

# **BUILDERS FIRSTSOURCE, INC.**

## **FORM 10-Q** (Quarterly Report)

Filed 08/05/16 for the Period Ending 06/30/16

Address	2001 BRYAN STREET, SUITE 1600 DALLAS, TX 75201
Telephone	(214) 880-3500
CIK	0001316835
Symbol	BLDR
SIC Code	5211 - Lumber and Other Building Materials Dealers
Industry	Retail (Home Improvement)
Sector	Services
Fiscal Year	12/31

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

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**Form 10-Q**

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

For the quarterly period ended June 30, 2016

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-51357

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**BUILDERS FIRSTSOURCE, INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**2001 Bryan Street, Suite 1600**  
**Dallas, Texas**  
(Address of principal executive offices)

**52-2084569**  
(I.R.S. Employer  
Identification No.)

**75201**  
(Zip Code)

**(214) 880-3500**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

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

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

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**BUILDERS FIRSTSOURCE, INC.**

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

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

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

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

	June 30, 2016	December 31, 2015
	(Unaudited)	
	(In thousands, except per share amounts)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 6,192	\$ 65,063
Accounts receivable, less allowance of \$9,683 and \$8,049 at June 30, 2016 and December 31, 2015, respectively	667,905	528,544
Other receivables	37,583	57,778
Inventories, net	578,776	513,045
Other current assets	28,429	29,899
Total current assets	1,318,885	1,194,329
Property, plant and equipment, net	698,969	734,329
Assets held for sale	9,063	5,585
Goodwill	740,411	739,625
Intangible assets, net	174,908	189,604
Other assets, net	22,954	18,566
Total assets	\$ 2,965,190	\$ 2,882,038
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Checks outstanding	\$ 39,458	\$ 46,833
Accounts payable	482,629	365,347
Accrued liabilities	246,564	293,905
Current maturities of long-term debt and lease obligations	28,540	29,153
Total current liabilities	797,191	735,238
Long-term debt and lease obligations, net of current maturities, debt discount and deferred loan costs	1,909,823	1,922,518
Other long-term liabilities	89,055	75,087
Total liabilities	2,796,069	2,732,843
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, \$0.01 par value, 10,000 shares authorized; zero shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	—	—
Common stock, \$0.01 par value, 200,000 shares authorized; 110,839 and 109,726 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	1,108	1,097
Additional paid-in capital	519,256	511,802
Accumulated deficit	(351,243)	(363,704)
Total stockholders' equity	169,121	149,195
Total liabilities and stockholders' equity	\$ 2,965,190	\$ 2,882,038

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

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

	Six months ended June 30,	
	2016	2015
	(Unaudited) (In thousands)	
Cash flows from operating activities:		
Net income (loss)	\$ 12,461	\$ (3,494)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	61,349	6,782
Asset impairments	1,357	—
Amortization of deferred loan costs	3,721	1,232
Amortization of debt discount	363	—
Gain on extinguishment of debt	(7,065)	—
Accretion of lease finance obligation	456	—
Fair value adjustment of stock warrants	—	4,563
Deferred income taxes	6,650	28
Bad debt expense	(87)	161
Stock compensation expense	5,127	3,369
Net gain on sale of assets	(361)	(114)
Changes in assets and liabilities, net of assets acquired and liabilities assumed:		
Receivables	(124,728)	(37,194)
Inventories	(67,472)	(6,976)
Other current assets	3,448	2,942
Other assets and liabilities	3,207	1,046
Accounts payable and checks outstanding	111,741	34,471
Accrued liabilities	(43,016)	10,741
Net cash provided by (used in) operating activities	(32,849)	17,557
Cash flows from investing activities:		
Purchases of property, plant and equipment	(22,672)	(14,331)
Proceeds from sale of property, plant and equipment	923	180
Cash used for acquisitions, net	(3,970)	(5,797)
Net cash used in investing activities	(25,719)	(19,948)
Cash flows from financing activities:		
Borrowings under revolving credit facility	479,000	25,000
Repayments under revolving credit facility	(435,000)	—
Repayments of long-term debt and other loans	(42,189)	(36)
Payments of loan costs	(4,452)	—
Payments of transaction costs	—	(326)
Exercise of stock options	3,430	1,117
Repurchase of common stock	(1,092)	(986)
Net cash provided by (used in) financing activities	(303)	24,769
Net change in cash and cash equivalents	(58,871)	22,378
Cash and cash equivalents at beginning of period	65,063	17,773
Cash and cash equivalents at end of period	\$ 6,192	\$ 40,151

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

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

**1. Basis of Presentation**

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

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

The condensed consolidated balance sheet as of December 31, 2015 is derived from the audited consolidated financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. This condensed consolidated balance sheet as of December 31, 2015 and the unaudited condensed consolidated financial statements included herein should be read in conjunction with the more detailed audited consolidated financial statements for the year ended December 31, 2015 included in our most recent annual report on Form 10-K. Accounting policies used in the preparation of these unaudited condensed consolidated financial statements are consistent with the accounting policies described in the Notes to Consolidated Financial Statements included in our Form 10-K.

