

BEACON ROOFING SUPPLY INC  
Form 10-Q  
February 09, 2012

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D. C. 20549**

**FORM 10-Q**

**<sup>x</sup> QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2011**

**OR**

**<sup>o</sup> TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**FOR THE TRANSITION PERIOD FROM TO**

**COMMISSION FILE NO.: 000-50924**

**BEACON ROOFING SUPPLY, INC.**

(Exact name of Registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction of

36-4173371  
(I.R.S. Employer

incorporation or organization) Identification No.)

One Lakeland Park Drive,  
Peabody, Massachusetts 01960  
(Address of principal executive offices) (Zip Code)

**978-535-7668**

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. (Check one):

Large accelerated filer

Accelerated filer

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

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

As of February 1, 2012, there were 46,403,457 outstanding shares of the registrant's common stock, \$.01 par value per share.

**BEACON ROOFING SUPPLY, INC.**

**Quarterly Report on Form 10-Q**

**INDEX**

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**BEACON ROOFING SUPPLY, INC.****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****Consolidated Balance Sheets**

|  | (Unaudited)<br>December 31,<br>2011 | (Unaudited)<br>December 31,<br>2010 | (Note)<br>September 30,<br>2011 |
|--|-------------------------------------|-------------------------------------|---------------------------------|
|  | (Dollars in thousands)              |                                     |                                 |
| Assets   |                                     |                                     |                                 |
| Current assets:  |                                     |                                     |                                 |
| Cash and cash equivalents  | \$ 155,171                          | \$ 175,674                          | \$ 143,027                      |
| Accounts receivable, less allowances of \$14,944 at December 31, 2011, \$12,530 at December 31, 2010, and \$13,816 at September 30, 2011 | 221,665                             | 184,546                             | 280,322                         |
| Inventories  | 193,020                             | 155,190                             | 202,474                         |
| Prepaid expenses and other assets  | 57,083                              | 49,152                              | 37,573                          |
| Deferred income taxes  | 14,881                              | 16,680                              | 15,469                          |
| Total current assets   | 641,820                             | 581,242                             | 678,865                         |
| Property and equipment, net  | 48,537                              | 44,746                              | 47,427                          |
| Goodwill   | 400,140                             | 365,650                             | 380,916                         |
| Other assets, net  | 61,008                              | 48,927                              | 49,756                          |
| Total assets   | \$ 1,151,505                        | \$ 1,040,565                        | \$ 1,156,964                    |
| Liabilities and stockholders' equity   |                                     |                                     |                                 |
| Current liabilities:   |                                     |                                     |                                 |
| Accounts payable   | \$ 149,699                          | \$ 128,121                          | \$ 182,523                      |
| Accrued expenses   | 73,101                              | 49,876                              | 69,906                          |
| Current portion of long-term obligations   | 15,201                              | 16,058                              | 15,605                          |
| Total current liabilities  | 238,001                             | 194,055                             | 268,034                         |
| Senior notes payable, net of current portion   | 300,723                             | 310,932                             | 301,544                         |
| Deferred income taxes  | 39,145                              | 39,885                              | 38,992                          |
| Long-term obligations under equipment financing and other, net of current portion  | 8,909                               | 11,432                              | 9,967                           |
| Commitments and contingencies  |                                     |                                     |                                 |

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Stockholders' equity:

|   |             |              |              |
|---|-------------|--------------|--------------|
| Common stock (voting); \$.01 par value; 100,000,000 shares authorized; 46,397,165 issued and 46,289,132 outstanding at December 31, 2011, 45,858,201 issued and 45,772,718 outstanding at December 31, 2010, and 46,262,140 issued and 46,154,107 outstanding at September 30, 2011 | 463         | 458          | 462          |
| Undesignated preferred stock; 5,000,000 shares authorized, none issued or outstanding   | -           | -            | -            |
| Additional paid-in capital  | 251,623     | 238,778      | 248,260      |
| Retained earnings   | 312,225     | 243,942      | 293,110      |
| Accumulated other comprehensive income (loss)   | 416         | 1,083        | (3,405 )     |
| Total stockholders' equity  | 564,727     | 484,261      | 538,427      |
| Total liabilities and stockholders' equity  | \$1,151,505 | \$ 1,040,565 | \$ 1,156,964 |

Note: The balance sheet at September 30, 2011

has been derived from the audited financial statements at that date

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

**BEACON ROOFING SUPPLY, INC.****Consolidated Statements of Operations**

|   | Three Months Ended December 31, |            |
|---|---------------------------------|------------|
|   | 2011                            | 2010       |
| Unaudited<br>(Dollars in thousands, except per share data)      |                                 |            |
| Net sales   | \$ 489,850                      | \$ 404,793 |
| Cost of products sold   | 372,525                         | 309,983    |
| Gross profit  | 117,325                         | 94,810     |
| Operating expenses  | 82,985                          | 74,970     |
| Income from operations  | 34,340                          | 19,840     |
| Interest expense  | 3,280                           | 3,469      |
| Income before income taxes                                      | 31,060                          | 16,371     |
| Income tax expense  | 11,945                          | 6,319      |
| Net income  | \$ 19,115                       | \$ 10,052  |
| Net income per share:   |                                 |            |
| Basic   | \$ 0.41                         | \$ 0.22    |
| Diluted   | \$ 0.41                         | \$ 0.22    |
| Weighted average shares used in computing net income per share: |                                 |            |
| Basic   | 46,190,888                      | 45,754,466 |
| Diluted   | 46,830,178                      | 46,167,814 |

