued liabilities" on its condensed consolidated balance sheets at September 30, 2011, December 31, 2010 and September 30, 2010, respectively.

### **7. INCOME TAXES**

Huttig recognized no income tax expense or benefit in the first nine months of 2011 and a \$0.1 million tax benefit in the first nine months of 2010. At September 30, 2011, the Company had gross deferred tax assets of \$38.7 million and a valuation allowance of \$30.2 million for net deferred tax assets of \$8.5 million. The Company had deferred tax liabilities of \$8.5 million at September 30, 2011. After classifying \$0.7 million of short-term deferred tax assets with short-term deferred tax liabilities and \$0.1 million of long-term deferred tax liabilities with long-term deferred tax assets, the Company had current net deferred tax liabilities of \$7.7 million, as well as long term deferred tax assets of \$7.7 million at September 30, 2011. The Company expects its deferred tax liabilities to be settled with utilization of its deferred tax assets. The deferred tax liabilities enable the Company to partially utilize the deferred tax assets at September 30, 2011 and the balance of the deferred tax assets are covered by the Company's valuation allowance. The Company is not relying on future pre-tax income at September 30, 2011 to support the utilization of the deferred tax assets.

### **8. STOCK-BASED EMPLOYEE COMPENSATION**

The Company recognized \$0.4 million and \$0.6 million in non-cash stock-based compensation in the nine months ended September 30, 2011 and 2010, respectively. During the first nine months of 2011, the Company granted an aggregate of 817,750 shares of restricted stock at a fair market value of \$0.89 per share under its 2005 Executive Incentive Compensation Plan. The restricted shares vest in three equal installments on the first, second and third anniversaries of the grant date. During the first nine months of 2011, the Company granted 52,500 restricted stock units under its 2005 Non-employee Directors' Restricted Stock Plan at a fair market value of \$0.94 per share. The restricted stock units vest on the date of the 2012 Annual Meeting. The unearned compensation expense is being amortized into expense on a straight-line basis over the requisite service period for the entire award. As of September 30, 2011 and 2010, the total compensation expense not yet recognized related to all outstanding restricted stock/unit awards was approximately \$0.9 million and \$0.8 million, respectively.

**Table of Contents****ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Overview**

Huttig is a distributor of a broad array of building material products used principally in new residential construction, home improvement, and remodeling and repair projects. We distribute our products through 27 distribution centers serving 41 states and sell primarily to building materials dealers, national buying groups, home centers and industrial users, including makers of manufactured homes.

The following table sets forth our sales from continuing operations, by product classification as a percentage of total sales:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Millwork(1)	44%	46%	44%	47%
General Building Products(2)	46%	43%	45%	42%
Wood Products(3)	10%	11%	11%	11%
Total Net Product Sales	100%	100%	100%	100%

- (1) Millwork includes exterior and interior doors, pre-hung door units, windows, patio doors, mouldings, frames, stair parts and columns.
- (2) General building products include composite decking, connectors, fasteners, housewrap, roofing products, insulation and other miscellaneous building products.
- (3) Wood products include engineered wood products and other wood products, such as lumber and panels.

**Industry Conditions**

The prolonged downturn in the residential construction market has become one of the most severe housing downturns in U.S. history with significant challenges still remaining for the U.S. economy. Our sales depend heavily on the strength of local and national new residential construction, as well as the home improvement and remodeling markets. Beginning in 2006, our results of operations have been adversely affected by the severe downturn in new housing activity in the United States. Though we expect the severe downturn in new residential construction to continue to adversely affect our operating results through the remainder of 2011, and while housing starts remain well below long-term historical levels, the decline in annualized housing starts appears to have leveled off since 2008. Through September 2011, however, based on the most recent data provided by the United States Census Bureau, total housing starts are running approximately 2% behind 2010 levels.

In reaction to the housing downturn, the Company has been restructuring its operations since the second quarter of 2006. Since then, the Company closed, consolidated or sold 20 distribution centers. Additionally, the Company reduced its workforce by approximately 1,200, with less than 1,000 employees at September 30, 2011. We continue to review our operating expenses and implement cost savings actions. We believe that through our aggressive restructuring and ongoing cost control activities, we are able to mitigate the impact of the severe downturn in the housing market while providing a more scalable cost structure to support future growth opportunities.