***Recent Accounting Pronouncements***

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

In February 2016, the FASB issued an update to the existing guidance under *Leases* topic. Under the new guidance, lessees will be required to recognize the following for all leases, with the exception of short-term leases, at the commencement date: (1) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. This update requires a modified retrospective transition as of the beginning of the earliest comparative period presented in the financial statements. This update is effective for public companies for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. We are currently evaluating the impact of this guidance on our financial statements.

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

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

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

## **2. Acquisitions**

### ***ProBuild Acquisition***

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

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

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



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

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

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

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

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

	<u>Three Months Ended</u> <u>June 30, 2015</u>	<u>Six Months Ended</u> <u>June 30, 2015</u>
	(Unaudited pro-forma)	
	(in thousands, except per share amounts)	
Net sales	\$ 1,627,840	\$ 2,911,966
Net income (loss)	\$ 25,162	\$ (22,533)
Basic net income (loss) per share	\$ 0.23	\$ (0.21)
Diluted net income (loss) per share	\$ 0.22	\$ (0.21)

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

### Alaska Truss Acquisition

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

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

### 3. Net Income (Loss) per Common Share

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

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

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

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

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

#### 4. Debt

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

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

#### *Note Exchange Transactions*

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

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

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

#### *Note Redemption Transaction*

In May 2016 the Company exercised its contractual right to redeem \$35.0 million in aggregate principal amount of 2021 notes at a price of 103.0%, plus accrued and unpaid interest. The redemption transaction was considered to be a debt extinguishment. As such, we recognized a loss of \$1.7 million which was recorded as a component of interest expense in the accompanying condensed consolidated statements of operations and comprehensive income (loss) in the second quarter of 2016. Of this \$1.7 million loss, \$1.0 million was attributable to the payment of the redemption premium and \$0.7 million was attributable to the write-off of unamortized debt issuance costs associated with the redeemed notes.

#### *2015 Facility Borrowings*

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

#### *Fair Value*

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

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

Derivative Not Designated as Hedging Instrument	Location of Loss Recognized in Income	Amount of Loss Recognized in Income			
		Three Months Ended June 30,		Six Months Ended June 30,	
		2016	2015	2016	2015
Warrants	Interest expense, net	\$ —	\$ 4,730	\$ —	\$ 4,563

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

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

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

## 5. Employee Stock-Based Compensation

### *Time Based Restricted Stock Unit Grants*

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

### *Performance and Service Condition Based Restricted Stock Unit Grants*

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

### *Market and Service Condition Based Restricted Stock Unit Grants*

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

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

The expected volatilities are based on the historical volatilities of our common stock and the common stocks of the constituents of the Company's peer group over the most recent period equal to the measurement period. The expected dividend yield is based on our history of not paying regular dividends in the past and our current intention to not pay regular dividends in the foreseeable future. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant and has a term equal to the measurement period.

### **Stock Option Grant**

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

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

The expected life represents the period of time the options are expected to be outstanding. We used the simplified method for determining the expected life assumption due to limited historical exercise experience on our stock options. The expected volatility is based on the historical volatility of our common stock over the most recent period equal to the expected life of the option. The expected dividend yield is based on our history of not paying regular dividends in the past and our current intention to not pay regular dividends in the foreseeable future. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant and has a term equal to the expected life of the options.

## **6. Income Taxes**

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

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

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

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

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

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

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

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

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

## **7. Commitments and Contingencies**

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

## **8. Segment and Product Information**

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

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

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

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

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

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

Reportable segments	Six months ended June 30, 2016			
	Net Sales	Depreciation & Amortization	Interest	Income (loss) before income taxes
Northeast	\$ 583,785	\$ 10,889	\$ 8,758	\$ 15,082
Southeast	676,074	6,414	9,247	17,485
South	840,222	12,146	10,961	33,981
West	909,797	19,517	13,238	26,998
<b>Total reportable segments</b>	<b>3,009,878</b>	<b>48,966</b>	<b>42,204</b>	<b>93,546</b>
All other	64,537	12,383	35,823	(72,371)
<b>Total consolidated</b>	<b>\$ 3,074,415</b>	<b>\$ 61,349</b>	<b>\$ 78,027</b>	<b>\$ 21,175</b>

**Three months ended June 30, 2015**

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

**Six months ended June 30, 2015**

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	Lumber & lumber sheet goods	\$ 557,314	\$ 140,302	\$ 1,016,221
Windows, doors & millwork	342,589	137,959	649,380	253,416
Manufactured products	291,110	102,639	531,859	181,480
Gypsum, roofing & insulation	139,769	13,021	251,781	23,408
Siding, metal & concrete products	149,471	11,253	268,395	20,278
Other building products & services	197,047	56,347	356,779	99,317
Net sales	<u>\$ 1,677,300</u>	<u>\$ 461,521</u>	<u>\$ 3,074,415</u>	<u>\$ 832,507</u>