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

**BEACON ROOFING SUPPLY, INC.****Consolidated Statements of Cash Flows**

|  | Three Months Ended December 31, |            |
|--|---------------------------------|------------|
|  | 2011                            | 2010       |
|  | Unaudited (in thousands)        |            |
| Operating activities:  |                                 |            |
| Net income   | \$ 19,115                       | \$ 10,052  |
| Adjustments to reconcile net income to net cash provided by operating activities:                          |                                 |            |
| Depreciation and amortization  | 6,055                           | 6,453      |
| Stock-based compensation   | 1,747                           | 1,446      |
| Adjustment of liability for contingent consideration   | (1,000)                         | -          |
| Gain on sale of assets   | (209)                           | (325)      |
| Deferred income taxes  | (662)                           | (541)      |
| Changes in assets and liabilities, net of the effects of businesses acquired:                              |                                 |            |
| Accounts receivable  | 71,446                          | 57,367     |
| Inventories  | 20,805                          | 3,528      |
| Prepaid expenses and other assets  | (19,126)                        | (5,282)    |
| Accounts payable and accrued expenses  | (39,195)                        | (15,185)   |
| Net cash provided by operating activities  | 58,976                          | 57,513     |
| Investing activities:  |                                 |            |
| Purchases of property and equipment  | (2,434)                         | (862)      |
| Acquisition of businesses  | (44,396)                        | -          |
| Proceeds from sales of assets  | 223                             | 923        |
| Net cash provided (used) by investing activities   | (46,607)                        | 61         |
| Financing activities:  |                                 |            |
| Repayments under revolving lines of credit, net  | (13)                            | (6)        |
| Repayments under senior notes payable and other, net   | (2,315)                         | (359)      |
| Proceeds from exercises of options   | 1,534                           | 1,109      |
| Income tax benefit from stock-based compensation deductions in excess of the associated compensation costs | 82                              | 88         |
| Net cash provided (used) by financing activities   | (712)                           | 832        |
| Effect of exchange rate changes on cash  | 487                             | 132        |
| Net increase in cash and cash equivalents  | 12,144                          | 58,538     |
| Cash and cash equivalents at beginning of year   | 143,027                         | 117,136    |
| Cash and cash equivalents at end of period   | \$ 155,171                      | \$ 175,674 |
| Cash paid during the year for:   |                                 |            |
| Interest   | \$ 3,145                        | \$ 3,526   |

|                              |       |       |
|------------------------------|-------|-------|
| Income taxes, net of refunds | 4,829 | 2,307 |
|------------------------------|-------|-------|

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



**BEACON ROOFING SUPPLY, INC.**

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

**1. Basis of Presentation**

Beacon Roofing Supply, Inc. (the "Company") prepared the consolidated financial statements following the accounting principles generally accepted in the United States (GAAP) for interim financial information and the requirements of the Securities and Exchange Commission (SEC). As permitted under those rules, certain footnotes or other financial information have been condensed or omitted. The balance sheet as of December 31, 2010 has been presented for a better understanding of the impact of seasonal fluctuations on the Company's financial condition.

In management's opinion, the financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of the Company's financial position and operating results. The results for the three-month period (first quarter) ended December 31, 2011 are not necessarily indicative of the results to be expected for the twelve months ending September 30, 2012 (fiscal year 2012 or "2012").

The three-month period ended December 31, 2011 had 60 business days, while the three-month period ended December 31, 2010 had 62 business days.

You should also read the financial statements and notes included in the Company's fiscal year 2011 ("2011") Annual Report on Form 10-K. The accounting policies used in preparing these financial statements are the same as those described in that Annual Report.

***Adoption of Recent Accounting Pronouncements***

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

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

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

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

**Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)****2. Income per Share**

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

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

|  | Three Months Ended December 31, |            |
|--|---------------------------------|------------|
|  | 2011                            | 2010       |
| Weighted-average common shares outstanding for basic         | 46,190,888                      | 45,754,466 |
| Dilutive effect of stock options and restricted stock awards | 639,290                         | 413,348    |
| Weighted-average shares assuming dilution                    | 46,830,178                      | 46,167,814 |

**3. Stock-Based Compensation**

The Company accounts for employee and non-employee director stock-based compensation using the fair value method of accounting. Compensation cost arising from stock options and restricted stock awards granted to employees and non-employee directors is recognized using the straight-line method over the vesting period, which represents the requisite service or performance period. The Company estimates forfeitures in calculating the expense related to stock-based compensation associated with stock awards. The Company projects the number of restricted shares and units that are expected to vest, based on the related performance measures, in determining the associated stock-based compensation.

The Company recorded stock-based compensation expense of \$1.7 million (\$1.1 million net of tax) and \$1.4 million (\$0.9 million net of tax) in the three months ended December 31, 2011 and 2010, respectively. At December 31, 2011, the Company had \$16.1 million of excess tax benefits available for potential deferred tax write-offs related to previously recognized stock-based compensation.