Various factors historically have caused our results of operations to fluctuate from period to period. These factors include levels of construction, home improvement and remodeling activity, weather, prices of commodity wood and steel products, interest rates, competitive pressures, availability of credit and other local, regional, national and economic conditions. Many of these factors are cyclical or seasonal in nature. We anticipate that further fluctuations in operating results from period to

## **Table of Contents**

period will continue in the future. Our first quarter and fourth quarter are generally adversely affected by winter weather patterns in the Midwest, Northeast and Northwest, which typically result in seasonal decreases in levels of construction activity in these areas. Because much of our overhead and expenses remain relatively fixed throughout the year, our operating profits tend to be lower during the first and fourth quarters.

We believe we have the product offerings, warehouse and support facilities, personnel, systems infrastructure and financial and competitive resources necessary for continued business success. Our future revenues, costs and profitability, however, are all likely to be influenced by a number of risks and uncertainties, including those discussed under **Cautionary Statement** below.

### **Critical Accounting Policies**

We prepare our condensed consolidated financial statements in accordance with U.S. generally accepted accounting principles, which require management to make estimates and assumptions. Management bases these estimates and assumptions on historical results and known trends as well as management forecasts. Actual results could differ from these estimates and assumptions. For a discussion of our significant accounting policies and estimates, see our Annual Report on Form 10-K for the year ended December 31, 2010 in Part II, Item 7 **Management's Discussion and Analysis of Financial Condition and Results of Operations-Critical Accounting Policies**. There were no material changes to the critical accounting policies and estimates discussed in our Annual Report on Form 10-K for the year ended December 31, 2010.

### **Results of Operations**

#### **Three Months Ended September 30, 2011 Compared to Three Months Ended September 30, 2010**

Net sales were \$135.5 million in 2011, which is \$8.3 million, or approximately 6.5%, higher than in 2010. This increase is primarily due to the increase in our roofing business and a 6% increase in housing starts in third quarter 2011 over third quarter 2010.

Sales increased in each product category in 2011 from 2010. Millwork sales increased approximately 1% in 2011 to \$59.1 million. Building product sales increased approximately 14% in 2011 to \$62.4 million. Wood products sales increased approximately 1% to \$14.0 million in 2011.

Gross margin increased approximately 10% to \$25.0 million, or 18.5% of sales, in 2011 as compared to \$22.8 million, or 17.9% of sales, in 2010. The increase in gross margin percentage in 2011 over 2010 was primarily due to higher margins on millwork sales. Additionally, we believe gross margins were adversely impacted in the second half of last year as the market declined with the expiration of the home buyer tax credit in the second quarter of 2010. We continue to see competitive pricing pressure brought by the down housing market, which we expect to continue for the remainder of 2011.

Operating expenses decreased \$1.2 million to \$25.4 million, or 18.7% of sales, in 2011, compared to \$26.6 million, or 20.9% of sales, in 2010. The reduction in operating expenses is primarily due to lower personnel costs.

During the third quarter of 2011, we determined that, based on a further decline in actual and forecasted operating results at one of our reporting units, an interim test for goodwill impairment was necessary for the impacted unit. This test resulted in a goodwill impairment charge of \$0.3 million, which was recorded in the Consolidated Statements of Operations.

Net interest expense was \$0.7 million in both 2011 and 2010.

We did not recognize a tax benefit from the additional net operating losses generated as we have fully reserved all net operating loss carry-forwards in 2011.

As a result of the foregoing factors, we incurred a loss from continuing operations of \$1.4 million in 2011 as compared to a loss of \$4.4 million in 2010.

#### **Nine Months Ended September 30, 2011 Compared to Nine Months Ended September 30, 2010**

Net sales were \$365.6 million in 2011, which is \$1.0 million, or approximately 0.3%, higher than in 2010. This increase is primarily due to the increase in our roofing business partially offset by declines in certain other product categories brought by the down housing market.



## **Table of Contents**

Sales declined in the millwork category but increased in both building products and in the wood product category in 2011 from 2010. Millwork sales decreased approximately 6% in 2011 to \$161.9 million. Building product sales increased approximately 6% in 2011 to \$162.0 million. Wood products sales increased approximately 6% to \$41.7 million in 2011.

Gross margin for both 2011 and 2010 was \$66.7 million, or 18.2% of sales in 2011 and 18.3% of sales in 2010. Gross margin was flat from 2011 compared to 2010 which is in line with overall sales volume.