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

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



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

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

### Cautionary Statement

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

## COMPANY OVERVIEW

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

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

We group our building products into six product categories:

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

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

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

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

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

## RECENT DEVELOPMENTS

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

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

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

## CURRENT OPERATING CONDITIONS AND OUTLOOK

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

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

Our net sales for the second quarter of 2016 were up 263% over the same period last year largely due to the acquisition of ProBuild. Our gross margin percentage increased by 0.9% during the second quarter of 2016 compared to the second quarter of 2015. Our gross margin percentage increased primarily due to the ProBuild acquisition, as well as improved profitability in our value-added product categories in the second quarter of 2016 compared to the second quarter of 2015. We made significant changes to our business during the downturn that have improved our operating efficiency and allowed us to better leverage our operating costs against changes in net sales. We intend to implement similar changes in ProBuild’s business activities to the extent feasible. Our selling, general and administrative expenses, as a percentage of net sales, were 20.4% in the second quarter of 2016, a 0.1% decrease from 20.5% in the second quarter of 2015. Selling, general and administrative expenses as a percentage of net sales remained consistent primarily due to the ProBuild acquisition and the continuing integration activities.

We still believe that the long-term outlook for the housing industry is positive due to growth in the underlying demographics. We feel we are well-positioned to take advantage of the construction activity in our markets and to increase our market share, which may include strategic acquisitions. We will continue to focus on working capital by closely monitoring the credit exposure of our customers and by working with our vendors to improve our payment terms and pricing on our products. We will also continue to work diligently to achieve the appropriate balance of short-term expense control while maintaining the expertise and capacity to grow the business as market conditions improve. We want to create long-term shareholder value and avoid taking steps that will limit our ability to compete.

## **SEASONALITY AND OTHER FACTORS**

Our first and fourth quarters have historically been, and are generally expected to continue to be, adversely affected by weather causing reduced construction activity during these quarters. 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 historically have been financed through available cash and borrowing availability under credit facilities. Collection of receivables and reduction in inventory levels following the peak building and construction season have in the past positively impacted cash flow.

## RESULTS OF OPERATIONS

The following table sets forth, for the three and six months ended June 30, 2016 and 2015, the percentage relationship to net sales of certain costs, expenses and income items:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	75.1%	76.0%	75.0%	76.7%
Gross margin	24.9%	24.0%	25.0%	23.3%
Selling, general and administrative expenses	20.4%	20.5%	21.8%	21.3%
Income from operations	4.5%	3.5%	3.2%	2.0%
Interest expense, net	2.6%	2.7%	2.5%	2.4%
Income tax expense (benefit)	0.2%	(0.0)%	0.3%	(0.0)%
Net income (loss)	1.7%	0.8%	0.4%	(0.4)%

### Three Months Ended June 30, 2016 Compared with the Three Months Ended June 30, 2015

*Net Sales.* Net sales for the three months ended June 30, 2016 were \$1,677.3 million, a 263% increase over net sales of \$461.5 million for the three months ended June 30, 2015. Net sales increased \$1,189.4 million, or approximately 258%, due to the ProBuild acquisition. Excluding the impact of the ProBuild acquisition, we estimate net sales increased \$26.4 million, or approximately 6% due to increased volume, which was partially offset by a 1% decrease due to the impact of commodity price deflation on net sales. According to the U.S. Census Bureau, actual U.S. single-family housing starts increased 7.3% and single-family units under construction increased 16.2% in the second quarter of 2016 compared to the second quarter of 2015.

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

	Three Months Ended June 30,					
	2016		2015		% Change	
	Net Sales	% of Net Sales	Net Sales	% of Net Sales		
Lumber & lumber sheet goods	\$ 557.3	33.2%	\$ 140.3	30.4%	297.2%	
Windows, doors & millwork	342.6	20.4%	138.0	29.9%	148.3%	
Manufactured products	291.1	17.4%	102.6	22.2%	183.6%	
Gypsum, roofing & insulation	139.8	8.3%	13.0	2.8%	973.4%	
Siding, metal & concrete products	149.5	8.9%	11.3	2.4%	1,228.3%	
Other building products & services	197.0	11.8%	56.3	12.3%	249.7%	
Net sales	\$ 1,677.3	100.0%	\$ 461.5	100.0%	263.4%	

Due to the ProBuild acquisition, we achieved increased net sales across all product categories. Our sales classification by product categories has shifted as we diversified our product offerings to support a broader customer mix across 40 states through the ProBuild acquisition. Excluding ProBuild, net sales increased across all product categories primarily due to increased sales volume.