The amended and restated Beacon Roofing Supply, Inc. 2004 Stock Plan (the "Plan") provides for grants of stock options and restricted stock awards of up to 7,800,000 shares of common stock to key employees and directors. As of December 31, 2011, there were 2,109,879 shares of common stock available for awards under the Plan.

*Stock options*

As of December 31, 2011, there was \$10.5 million of total unrecognized compensation cost related to unvested stock options. That cost is expected to be recognized over a weighted-average period of 2.5 years. Except under certain conditions, the options are subject to continued employment and vest in one-third increments over a three-year period following the grant dates.

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

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

|                         | Three Months Ended December 31, |   |       |   |
|-------------------------|---------------------------------|---|-------|---|
|                         | 2011                            |   | 2010  |   |
| Risk-free interest rate | 0.94                            | % | 1.49  | % |
| Expected life in years  | 6.5                             |   | 7.0   |   |
| Expected volatility     | 47.00                           | % | 48.00 | % |
| Dividend yield          | 0.00                            | % | 0.00  | % |

Expected lives of the options granted are based primarily on history, while expected volatilities are based on historical volatilities of the Company's stock and stocks of comparable public companies. Estimated forfeiture rates vary by grant and range up to 8.0% as of December 31, 2011.

The following table summarizes stock options outstanding as of December 31, 2011, as well as activity during the three months then ended:

|   | Number of Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life (in Years) | Aggregate Intrinsic Value (in Millions) |
|---|------------------|---------------------------------|--|---|
| Outstanding at September 30, 2011               | 3,895,583        | \$ 15.06                        |  |   |
| Granted   | 781,832          | 18.72                           |  |   |
| Exercised                                       | (135,025 )       | 11.36                           |  |   |
| Canceled  | (39,091 )        | 15.19                           |  |   |
| Outstanding at December 31, 2011                | 4,503,299        | \$ 15.80                        | 6.9  | \$ 21.6                                 |
| Vested or Expected to Vest at December 31, 2011 | 4,397,369        | \$ 15.77                        | 6.8  | \$ 21.2                                 |
| Exercisable at December 31, 2011                | 3,021,746        | \$ 15.18                        | 5.7  | \$ 16.9                                 |

The aggregate intrinsic values above include only in-the-money options. The weighted-average grant date fair values of stock options granted during the three months ended December 31, 2011 and December 31, 2010 were \$8.75 and \$7.76, respectively. The intrinsic values of stock options exercised were \$1.1 and \$0.8 million during the three months ended December 31, 2011 and December 31, 2010, respectively.

***Restricted stock awards***

As of December 31, 2011, there was \$3.1 million of total unrecognized compensation cost related to unvested restricted stock awards. That cost is expected to be recognized over a weighted-average period of 2.6 years.

The total fair values of the restricted stock awards were determined based upon the number of shares or units and the closing prices of the Company's common stock on the dates of the grants. The restricted stock awards granted to management are subject to continued employment, except under certain conditions, and will vest if the Company attains a targeted rate of return on invested capital at the end of a three-year period. The actual number of shares or units that will vest can range from 0% to 125% of the management grants depending upon actual Company performance below or above the target level. The restricted stock awards granted to directors are subject to continued employment and vest over one year, except under certain conditions, and contain a restriction on the sale of the underlying common shares until six months after the director separates from the Company.

The following table summarizes restricted shares and units outstanding as of December 31, 2011, as well as the activity during the three months then ended:

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

|   | Number of<br>Shares/Units | Weighted-<br>Average<br>Grant<br>Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Life<br>(in Years) | Aggregate<br>Intrinsic<br>Value<br>(in Millions) |
|---|---------------------------|--|--|--|
| Outstanding at September 30, 2011               | 135,009                   | \$ 16.70                               |  |  |
| Granted   | 110,035                   | \$ 18.72                               |  |  |
| Lapse of restrictions                           | -                         |  |  |  |
| Canceled  | -                         |  |  |  |
| Outstanding at December 31, 2011                | 245,044                   | \$ 17.61                               | 2.2  | \$ 5.0   |
| Vested or Expected to Vest at December 31, 2011 | 245,044                   | \$ 17.61                               | 2.2  | \$ 5.0   |

**4. Comprehensive Income**

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

| (Dollars in thousands)                        | Three Months Ended December 31, |           |
|---|---------------------------------|-----------|
|   | 2011                            | 2010      |
| Net income                                    | \$ 19,115                       | \$ 10,052 |
| Foreign currency translation adjustment       | 2,833                           | 1,808     |
| Tax effect                                    | -                               | (328)     |
| Foreign currency translation adjustment, net  | 2,833                           | 1,480     |
| Unrealized gain on financial derivatives      | 1,583                           | 1,891     |
| Tax effect                                    | (595)                           | (649)     |
| Unrealized gain on financial derivatives, net | 988                             | 1,242     |
| Comprehensive income                          | \$ 22,936                       | \$ 12,774 |

**5. Acquisitions**

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

In November 2011, the Company purchased all of the stock of Fowler & Peth, Inc., a distributor of residential and commercial roofing products and related accessories that has five branches in Colorado, two in Wyoming and one in Nebraska, with annual sales of approximately \$60 million. The purchase price of \$36.7 million resulted in goodwill of \$14.7 million. The purchase price allocation is preliminary. The Company and the selling stockholders mutually agreed to file a Section 338 election with the Internal Revenue Service to treat the transaction for tax purposes as an asset purchase.