Operating expenses decreased \$4.3 million to \$74.3 million, or 20.3% of sales, in 2011, compared to \$78.6 million, or 21.6% of sales, in 2010. The reduction in operating expenses is primarily due to lower personnel costs and fuel costs.

Net interest expense was \$2.0 million in 2011, compared to \$1.5 million in 2010, due to higher debt levels and higher interest rates in 2011.

We did not recognize a tax benefit from the additional net operating losses generated as we have fully reserved all net operating loss carry-forwards in 2011.

As a result of the foregoing factors, we incurred a loss from continuing operations of \$9.9 million in 2011 as compared to a loss of \$13.3 million in 2010.

## **Discontinued Operations**

We recorded a \$0.4 million after tax loss from discontinued operations in the first nine months of 2011 compared to a \$0.7 million after tax gain in the first nine months of 2010, primarily related to sale of a facility in the first quarter of 2010.

## **Liquidity and Capital Resources**

We depend on cash flow from operations and funds available under our revolving credit facility to finance seasonal working capital needs, capital expenditures and any acquisitions that we may undertake. Our working capital requirements are generally greatest in the second and third quarters, which reflect the seasonal nature of our business. The second and third quarters are also typically our strongest operating quarters, largely due to more favorable weather throughout many of our markets compared to the first and fourth quarters. We typically generate cash from working capital reductions in the fourth quarter of the year and build working capital during the first quarter in preparation for our second and third quarters. We also maintain relatively larger inventories through peak periods to better position us to meet the rapid delivery requirements of our customers and to enable us to obtain more favorable pricing, delivery and service terms with our suppliers. Accounts receivable also typically increase during peak periods commensurate with the sales increase. At September 30, 2011, December 31, 2010 and September 30, 2010, inventories and accounts receivable constituted approximately 72%, 66% and 71% of our total assets, respectively. We also closely monitor operating expenses and inventory levels during seasonally affected periods and, to the extent possible, manage variable operating costs to minimize seasonal effects on our profitability.

**Operations.** Cash used in operating activities increased by \$5.2 million to \$20.3 million in the first nine months of 2011, compared to a usage of \$15.1 million in the first nine months of 2010. In 2011, our net loss decreased \$2.3 million compared to 2010. Accounts receivable increased by \$18.1 million during 2011, compared to an increase of \$9.5 million a year ago. Days sales outstanding were relatively flat at 37.2 days at September 30, 2011 as compared to 36.8 days at September 30, 2010 based on annualized third quarter sales and quarter end accounts receivable balances for the respective periods. The increase in accounts receivable is commensurate with the seasonality of our sales. Inventory increased by \$7.7 million in 2011 compared to an increase of \$8.6 million in 2010. Our inventory turns increased to 7.8 turns in 2011 from 7.3 turns in 2010 based on annualized third quarter costs of goods sold and average inventory balances for the respective quarters. The increase in inventories represents normal seasonal build. Accounts payable increased by \$12.1 million during 2011, compared to a \$7.0 million increase in the year ago period. The increase is primarily a result of our seasonal inventory build. Days payable outstanding increased to 31.5 days at September 30, 2011 from 28.8 days at September 30, 2010 based on annualized third quarter costs of goods sold and quarter end accounts payable balances for the respective periods. The Company also received a \$3.1 million Federal income tax refund in 2010.

**Investing.** In 2011, net cash used in investing activities was \$1.8 million which compares to net cash provided from investing activities of \$0.6 million in 2010. In 2011, the Company invested \$1.0 in a new facility and invested \$0.8 million in machinery and equipment at various locations. In 2010, the Company invested \$0.7 million in machinery and equipment at various locations and received \$1.3 million primarily from the sale of real estate from previously closed facilities related to discontinued operations.





---

## **Table of Contents**

**Financing.** Cash provided from financing activities of \$23.5 million in 2011 and \$14.3 million in 2010 reflects net debt borrowings from our credit facility in each period.

**Credit Agreement** We have a \$120.0 million asset based senior secured revolving credit facility ( credit facility ). In October 2011, we amended our credit facility to, among other things, amend the cash dominion threshold. Borrowing availability under the credit facility is based on eligible accounts receivable, inventory and real estate. The real estate component of the borrowing base amortizes monthly over ten years on a straight-line basis. Borrowings under the credit facility are collateralized by substantially all of our assets and are subject to certain operating limitations applicable to a loan of this type, which, among other things, place limitations on indebtedness, liens, investments, mergers and acquisitions, dispositions of assets, cash dividends and transactions with affiliates. The entire unpaid balance under the credit facility is due and payable on September 3, 2014, the maturity date of the credit agreement.