*Gross Margin.* Gross margin increased \$307.7 million to \$418.3 million. Of this increase, \$303.1 million is due to the ProBuild acquisition. Excluding ProBuild, gross margin increased \$4.6 million. Our gross margin percentage increased to 24.9% in the second quarter of 2016 from 24.0% in the second quarter of 2015, a 0.9% increase. Our gross margin percentage increased primarily due to the ProBuild acquisition, as well as improved profitability in our value-added product categories in the second quarter of 2016 compared to the second quarter of 2015.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses increased \$247.2 million, or 261.2%, largely due to the ProBuild acquisition. Our salaries and benefits expense, excluding stock compensation expense, was \$224.5 million, an increase of \$167.8 million from the second quarter of 2015 primarily due to increased full time equivalent employees following the ProBuild acquisition. Delivery expense increased \$34.8 million, office general and administrative expense increased \$24.0 million, occupancy expense increased \$17.6 million and intangible asset amortization increased \$5.2 million. These increases were primarily a result of the ProBuild acquisition, the related integration activities and increased sales volume.

As a percentage of net sales, selling, general and administrative expenses were 20.5 % in the second quarter of 2015 compared to 20.4 % in the second quarter of 2016. As a percentage of net sales, salaries and benefits expense, excluding stock compensation expense, increased 1.1 %, intangible asset amortization expense increased 0.2 % and occupancy expense increased 0.1 %. These increases were partially offset by a 0.9 % decrease in office general and administrative expense and a 0.2 % decrease in delivery expense. The increase in selling, general and administrative expenses, as a percentage of net sales, was primarily due to the factors discussed above.

*Interest Expense, Net.* Interest expense was \$42.8 million in the second quarter of 2016, an increase of \$30.2 million from the second quarter of 2015. Of the \$30.2 million increase, \$26.1 million was attributable to increased interest expense associated with our increased debt balances following the ProBuild acquisition financing, \$5.8 million was due to lease finance obligations assumed in the ProBuild acquisition, \$2.0 million was related to increased amortization and write-off of debt discount and debt issuance costs and \$1.0 million was due to the payment of the redemption premium on the 2021 notes redeemed in the second quarter of 2016. These increases were partially offset by a \$4.7 million decrease in interest expense due to non-cash fair value adjustments related to the exercise of all remaining stock warrants in the second quarter of 2015.

*Income Tax Expense.* We recorded income tax expense of \$4.2 million in the second quarter of 2016 compared to an income tax benefit of \$0.2 million in the second quarter of 2015. We recorded a reduction of the after-tax, non-cash valuation allowance on our net deferred tax assets of \$16.0 million and \$1.3 million in the second quarters of 2016 and 2015, respectively. Absent the valuation allowance, our effective tax rate would have been 41.9% and 33.2% in the second quarters of 2016 and 2015, respectively.

### **Six Months Ended June 30, 2016 Compared with the Six Months Ended June 30, 2015**

*Net Sales.* Net sales for the six months ended June 30, 2016 were \$3,074.4 million, a 269% increase over net sales of \$832.5 million for the six months ended June 30, 2015. Net sales increased \$2,172.6 million, or approximately 261%, due to recent acquisitions, primarily ProBuild. Excluding the impact of acquisitions, we estimate net sales increased \$69.3 million, or approximately 12%, due to increased volume, which was partially offset by a 4% decrease due to the impact of commodity price deflation on net sales. According to the U.S. Census Bureau, actual U.S. single-family housing starts increased 13.1% and single-family units under construction increased 17.0% in the first six months of 2016 compared to the first six months of 2015.

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

	Six Months Ended June 30,				% Change
	2016		2015		
	Net Sales	% of Net Sales	Net Sales	% of Net Sales	
Lumber & lumber sheet goods	\$ 1,016.2	33.1%	\$ 254.6	30.6%	299.1%
Windows, doors & millwork	649.4	21.1%	253.4	30.4%	156.3%
Manufactured products	531.8	17.3%	181.5	21.8%	193.1%
Gypsum, roofing & insulation	251.8	8.2%	23.4	2.8%	975.6%
Siding, metal & concrete products	268.4	8.7%	20.3	2.4%	1,223.6%
Other building products & services	356.8	11.6%	99.3	12.0%	259.2%
Net sales	\$ 3,074.4	100.0%	\$ 832.5	100.0%	269.3%

Due to the ProBuild acquisition, we achieved increased net sales across all product categories. Our sales classification by product categories has shifted as we diversified our product offerings to support a broader customer mix across 40 states through the ProBuild acquisition. Excluding ProBuild, net sales increased across all product categories primarily due to increased sales volume.

*Gross Margin.* Gross margin increased \$573.7 million to \$768.1 million. Of this increase, \$554.1 million is due to the ProBuild acquisition. Excluding ProBuild, gross margin increased \$19.6 million. Our gross margin percentage increased to 25.0% in the first six months of 2016 from 23.3% in the first six months of 2015, a 1.7% increase. Our gross margin percentage increased primarily due to the ProBuild acquisition, as well as improved profitability in our value-added product categories in the first six months of 2016 compared to the first six months of 2015.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses increased \$491.2 million, or 276.5%, largely due to the ProBuild acquisition. Our salaries and benefits expense, excluding stock compensation expense, was \$436.2 million, an increase of \$331.1 million from the first six months of 2015 primarily due to increased full time equivalent employees following the ProBuild acquisition. Delivery expense increased \$68.9 million, office general and administrative expense increased \$47.1 million, occupancy expense increased \$36.5 million and intangible asset amortization increased \$10.7 million. These increases were primarily a result of the ProBuild acquisition, the related integration activities and increased sales volume.