In May 2011, the Company purchased all of the stock of Enercon Products ("Enercon") for \$34.9 million plus a potential earn-out amount discussed herein. The purchase allocation resulted in goodwill of \$17.8 million. Enercon is a roofing distributor with six locations in Western Canada. Headquartered within its branch in Edmonton, Enercon also has branches in Calgary, Regina and Saskatoon and two branches in Vancouver and generated annual sales of approximately \$45 million in 2010. There may be an additional payout of up to C\$5.5 million if certain earn-out targets (based on defined EBITDA) are met for the twelve-month period ending May 2012. An estimated liability for the fair value of this contingent consideration, currently \$3.9 million, has been established and included in accrued expenses in the consolidated balance sheet. This estimate has been and will continue to be reviewed prior to the due date and any adjustment will be recorded through income (loss) from continuing operations. A reduction in the liability of \$1.0 million was recorded in the first quarter of 2012 and recognized as a reduction of operating expenses. This adjustment is not taxable and has been recorded as a permanent difference for income tax reporting purposes.



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

A total of \$2.7 million of the prior acquisition prices remained in escrow at December 31, 2011, primarily for purchase price adjustments and post-closing indemnification claims, with \$1.2 million included in other current assets and accrued expenses and \$1.5 million included in other long-term assets and liabilities.

### 6. Debt

The Company currently has the following credit facilities:

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

#### *Senior Secured Credit Facilities*

On November 2, 2006, the Company entered into an amended and restated seven-year \$500 million U.S. senior secured credit facility and a C\$15 million senior secured Canadian credit facility with GE Antares Capital ("GE Antares") and a syndicate of other lenders (combined, the "Credit Facility"). The Credit Facility consists of a U.S. revolving credit facility providing up to \$150 million, which includes a sub-facility of \$20 million for letters of credit, and a term loan with an initial principal amount of \$350 million (the "Term Loan"). The Credit Facility also includes a C\$15 million senior secured revolving credit facility provided by GE Canada Finance Holding Company.

As of December 31, 2011, there was less than \$0.1 million of outstanding revolver borrowings and \$311.0 million of outstanding Term Loan maturing in September 2013. The Company is in compliance with the covenants under the Credit Facility. The current portion of long-term obligations for each period presented includes a \$7 million accelerated payment that was due under the Term Loan. The accelerated payments for 2011 and 2010 were made in the following January. Substantially all of the Company's assets, including the capital stock and assets of wholly-owned subsidiaries secure obligations under the Credit Facility.

### ***Equipment Financing Facilities***

As of December 31, 2011, there was a total of \$10.9 million outstanding under prior equipment financing facilities, with fixed interest rates ranging from 3.6% to 7.1% and payments due through March 2016. No further amounts can be drawn on the prior facilities. The Company's current facility provides financing for up to \$5.5 million of purchased transportation and material handling equipment through May 15, 2012 at an interest rate approximately 2.75% above the 3-year term swap rate at the time of the advances. No amounts were outstanding under the current facility at December 31, 2011.

## **7. Financial Instruments**

### ***Financial Derivatives***

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

The Company is using interest rate derivative instruments to manage the risk related to fluctuating cash flows from interest rate changes by converting a portion of its variable-rate borrowings into fixed-rate borrowings. As of December 31, 2011, the following interest rate derivative instruments were outstanding: a) a \$100 million interest rate swap with interest payments at a fixed rate of 2.72%; b) a \$50 million interest rate swap with interest payments at a fixed rate of 3.12%; and c) a \$50 million interest rate swap with interest payments at a fixed rate of 3.11%. These interest rate swaps expire in April 2013.

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

These derivative instruments are designated as cash flow hedges, for which the Company records the effective portions of changes in their fair value, net of taxes, in other comprehensive income (Note 4). The effectiveness of the hedges is periodically assessed by the Company during the lives of the hedges by 1) comparing the current terms of the hedges with the related hedged debt to assure they continue to coincide and 2) through an evaluation of the ability of the counterparties to the hedges to honor their obligations under the hedges. Any ineffective portions of the hedges are recognized in earnings, of which there have been none to date and none are anticipated.

The Company records any differences paid or received on its interest rate hedges as adjustments to interest expense. Since inception, the Company has not recognized any gains or losses on these hedges and there has been no effect on income from hedge ineffectiveness. The table below presents the combined fair values of the interest rate derivative instruments:

| Location on Balance Sheet | Unrealized Losses             |                   |                    | Fair Value Hierarchy |
|---------------------------|-------------------------------|-------------------|--------------------|----------------------|
|                           | December 31, 2011             | December 31, 2010 | September 30, 2011 |                      |
|                           | <b>(Dollars in thousands)</b> |                   |                    |                      |
| Accrued expenses          | \$5,653                       | \$ 9,193          | \$ 7,235           | Level 2              |

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

***Cash and Cash Equivalents***

The Company considers all highly liquid investments with maturities of three months or less when purchased to be cash equivalents. Cash and cash equivalents also include unsettled credit card transactions. As of December 31, 2011, the cash equivalents were mostly comprised of money market funds, which invest primarily in commercial paper or bonds with a rating of A-1 or better, and bank certificates of deposit. The carrying values of the cash equivalents for the periods presented equaled the fair values, which were determined under Level 1 of the Fair Value Hierarchy.