At September 30, 2011, under the credit facility, we had revolving credit borrowings of \$65.3 million outstanding at a weighted average interest rate of 3.07%, letters of credit outstanding totaling \$5.2 million, primarily for health and workers compensation insurance, and \$29.6 million of additional committed borrowing capacity. We pay an unused commitment fee in the range of 0.30% to 0.375% per annum. In addition, we had \$0.2 million of capital lease and other obligations outstanding at September 30, 2011.

The sole financial covenant in the credit facility is the fixed charge coverage ratio ( FCCR ) that must be tested by us if the excess borrowing availability falls below a range of \$10.0 million to \$15.0 million depending on our borrowing base and must also be tested on a pro forma basis prior to consummation of certain significant business transactions outside our ordinary course of business, as defined in the agreement. The FCCR is 1.25:1.00. At September 30, 2011, the FCCR testing threshold was \$11.9 million and we had \$29.6 million of excess availability. In addition to the sole financial covenant, the credit facility, as amended, gives the lenders the right to dominion of our bank accounts should excess borrowing availability fall below \$5.0 million over the FCCR testing threshold, or \$16.9 million at September 30, 2011. This right does not change our ability to borrow on the credit facility in any manner nor does it make the underlying debt callable by the lender, however, under ASC 470, Debt , if the excess availability were to fall below the dominion threshold, we would be required to reclassify long-term debt to current debt on its balance sheet.

We believe that cash generated from its operations and funds available under the credit facility will provide sufficient funds to meet its currently anticipated short-term and long-term liquidity and capital expenditure requirements. In the first nine months of 2011, the minimum FCCR was not required to be tested as excess borrowing availability was greater than the minimum threshold. However, if availability would have fallen below that threshold, we would not have met the minimum FCCR. If we are unable to maintain excess borrowing availability of more than the applicable amount in the range of \$10.0 million to \$15.0 million and were also unable to comply with this financial covenant, our lenders would have the right, but not the obligation, to terminate the loan commitments and accelerate the repayment of the entire amount outstanding under the credit facility. The lenders could also foreclose on our assets that secure the credit facility. In that event, we would be forced to seek alternative sources of financing, which may not be available on terms acceptable to it, or at all.

## **Off-Balance Sheet Arrangements**

In addition to funds available from operating cash flows and the credit facility as described above, we use operating leases as a principal off-balance sheet financing technique. Operating leases are employed as an alternative to purchasing certain property, plant and equipment. For a discussion of our off-balance sheet arrangements, see our Annual Report on Form 10-K for the year ended December 31, 2010 in Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations-Commitments and Contingencies. There were no material changes to our off-balance sheet arrangements discussed in our Annual Report on Form 10-K for the year ended December 31, 2010.

## **Contingencies**

We carry insurance policies on insurable risks with coverage and other terms that we believe to be appropriate. We generally have self-insured retention limits and have obtained fully insured layers of coverage above such self-insured retention limits. Accruals for self-insurance losses are made based on claims experience. Liabilities for existing and unreported claims are accrued for when it is probable that future costs will be incurred and can be reasonably estimated.

---

## **Table of Contents**

In 1995, we were identified as a potentially responsible party in connection with the clean up of contamination at a formerly owned property in Montana that was used for the manufacture of wood windows. We are voluntarily remediating this property under the oversight of and in cooperation with the Montana Department of Environmental Quality ( Montana DEQ ) and are complying with a 1995 unilateral administrative order of the Montana DEQ to complete a remedial investigation and feasibility study. The remedial investigation was completed and approved in 1998 by the Montana DEQ, which has issued its final risk assessment of this property. In March 2003, the Montana DEQ approved Huttig's work plan for conducting a feasibility study to evaluate alternatives for cleanup. In July 2004, we submitted the feasibility study report, which evaluated several potential remedies, including continuation and enhancement of remedial measures already in place and operating. Huttig also submitted plans for testing a newer technology that could effectively remediate the site. The Montana DEQ approved these plans and a pilot test of the remediation technology was completed in July 2007. The Montana DEQ is in the process of reviewing the results of the pilot test. After evaluating the results of the pilot test, the Montana DEQ will comment on the feasibility study report and its recommended remedy, and then will select a final remedy, publish a record of decision and negotiate with us for an administrative order of consent on the implementation of the final remedy. We spent less than \$0.4 million on remediation costs at this site for the nine months ended September 30, 2011 and 2010. The annual level of future remediation expenditures is difficult to estimate because of the uncertainty relating to the final remedy to be selected by the Montana DEQ. As of September 30, 2011, the Company has accrued \$0.7 million in Other non-current liabilities for future costs of remediating this site, which management believes represents a reasonable estimate, based on current facts and circumstances, of the currently expected costs of remediation. Until the Montana DEQ selects a final remedy, however, management cannot estimate the top of the range of loss or cost to Huttig of the final remediation order.