As a percentage of net sales, selling, general and administrative expenses increased from 21.3% in the first six months of 2015 to 21.8% in the first six months of 2016. As a percentage of net sales, salaries and benefits expense, excluding stock compensation expense, increased 1.6%, intangible asset amortization expense increased 0.2% and occupancy expense increased 0.1%. These increases were partially offset by a 0.9% decrease in office general and administrative expense and a 0.2% decrease in delivery expense. The increase in selling, general and administrative expenses, as a percentage of net sales, was primarily due to the factors discussed above.

**Interest Expense, Net.** Interest expense was \$78.0 million in the first six months of 2016, an increase of \$57.8 million from the first six months of 2015. Of the \$57.8 million increase, \$53.8 million was attributable to increased interest expense associated with our increased debt balances following the ProBuild acquisition financing, \$11.8 million was due to lease finance obligations assumed in the ProBuild acquisition and \$10.5 million was related to non-cash interest expense primarily due to \$7.7 million in write offs of debt issuance costs on extinguished debt in the first six months of 2016 as well as increased debt discount and debt issuance cost amortization. These increases were partially offset by a \$13.7 million gain on debt extinguishment largely due to a reduction in principal as a result of the debt exchange transactions in the first quarter of 2016 as well as a \$4.6 million decrease in interest expense due to non-cash fair value adjustments related to the exercise of all remaining stock warrants in 2015.

**Income Tax Expense.** We recorded income tax expense of \$8.7 million during the six months ended June 30, 2016 compared to an income tax benefit of \$0.0 million during the six months ended June 30, 2015. We recorded a reduction of the after-tax, non-cash valuation allowance on our net deferred tax assets of \$10.9 million during the six months ended June 30, 2016 compared to an increase of \$1.8 million during the six months ended June 30, 2015. Absent the valuation allowance, our effective tax rate would have been 42.4% and 50.5% for the six months ended June 30, 2016 and 2015, respectively.

### Results by Reportable Segment

The following table shows net sales and income (loss) from continuing operations before income taxes by reportable segment (dollars in thousands):

	Three months ended June 30,									
	Net sales					Income (loss) before income taxes				
	2016	% of net sales	2015	% of net sales	% change	2016	% of net sales	2015	% of net sales	% change
Northeast	\$ 325,765	19.8%	\$ 68,424	15.9%	376.1%	\$ 12,460	3.8%	\$ 4,288	6.3%	190.6%
Southeast	364,954	22.2%	193,525	44.9%	88.6%	11,652	3.2%	5,078	2.6%	129.5%
South	430,893	26.2%	169,226	39.2%	154.6%	18,982	4.4%	4,568	2.7%	315.5%
West	523,537	31.8%	—	—	—	28,407	5.4%	—	—	—
	<u>\$ 1,645,149</u>	<u>100.0%</u>	<u>\$ 431,175</u>	<u>100.0%</u>		<u>\$ 71,501</u>	<u>4.3%</u>	<u>\$ 13,934</u>	<u>3.2%</u>	

	Six months ended June 30,									
	Net sales					Income (loss) before income taxes				
	2016	% of net sales	2015	% of net sales	% change	2016	% of net sales	2015	% of net sales	% change
Northeast	\$ 583,785	19.4%	\$ 111,909	14.4%	421.7%	\$ 15,082	2.6%	\$ 3,637	3.2%	314.7%
Southeast	676,074	22.5%	340,994	44.0%	98.3%	17,485	2.6%	3,382	1.0%	417.0%
South	840,222	27.9%	321,957	41.6%	161.0%	33,981	4.0%	7,222	2.2%	370.5%
West	909,797	30.2%	—	—	—	26,998	3.0%	—	—	—
	<u>\$ 3,009,878</u>	<u>100.0%</u>	<u>\$ 774,860</u>	<u>100.0%</u>		<u>\$ 93,546</u>	<u>3.1%</u>	<u>\$ 14,241</u>	<u>1.8%</u>	

As a result of our reorganization following the ProBuild acquisition, we now have four reportable segments based on an aggregation of the geographic regions in which we operate. We achieved increased net sales and profitability across all our reportable segments, primarily due to the ProBuild acquisition and sales volume increases. According to the U.S. Census Bureau actual single-family housing starts in the second quarter of 2016 increased 10.1% and 22.0% in the South region and Northeast region, respectively. According to the U.S. Census Bureau actual single-family housing starts in the first six months of 2016 increased 13.3% and 28.5% in the South region and Northeast region, respectively. The West reportable segment operations were acquired through the ProBuild acquisition.