## 8. Foreign Net Revenue

Foreign (Canadian) net revenue totaled \$40.4 and \$29.1 million in the three months ended December 31, 2011 and 2010, respectively.

## 9. Recent Accounting Pronouncements

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

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

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

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

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

*You should read the following discussion in conjunction with Management's Discussion and Analysis included in our 2011 Annual Report on Form 10-K. Unless otherwise specifically indicated, all references to "2012" refer to the three months (first quarter) ended December 31, 2011 of our fiscal year ending September 30, 2012, and all references to "2011" refer to the three months (first quarter) ended December 31, 2010 of our fiscal year ended September 30, 2011. Certain tabular information may not foot due to rounding and certain reclassifications are made to prior year sales by product line to conform to the current year presentation.*

### **Overview**

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

We currently distribute up to 10,000 SKUs through 192 branches in the United States and Canada. We had 2,321 employees as of December 31, 2011, including our sales and marketing team of 999 employees (which includes branch management).

In fiscal year 2011, approximately 92% of our net sales were in the United States. We stock one of the most extensive assortments of high-quality branded products in the industry, enabling us to deliver products to our customers on a timely basis.

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

Our growth strategy includes both internal growth (opening branches, growing sales with existing customers, adding new customers and introducing new products) and acquisition growth. Our main acquisition strategy is to target market leaders in geographic areas that we do not service. Our May 2011 acquisition of Enercon is one example of this approach. Enercon is a roofing distributor with six locations in Western Canada. Headquartered within its branch in Edmonton, Enercon also has branches in Calgary, Regina and Saskatoon and two branches in Vancouver, with no branch overlap with our existing operations. In addition, we also acquire companies to supplement branch openings within existing markets. Our November 2011 acquisition of Fowler & Peth, a distributor of residential and commercial roofing products with eight branches located in Colorado, Wyoming, and Nebraska, which we integrated into our Shelter Distribution region in the Midwest, is an example of such an acquisition.

**Results of Operations**

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

|                            | Three Months Ended December 31, |   |       |   |
|----------------------------|---------------------------------|---|-------|---|
|                            | 2011                            |   | 2010  |   |
| Net sales                  | 100.0                           | % | 100.0 | % |
| Cost of products sold      | 76.0                            |   | 76.6  |   |
| Gross profit               | 24.0                            |   | 23.4  |   |
| Operating expenses         | 16.9                            |   | 18.5  |   |
| Income from operations     | 7.0                             |   | 4.9   |   |
| Interest expense           | (0.7                            | ) | (0.9  | ) |
| Income before income taxes | 6.3                             |   | 4.0   |   |
| Income tax expense         | (2.4                            | ) | (1.6  | ) |
| Net income                 | 3.9                             | % | 2.5   | % |

In managing our business, we consider all growth, including the opening of new branches, to be internal (organic) growth unless it results from an acquisition. When we refer to growth in existing markets or internal growth, we include growth from existing and newly opened branches but excluded growth from acquired branches until they have been under our ownership for at least four full fiscal quarters at the start of the fiscal reporting period. When we refer to regions, we are referring to our geographic regions. At December 31, 2011, we had a total of 192 branches in operation. For 2012, 177 branches were included in our existing market calculations and 15 branches were excluded because they were acquired after fiscal year 2010. Acquired markets for 2012 included Enercon, The Roofing Connection, and Fowler & Peth (See Note 5 to the Condensed Consolidated Financial Statements). When we refer to our net product costs, we are referring to our invoice cost less the impact of short-term buying programs (also referred to as "special buys" given the manner in which they are offered).

**Three Months Ended December 31, 2011 ("2011") Compared to the Three Months Ended December 31, 2010 ("2010")****Existing and Acquired Markets**



|  | Existing Markets       |           | Acquired Markets     |      | Consolidated         |           |
|--|------------------------|-----------|----------------------|------|----------------------|-----------|
|  | December 31,<br>2011   | 2010      | December 31,<br>2011 | 2010 | December 31,<br>2011 | 2010      |
|  | (dollars in thousands) |           |                      |      |                      |           |
| Net Sales                              | \$473,653              | \$404,793 | \$ 16,197            | \$ - | \$489,850            | \$404,793 |
| Gross Profit                           | 113,397                | 94,810    | 3,928                | -    | 117,325              | 94,810    |
| Gross Margin                           | 23.9 %                 | 23.4 %    | 24.3 %               |      | 24.0 %               | 23.4 %    |
| Operating Expenses                     | 78,861                 | 74,970    | 4,124                | -    | 82,985               | 74,970    |
| Operating Expenses as a % of Net Sales | 16.6 %                 | 18.5 %    | 25.5 %               |      | 16.9 %               | 18.5 %    |
| Operating Income (Loss)                | \$34,536               | \$19,840  | \$ (196 )            | \$ - | \$34,340             | \$19,840  |
| Operating Margin                       | 7.3 %                  | 4.9 %     | -1.2 %               |      | 7.0 %                | 4.9 %     |