In addition, some of our current and former distribution centers are located in areas of current or former industrial activity where environmental contamination may have occurred, and for which we, among others, could be held responsible. We currently believe that there are no material environmental liabilities at any of our distribution center locations.

In October 2011, one of the Company's vehicles was involved in an accident resulting in two fatalities. As of the date of the filing of this report, the Company's investigation into the scope of its liability, if any, in connection with the accident is in the preliminary stages. In addition, as of the date of the filing of this report, to the Company's knowledge, no lawsuits have been filed against the Company relating to the accident, and no claims otherwise have been overtly asserted against the Company. In the event that the Company were to incur any liability as a result of the accident, the Company believes that its financial exposure, if any, would be covered by the Company's insurance policies and limited by the underlying deductibles on those policies.

We accrue expenses for contingencies when it is probable that an asset has been impaired or a liability has been incurred and management can reasonably estimate the expense. Contingencies for which we have made accruals include environmental, product liability and other legal matters. It is possible, however, that future results of operations for any particular quarter or annual period and our financial condition could be materially affected by changes in assumptions or other circumstances related to these matters.

## **Cautionary Statement**

Certain statements in this Quarterly Report on Form 10-Q contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including but not limited to statements regarding:

our belief that there are no material environmental liabilities at any of our distribution center locations;

our expectation that the severe downturn in new residential construction will continue to adversely affect our operating results in 2011;

our expectation that the pricing pressure in the down housing market will continue through the remainder of 2011;

our belief that cash generated from our operations and funds available under our credit facility will provide sufficient funds to meet our currently anticipated short-term liquidity and long-term liquidity and capital expenditure requirements;



**Table of Contents**

our belief that we have the product offerings, warehouse and support facilities, personnel, systems infrastructure and financial and competitive resources necessary for continued business success; and

cyclical and seasonal trends.

The words or phrases will likely result, are expected to, will continue, is anticipated, estimate, project, believe or similar expressions in forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

These statements present management's expectations, beliefs, plans and objectives regarding our future business and financial performance. These forward-looking statements are based on current projections, estimates, assumptions and judgments, and involve known and unknown risks and uncertainties. There are a number of factors that could cause our actual results to differ materially from those expressed or implied in the forward-looking statements. These factors include, but are not limited to, the following:

the strength of the national and local new residential construction and home improvement and remodeling markets, which in turn depend on factors such as:

interest rates;

immigration patterns;

unemployment rates;

job and household formation;

household prices;

tax policy;

regional demographics;

employment levels;

availability of credit;

inventory levels of new and existing homes for sale;

prices of wood and steel-based products; and

## Edgar Filing: HUTTIG BUILDING PRODUCTS INC - Form 10-Q

consumer confidence;

the level of competition in our industry;

our relationships with suppliers of the products we distribute;

our ability to comply with availability requirements and the financial covenant under our revolving credit facility;

the financial condition and credit worthiness of our customers;

fluctuation in prices of wood and steel-based products;

fuel cost;

cyclical and seasonal trends;

costs of complying with laws and regulations including environmental and recent healthcare reform, the effects of which on the Company remain under review;

our exposure to product liability claims;

**Table of Contents**

our ability to attract and retain key personnel;

risk of losses associated with accidents;

costs of complying with federal and state transportation regulations, as well as fluctuations in the cost of fuel; and

accuracy of our assumptions underlying our projections of future taxable income, including available tax planning strategies. We disclaim any obligation to publicly update or revise any of these forward-looking statements.

**Table of Contents****ITEM 4 CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures** The Company, under the supervision and with the participation of our Disclosure Committee and management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities and Exchange Act of 1934). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective as of September 30, 2011.