## LIQUIDITY AND CAPITAL RESOURCES

Our primary capital requirements are to fund working capital needs and operating expenses, meet required interest and principal payments, and to fund capital expenditures and potential future acquisitions. Our capital resources at June 30, 2016 consist of cash on hand and borrowing availability under our revolving credit facility.

Our \$800.0 million senior secured revolving credit facility (“2015 facility”) will be primarily used for working capital, general corporate purposes, and funding acquisitions. In addition, we may use the 2015 facility to facilitate debt consolidation. Availability under the 2015 facility is determined by a borrowing base. Our borrowing base consists of trade accounts receivable, inventory, other receivables, including progress billings and credit card receivables, and qualified cash that all meet specific criteria contained within the credit agreement, minus agent specified reserves. Net excess borrowing availability is equal to the maximum borrowing amount minus outstanding borrowings and letters of credit.

The following table shows our borrowing base and excess availability as of June 30, 2016 and December 31, 2015 (in millions):

	As of	
	June 30, 2016	December 31, 2015
Accounts Receivable Availability	\$ 484.9	\$ 384.5
Inventory Availability	354.3	314.3
Other Receivables Availability	32.8	27.0
Gross Availability	872.0	725.8
Less:		
Agent Reserves	(35.5)	(23.5)
Plus:		
Cash in Qualified Accounts	11.8	55.5
Borrowing Base	848.3	757.8
Aggregate Revolving Commitments	800.0	800.0
Maximum Borrowing Amount (lesser of Borrowing Base and Aggregate Revolving Commitments)	800.0	757.8
Less:		
Outstanding Borrowings	(104.0)	(60.0)
Letters of Credit	(85.0)	(79.1)
Net Excess Borrowing Availability on Revolving Facility	\$ 611.0	\$ 618.7

As of June 30, 2016 we had \$104.0 million in outstanding borrowings under our 2015 facility and our net excess borrowing availability was \$611.0 million after being reduced by outstanding letters of credit of approximately \$85.0 million. Excess availability must equal or exceed a minimum specified amount, currently \$80.0 million, or we are required to meet a fixed charge coverage ratio of 1:00 to 1:00. We were not in violation of any covenants or restrictions imposed by any of our debt agreements at June 30, 2016.

### Liquidity

Our liquidity at June 30, 2016 was \$617.2 million, which consists of net borrowing availability under the 2015 facility and cash on hand.

We have substantially increased indebtedness following completion of the ProBuild acquisition in comparison to our indebtedness on a recent historical basis, which will increase our interest expense and could have the effect of, among other things, reducing our flexibility to respond to changing business and economic conditions. From time to time, based on market conditions and



other factors and subject to compliance with applicable laws and regulations, the Company may repurchase or call the 2021 notes or 2023 notes, repay debt, or otherwise enter into transactions regarding its capital structure.

Should the current industry conditions deteriorate or we pursue additional acquisitions, we may be required to raise additional funds through the sale of common stock or debt in the public capital markets or in privately negotiated transactions. There can be no assurance that any of these financing options would be available on favorable terms, if at all. Alternatives to help supplement our liquidity position could include, but are not limited to, idling or permanently closing additional facilities, adjusting our headcount in response to current business conditions, attempts to renegotiate leases, and divesting of non-core businesses. There are no assurances that these steps would prove successful.

### ***Consolidated Cash Flows***

Cash used in operating activities was \$32.8 million for the six months ended June 30, 2016 compared to cash provided by operating activities of \$17.6 million for the six months ended June 30, 2015. Our working capital increased \$120.0 million in the first six months of 2016 compared to a decrease of \$4.0 million in the first six months of 2015. The change in working capital is largely due to the ProBuild acquisition, as well as seasonal increases in receivables and inventory, increased customer demand and a decrease in accrued liabilities. These increases were partially offset by an increase in accounts payable due to increased purchases and increased accounts payable days. Cash interest payments increased \$81.4 million for the six months ended June 30, 2016 compared to the six months ended June 30, 2015. The remaining change is due to an increase in cash provided by operations primarily related to increased sales and profitability during the six months ended June 30, 2016 as a result of higher sales volume and the acquisition of ProBuild.

Cash used in investing activities was \$25.7 million and \$19.9 million for the six months ended June 30, 2016 and 2015, respectively. The change is primarily due to an \$8.3 million increase in capital expenditures during the six months ended June 30, 2016 compared to the six months ended June 30, 2015. The increase in capital expenditures is primarily due to facility relocation, improvements to existing facilities and the purchase of machinery and equipment to support sales growth. Cash used in acquisitions was \$4.0 million and \$5.8 million during the six months ended June 30, 2016 and 2015, respectively.