## Net Sales

Consolidated net sales increased \$85.1 million, or 21.0%, to \$489.9 million in 2012 from \$404.8 million in 2011. Existing market sales increased \$68.9 million or 17.0% (20.9% on a sales per day basis), while acquired market sales were \$16.2 million. There were 60 business days in 2012 compared to 62 in 2011. We believe our 2012 existing market sales were influenced primarily by the following factors:

- continued strong growth in the markets affected by last year's storms;
  - continued strong growth in non-residential roofing activity in all but one of our regions;
  - strong growth in residential re-roofing activity in all regions, partly due to better weather conditions; and
  - industry-wide price increases in non-residential products and asphalt shingles;
- partially offset by:
- decreases in our complementary product sales in most regions due to lower remodeling activity.

We acquired nine branches and closed two in this year's first quarter, while we closed two branches in last year's first quarter. We estimate the impact of inflation or deflation on our sales and gross profit by looking at changes in our net product costs and invoiced gross margins. Since last year's first quarter we experienced approximate 8% and 10% increases in residential and non-residential roofing product costs, respectively, while complementary product costs increased by about 5%. The net impact of these factors increased our overall net product costs by approximately 8%, which we believe did not have a material impact on our net operating results in 2012 compared to 2011. Existing market net sales by geographical region grew as follows: Northeast 23.1%; Mid-Atlantic 19.8%; Southeast 32.5%; Southwest 6.5%; Midwest 14.1%; West 39.1%; and Canada 4.8%. These variations were primarily caused by short-term factors such as local economic conditions, weather conditions and storm activity.

Product group sales for our existing markets were as follows:

### For the Three Months Ended

|                                  | December 31,<br>2011   |         | December 31,<br>2010 |         | Change   |        |
|----------------------------------|------------------------|---------|----------------------|---------|----------|--------|
|                                  | Sales                  | Mix     | Sales                | Mix     |          |        |
|                                  | (dollars in thousands) |         |                      |         |          |        |
| Residential roofing products     | \$220,056              | 46.5 %  | \$175,425            | 43.3 %  | \$44,631 | 25.4 % |
| Non-residential roofing products | 192,592                | 40.7 %  | 166,735              | 41.2 %  | 25,857   | 15.5   |
| Complementary building products  | 61,005                 | 12.9 %  | 62,633               | 15.5 %  | (1,628)  | -2.6   |
| Total existing market sales      | \$473,653              | 100.0 % | \$404,793            | 100.0 % | \$68,860 | 17.0 % |

For 2012, our acquired markets recognized sales of \$13.5, \$1.5 and \$1.2 million in residential roofing products, non-residential roofing products and complementary building products, respectively. The 2012 existing market sales of \$473.7 million plus the sales from acquired markets of \$16.2 million agrees (rounded) to our reported total 2012 sales of \$489.9 million. We believe the existing market information is useful to investors because it helps explain organic growth or decline.

### Gross Profit

### For the Three Months Ended

|                  | December 31,          |         | Change  |       |
|------------------|-----------------------|---------|---------|-------|
|                  | 2011                  | 2010    |         |       |
|                  | (dollars in millions) |         |         |       |
| Gross profit     | \$ 117.3              | \$ 94.8 | \$ 22.5 | 23.7% |
| Existing markets | 113.4                 | 94.8    | 18.6    | 19.6% |
| Gross margin     | 24.0 %                | 23.4 %  | 0.6 %   |       |
| Existing markets | 23.9 %                | 23.4 %  | 0.5 %   |       |

Our existing market gross profit increased \$18.6 million or 19.6% in 2012, while our acquired market gross profit was \$3.9 million. Our overall and existing market gross margins increased in 2012 from 2011 to 24.0% and 23.9%, respectively, from 23.4%. The higher gross margins in 2012 were mainly due to an increase in our mix of residential product sales, which generally have higher gross margins. In addition, higher average selling prices in most of our markets allowed us to generate gross margins more consistent with our historical results.

Direct sales (products shipped by our vendors directly to our customers), which typically have substantially lower gross margins than our warehouse sales, represented 16.9% and 19.6% of our net sales in 2012 and 2011, respectively. This decrease in the percentage of direct sales was primarily attributable to the lower mix of non-residential roofing product sales, which are more commonly facilitated by direct shipment. There were no material regional impacts from changes in the direct sales mix of our geographical regions.

**Operating Expenses****For the Three Months Ended**

|                                    | December<br>2011      | December<br>31,<br>2010 | Change |       |
|------------------------------------|-----------------------|-------------------------|--------|-------|
|                                    | (dollars in millions) |                         |        |       |
| Operating expenses                 | \$83.0                | \$ 75.0                 | \$8.0  | 10.7% |
| Existing markets                   | \$78.9                | \$ 75.0                 | \$3.9  | 5.2 % |
| Operating expenses as a % of sales | 16.9%                 | 18.5 %                  |        | -1.6% |
| Existing markets                   | 16.6%                 | 18.5 %                  |        | -1.9% |