**Changes in Internal Control of Financial Reporting** There have been no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2011, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION****ITEM 1 LEGAL PROCEEDINGS**

See Note 4 Contingencies of the Notes to Condensed Consolidated Financial Statements (unaudited) in Item 1 for information on legal proceedings in which the Company is involved. See also Part I, Item 3 Legal Proceedings in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

**ITEM 5 OTHER INFORMATION*****Salary and Director Fee Reductions***

In connection with its ongoing cost containment initiatives, the Company is instituting a 10% reduction in the annual base salaries of certain employees, including each of its executive officers, effective November 21, 2011. The reductions are being made in response to the continued prolonged decline in housing market activity.

The reduction in the salary of Mr. Jon P. Vrabely, the Company's President and Chief Executive Officer, was approved by the Company's Board of Directors (the Board) on October 27, 2011. The current and reduced salaries for each of the Company's named executive officers are as follows:

Name	Current Base Salary	Base Salary after 10% Reduction
Jon Vrabely	\$ 400,000	\$ 360,000
Phil Keipp	\$ 250,000	\$ 225,000
Greg Gurley	\$ 225,000	\$ 202,500

The Board also approved, on October 27, 2011, (i) the execution by the Company of an amendment to Mr. Vrabely's employment agreement to reflect the above-described reduction and to provide that any severance benefits payable thereunder shall be calculated without regard to such salary reduction, and (ii) the execution by the Company of amendments to each of the existing change of control agreements with the other executive officers to provide that any severance benefits payable thereunder shall be calculated without regard to the above-described salary reductions.

In addition, in October 2011 the Board approved a 10% reduction in the cash compensation paid to non-employee directors, effective December 1, 2011.

***Amendment to Credit Agreement***

Effective October 31, 2011, the Company entered into an amendment to its \$120.0 million amended and restated revolving credit agreement. The First Amendment to Amended and Restated Credit Agreement (the Amendment): (i) reduces the threshold at which the lenders have the right to assert cash dominion over the Company's bank accounts from \$20.0 million to a range of \$15.0 million to \$20.0 million depending on the Company's borrowing availability, and (ii) reduces the threshold at which such right terminates from \$25.0 million in borrowing availability for 90 consecutive days to \$20.0 million in borrowing availability for 90 consecutive days. In addition, pursuant to the Amendment, the Company



## Edgar Filing: HUTTIG BUILDING PRODUCTS INC - Form 10-Q

has agreed to obtain appraisals on six of its owned properties within sixty days after the date of the Amendment.

The foregoing summary of the Amendment is qualified in its entirety by reference to the full text of the Amendment attached hereto as Exhibit 10.3 and incorporated herein by reference.

---

**Table of Contents**

**ITEM 6 EXHIBITS**

<b>Exhibit Number</b>	<b>Description</b>
3.1	Restated Certificate of Incorporation of the Company (Incorporated by reference to Exhibit 3.1 to the Form 10 filed with the Securities and Exchange Commission on September 21, 1999).
3.2	Amended and Restated Bylaws of the Company (as of September 26, 2007) (Incorporated by reference to Exhibit 3.1 to the Form 8-K filed with the Securities and Exchange Commission on September 28, 2007).
10.1*	Amendment No. 3 to Amended and Restated Executive Agreement between Huttig Building Products, Inc. and Jon Vrabely effective as of November 21, 2011
10.2*	Form of letter amendment to change in control agreements dated November 21, 2011
10.3	First Amendment to Amended and Restated Credit Agreement dated as of October 31, 2011 among the Company, Huttig, Inc., General Electric Capital Corporation and the other lenders signatory thereto.
31.1	Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.

\* Management plan or compensatory arrangement.

**Table of Contents**

**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.

HUTTIG BUILDING PRODUCTS, INC.

*/s/ JON P. VRABELY*

Date: November 2, 2011

Jon P. Vrabely  
President and Chief Executive Officer  
(Principal Executive Officer)

HUTTIG BUILDING PRODUCTS, INC.

*/s/ PHILIP W. KEIPP*

Date: November 2, 2011

Philip W. Keipp  
Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
10.1*	Amendment No. 3 to Amended and Restated Executive Agreement between Huttig Building Products, Inc. and Jon Vrabely effective as of November 21, 2011
10.2*	Form of letter amendment to change in control agreements dated November 21, 2011
10.3	First Amendment to Amended and Restated Credit Agreement dated as of October 31, 2011 among the Company, Huttig, Inc., General Electric Capital Corporation and the other lenders signatory thereto.
31.1	Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.

\* Management plan or compensatory arrangement.