Cash used in financing activities was \$0.3 million for the six months ended June 30, 2016 compared to cash provided by financing activities of \$24.8 million for the six months ended June 30, 2015. Cash used in financing activities for the six months ended June 30, 2016 is primarily due to \$42.2 million in repayments of long-term debt and \$4.5 million in payments of deferred loan costs, which were mostly offset by \$44.0 million in net borrowings on our 2015 facility. Cash provided by financing activities for the six months ended June 30, 2015 was primarily due to \$25.0 million in borrowings on our previous revolving credit facility.

### **RECENT ACCOUNTING PRONOUNCEMENTS**

Information regarding recent accounting pronouncements is discussed in Note 1 to the condensed consolidated financial statements included in Item 1 of this quarterly report on Form 10-Q.

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

We may experience changes in interest expense if changes in our debt occur. Changes in market interest rates could also affect our interest expense. Our 2021 notes and our 2023 notes bear interest at a fixed rate, therefore, our interest expense related to the 2021 notes and 2023 notes would not be affected by an increase in market interest rates. Borrowings under the 2015 facility and the 2015 term loan bear interest at either a base rate or eurodollar rate, plus, in each case, an applicable margin. At June 30, 2016, a 1.0% increase in interest rates would result in approximately \$1.0 million in additional interest expense annually as we had \$104.0 million in outstanding borrowings under the 2015 facility. The 2015 facility also assesses variable commitment and outstanding letter of credit fees based on quarterly average loan utilization. At June 30, 2016, a 1.0% increase in interest rates on the 2015 term loan would result in approximately \$3.8 million in 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 and the related in-bound freight costs, 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.

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

*Disclosure 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.

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, 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 June 30, 2016, 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 Securities Exchange Act of 1934 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.

On July 31, 2015, the Company acquired all of the operating affiliates of ProBuild Holdings, LLC (“ProBuild”). The Company continues to evaluate processes, information technology systems and other components of internal controls over financial reporting (“ICFR”) as part of its ongoing integration activities and has concluded that ProBuild will be subject to the Company’s 2016 ICFR assessment.

## 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, 2015, 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) The following table provides information with respect to our purchases of Builders FirstSource, Inc. common stock during the second quarter of fiscal year 2016:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet be Purchased Under the Plans or Programs
April 1, 2016 — April 30, 2016	3,647	\$ 11.98	—	—
May 1, 2016 — May 31, 2016	—	—	—	—
June 1, 2016 — June 30, 2016	—	—	—	—
Total	3,647	\$ 11.98	—	—

The shares presented in the above table represent stock tendered in order to meet minimum withholding tax requirements for restricted stock shares vested.

### Item 3. Defaults Upon Senior Securities

(a) None

(b) None

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

(a) Disclosure pursuant to Section 13(r) of the Securities Exchange Act of 1934

Pursuant to Section 13(r) of the Securities Exchange Act of 1934, we may be required to disclose in our annual and quarterly reports to the SEC whether we or any of our “affiliates” knowingly engaged in certain activities, transactions or dealings relating to Iran or with certain individuals or entities targeted by U.S. economic sanctions. Disclosure is generally required even where the activities, transactions or dealings were conducted in compliance with applicable law. Because the SEC defines the term “affiliate” broadly, it includes any entity under common “control” with us (and the term “control” is also construed broadly by the SEC).

The description of the activities below has been provided to us by Warburg Pincus LLC (“WP”), affiliates of which: (i) beneficially owned more than 10% of our outstanding common stock and were members of our board of directors during the quarter and (ii) beneficially own more than 10% of the equity interests of, and have the right to designate members of the board of directors of Santander Asset Management Investment Holdings Limited (“SAMIH”). SAMIH may therefore be deemed to be under common “control” with us. However, this statement is not meant to be an admission that common control exists.

The disclosure below relates solely to activities conducted by SAMIH and its affiliates. The disclosure does not relate to any activities conducted by us or by WP and does not involve our or WP’s management. Neither we nor WP has had any involvement in or control over the disclosed activities. Neither we nor WP has independently verified or participated in the preparation of the disclosure. Neither we nor WP is representing as to the accuracy or completeness of the disclosure nor do we or WP undertake any obligation to correct or update it.

We understand that one or more SEC-reporting affiliates of SAMIH intend to disclose in its next annual or quarterly SEC report that:

(a) Santander UK plc (“Santander UK”) holds two frozen savings accounts and two frozen current accounts for three customers resident in the United Kingdom (“U.K.”) who are currently designated by the United States (“U.S.”) under the Specially Designated Global Terrorist (“SDGT”) sanctions program. The accounts held by each customer were blocked after the customer’s designation and have remained blocked and dormant through the first half of 2016. Revenue generated by Santander UK on these accounts in the first half of 2016 was £7.31 whilst net profits in the first half of 2016 were negligible relative to the overall profits of Banco Santander SA.