Operating expenses in our existing market increased by \$3.9 million or 5.2% in 2012 to \$78.9 million, compared to \$75.0 million in 2011, while our acquired market expenses were \$4.1 million. The operating expenses for acquired markets were favorably impacted by a \$1.0 million reduction of the liability for Enercon's contingent consideration as discussed in Note 5. The following factors were the leading causes of the higher operating expenses in our existing markets:

- increased payroll and related costs of \$2.8 million primarily due to higher incentive-based pay, overtime pay, certain benefits and payroll taxes;
- increased selling expenses of \$0.9 million mainly from higher fuel and transportation costs; and
- increases in other general and administrative costs of \$1.6 million principally from higher professional fees and higher general insurance and travel expenses;

partially offset by

- decreased depreciation and amortization expense of \$0.9 million from lower amortization of intangibles and reduced depreciation from the impact of low capital expenditures in recent years; and
- decreased bad debts of \$0.4 million due primarily to a lower percentage of past-due accounts.

In 2012, we expensed a total of \$2.1 million for the amortization of intangible assets recorded under purchase accounting compared to \$2.2 million in 2011. Our existing market operating expenses as a percentage of the related net sales decreased to 16.6% in 2012 from 18.5% in 2011 due to the positive impact from the higher sales, partially offset by the impact from the above increases.

**Interest Expense**

Interest expense was \$3.3 million in 2012 compared to \$3.5 million in 2011, as there was a beneficial impact from lower outstanding debt. Interest expense would have been \$1.3 million less in both 2012 and 2011 without the impact of our interest rate derivatives.

## **Income Taxes**

The income tax expense was \$11.9 million in 2012, an effective tax rate of 38.5%, compared to \$6.3 million in 2011, an effective rate of 38.6%. The rates in both years reflect beneficial impacts from certain discrete tax items. We currently expect our annual tax rate to average approximately 39.0% to 39.5%, excluding discrete items.

## **Seasonality and Quarterly Fluctuations**

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

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

We generally experience a slowing of collections of our accounts receivable during our second quarter, mainly due to the inability of some of our customers to conduct their businesses effectively in inclement weather in certain regions. We continue to attempt to collect those receivables, which require payment under our standard terms. We do not provide material concessions to our customers during this quarter of the year.

Our vendors are also affected by the seasonality in the industry and are more likely to provide seasonal incentives in our second quarter as a result of the lower level of roofing activity. Also during the second quarter, we generally experience our lowest availability under our senior secured credit facilities, which are asset-based lending facilities.

### Certain Quarterly Financial Data

The following table sets forth certain unaudited quarterly data for fiscal year 2011 (ending September 30, 2011) and fiscal year 2010 which, in the opinion of management, reflect all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of this data. Results of any one or more quarters are not necessarily indicative of results for an entire fiscal year or of continuing trends. Totals may not total due to rounding.

|  | Fiscal year 2011                             |         |           |         |         |
|--|--|---------|-----------|---------|---------|
|  | Qtr 1  | Qtr 1   | Qtr 2     | Qtr 3   | Qtr 4   |
|  | (dollars in millions, except per share data) |         |           |         |         |
|  | (unaudited)                                  |         |           |         |         |
| Net sales  | \$489.9                                      | \$404.8 | \$296.3   | \$540.7 | \$575.6 |
| Gross profit   | 117.3  | 94.8    | 65.2      | 126.7   | 132.9   |
| Income (loss) from operations  | 34.3   | 19.8    | (6.8 )    | 43.1    | 47.6    |
| Net income (loss)  | \$19.1                                       | \$10.1  | \$(6.2 )  | \$24.1  | \$31.3  |
| Earnings (loss) per share - basic                                      | \$0.41                                       | \$0.22  | \$(0.13 ) | \$0.52  | \$0.68  |
| Earnings (loss) per share - fully diluted                              | \$0.41                                       | \$0.22  | \$(0.13 ) | \$0.51  | \$0.67  |
| Quarterly sales as % of year's sales                                   | 22.3 %                                       | 16.3 %  | 29.8 %    | 31.7 %  |         |
| Quarterly gross profit as % of year's gross profit                     | 22.6 %                                       | 15.5 %  | 30.2 %    | 31.7 %  |         |
| Quarterly income from operations as % of year's income from operations | 19.1 %                                       | -6.6 %  | 41.6 %    | 45.9 %  |         |

Earnings in the first quarter of 2012 included the beneficial impact of \$1.0 million, \$0.02 diluted earnings per share, from the reduction in the liability for Enercon's contingent consideration (Note 5). Earnings in the fourth quarter of 2011 included the beneficial impact of \$5.1 million, \$0.11 diluted earnings per share, from the reversal of a net deferred tax liability associated with a change in the tax status of our Canadian operations. The calculation of the net loss per share for the second quarter of 2011 does not include the effects of outstanding stock awards since the impact would have been anti-dilutive.

### Liquidity and Capital Resources

We had cash and cash equivalents of \$155.2 million at December 31, 2011 compared to \$175.7 million at December 31, 2010 and \$143.0 million at September 30, 2011. Our net working capital was \$403.8 million at December 31, 2011 compared to \$387.2 million at December 31, 2010 and \$410.8 million at September 30, 2011.