(b) An Iranian national, resident in the U.K., who is currently designated by the U.S. under the Iranian Financial Sanctions Regulations (“IFSR”) and the Weapons of Mass Destruction Proliferators Sanctions Regulations, held a mortgage with Santander UK that was issued prior to any such designation. The mortgage account was redeemed and closed on April 13, 2016. No further drawdown has been made (or would be allowed) under this mortgage although Santander UK continued to receive repayment instalments prior to redemption. In the first half of 2016, total revenue generated by Santander UK in connection with the mortgage was £434.64 whilst net profits were negligible relative to the overall profits of Banco Santander SA. Santander UK does not intend to enter into any new relationships with this customer, and any disbursements will only be made in accordance with applicable sanctions. The same Iranian national also held two investment accounts with Santander ISA Managers Limited. The funds within both accounts were invested in the same portfolio fund. The accounts remained frozen until the investments were closed on May 12, 2016 and checks issued to customer on May 13, 2016. Total revenue in the first half of 2016 generated by Santander UK in connection with the investment accounts was £7.60 whilst net profits in the first half of 2016 were negligible relative to the overall profits of Banco Santander SA.

(c) A U.K. national designated by the U.S. under the SDGT sanctions program holds a Santander UK current account. The account remained in arrears through the first half of 2016 (£1,344.01 in debit) and is currently being managed by Santander UK Collections & Recoveries department.

(d) In addition, during the first half of 2016, Santander UK has identified an OFAC match on a power of attorney account. A party listed on the account is currently designated by the U.S. under the SDGT and IFSR sanctions programs. During the first half of 2016, related revenue generated by Santander UK was £129.21 whilst net profits in the first half of 2016 were negligible relative to the overall profits of Banco Santander SA.

(b) None

**Item 6. Exhibits**

<b>Exhibit Number</b>	<b>Description</b>
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 May 29, 2013, among Builders FirstSource, Inc., the guarantors party thereto, and Wilmington Trust Company, as trustee (form of Note included therein) (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, filed with the Securities Exchange Commission on June 3, 2013, File Number 0-51357)
4.3	Supplemental Indenture to the Indenture dated as of May 29, 2013, dated as of July 31, 2015, among the Company, the Guaranteeing Subsidiaries (as defined therein) and Wilmington Trust, National Association, as trustee (incorporated by reference to Exhibit 4.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2015, filed with the Securities and Exchange Commission on August 7, 2015, File Number 0-51357)
4.4	Indenture, dated as of July 31, 2015, among the Company, the Guarantors (as defined therein), and Wilmington Trust, National Association, as trustee (form of Note included therein) (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on August 6, 2015, File Number 0-51357)
4.5	Supplemental Indenture to the Indenture dated as of July 31, 2015, dated as of July 31, 2015, among the Company, the Guaranteeing Subsidiaries (as defined therein) and Wilmington Trust, National Association, as trustee (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on August 6, 2015, File Number 0-51357)
10.1	Amendment to the Builders FirstSource, Inc. 2014 Incentive Plan (incorporated by reference to Appendix A of the Company's Definitive Proxy Statement on Schedule 14A filed with the Securities and Exchange Commission on April 14, 2016, File Number 0-51357)
31.1*	Certification of Chief Executive Officer 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*	Certification of Chief Financial Officer 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**	Certification of Chief Executive Officer and Chief Financial Officer 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
101*	The following financial information from Builders FirstSource, Inc.'s Form 10-Q filed on August 5, 2016, formatted in eXtensible Business Reporting Language ("XBRL"): (i) Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) for the three and six months ended June 30, 2016 and 2015, (ii) Condensed Consolidated Balance Sheets as of June 30, 2016 and December 31, 2015, (iii) Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2016 and 2015 and (iv) the Notes to Condensed Consolidated Financial Statements.

\* Filed herewith.

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

## 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)

August 5, 2016

/s/ M. CHAD CROW

M. Chad Crow  
President, Chief Operating Officer and Chief Financial Officer  
(Principal Financial Officer)

August 5, 2016

/s/ JAMI COULTER

Jami Coulter  
Vice President and Chief Accounting Officer  
(Principal Accounting Officer)

August 5, 2016

**Certification of Chief Executive Officer  
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Floyd F. Sherman, certify that:

1. I have reviewed this report on Form 10-Q of Builders FirstSource, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ FLOYD F. SHERMAN  
Floyd F. Sherman  
Chief Executive Officer

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Date: August 5, 2016

**Certification of Chief Financial Officer  
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, M. Chad Crow, certify that:

1. I have reviewed this report on Form 10-Q of Builders FirstSource, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ M. CHAD CROW

M. Chad Crow

President and Chief Financial Officer

Date: August 5, 2016



**Certification of CEO and CFO Pursuant to 18 U.S.C. Section 1350  
(Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002)**

In connection with the quarterly report of Builders FirstSource, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, Floyd F. Sherman, as Chief Executive Officer of the Company, and M. Chad Crow, as President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to our knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ FLOYD F. SHERMAN

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Floyd F. Sherman  
Chief Executive Officer

/s/ M. CHAD CROW

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M. Chad Crow  
President and Chief Financial Officer

Date: August 5, 2016

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.