***2012 Compared to 2011***

Our net cash provided by operating activities was \$59.0 million in 2012 compared to \$57.5 million in 2011. The slight increase in cash from operations was principally due to the increase in net income of \$9.1 million, mostly offset by less cash provided by working capital changes in 2012. The current quarter changes in working capital consisted of favorable decreases of \$71.4 and \$20.8 million in accounts receivable and inventories, respectively, partially offset by an unfavorable increase of \$19.1 million in prepaid expenses and other assets and an unfavorable decrease of \$39.2 million in accounts payable and accrued expenses. Our accounts receivable days sales outstanding (calculated based on the ending accounts receivable balance and the most recent quarter's sales) were down slightly, mainly due to a higher concentration of residential roofing sales this year, which generally have shorter customer payment terms. Inventory turns were flat year over year, as the impact of this year's higher inventory levels were offset by the positive impact of the higher sales. The increase in prepaid expenses and other assets was mostly due to higher amounts due from vendors for incentives, which resulted primarily from higher levels of purchases. Lastly, the decrease in accounts payable and accrued expenses were primarily due to normal seasonal factors.

Net cash used by investing activities was \$46.6 million in 2012 compared to \$0.1 million provided in 2011. Capital expenditures were \$2.4 million in 2012 compared to \$0.9 million in 2011. Proceeds from sales of assets were \$0.6 million lower in 2012. In addition, we spent \$44.4 million on acquisitions in 2012. We currently expect fiscal year 2012 capital expenditures to total between 0.8% to 1.0% of net sales, mostly dependent upon our sales volume and exclusive of the impact of branch openings.

Net cash used by financing activities was \$0.7 million in 2012 compared to \$0.8 million provided in 2011. There were \$2.3 million of repayments under our credit and equipment financing facilities and \$1.5 million of proceeds from exercises of stock options in 2012. The financing activities in 2011 also primarily reflected repayments under our credit and equipment financing facilities and proceeds from exercises of stock options, but were net of additional equipment financing proceeds of \$1.7 million.

**Capital Resources**

Our principal source of liquidity at December 31, 2011 was our cash and cash equivalents of \$155.2 million and our available borrowings of \$160.1 million under revolving lines of credit, which takes into account all of the debt covenants, including the maximum consolidated leverage ratio and capital expenditures limit discussed below. Our borrowing base availability is determined primarily by trade accounts receivable, less outstanding borrowings and letters of credit. Borrowings outstanding under the revolving lines of credit in the accompanying balance sheets have been classified as short-term debt since there were no current expectations of a minimum level of outstanding revolver borrowings in the following twelve months.

Liquidity is defined as the current amount of readily available cash and the ability to generate adequate amounts of cash to meet the current needs for cash. We assess our liquidity in terms of our cash and cash equivalents on hand and the ability to generate cash to fund our operating activities, taking into consideration the seasonal nature of our business.

Significant factors which could affect future liquidity include the following:

- the adequacy of available bank lines of credit;
- the ability to attract long-term capital with satisfactory terms;
- cash flows generated from operating activities;
- acquisitions; and
- capital expenditures.

Our primary capital needs are for working capital obligations and other general corporate purposes, including acquisitions and capital expenditures. Our primary sources of working capital are cash from operations and cash equivalents supplemented by bank borrowings. In the past, we have financed acquisitions initially through increased bank borrowings, the issuance of common stock and other borrowings. We then repay any such borrowings with cash flows from operations. We have funded most of our past capital expenditures with cash on hand or through increased bank borrowings, including equipment financing, and then have reduced those obligations with cash flows from operations.

We believe we have adequate current liquidity and availability of capital to fund our present operations, meet our commitments on our existing debt and fund anticipated growth, including expansion in existing and targeted market areas. We seek potential acquisitions from time to time and hold discussions with certain acquisition candidates. If suitable acquisition opportunities or working capital needs arise that would require additional financing, we believe that our financial position and earnings history provide a sufficient base for obtaining additional financing resources at reasonable rates and terms, as we have in the past. We may also issue additional shares of common stock to raise funds, which we did in December 2005, or we may issue preferred stock.

## **Indebtedness**



We currently have the following credit facilities:

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

### ***Senior Secured Credit Facilities***

On November 2, 2006, we entered into an amended and restated seven-year \$500 million U.S. senior secured credit facility and a C\$15 million senior secured Canadian credit facility with GE Antares Capital ("GE Antares") and a syndicate of other lenders (combined, the "Credit Facility"). The Credit Facility provides for a cash receipts lock-box arrangement that gives us sole control over the funds in lock-box accounts, unless excess availability is less than \$10 million or an event of default occurs, in which case the senior secured lenders would have the right to take control over such funds and to apply such funds to repayment of the senior debt.

The Credit Facility consists of a U.S. revolving credit facility providing up to \$150 million (the "US Revolver"), which includes a sub-facility of \$20 million for letters of credit, and a term loan with an initial principal amount of \$350 million term loan (the "Term Loan"). The Credit Facility also includes a C\$15 million senior secured revolving credit facility provided by GE Canada Finance Holding Company (the "Canada Revolver"). There was a combined \$160.1 million available for revolver borrowings at December 31, 2011, which takes into account all of the debt covenants, including the maximum consolidated leverage ratio and capital expenditures limit discussed below, with less than \$0.1 million outstanding under the US Revolver at an interest rate of 3.25%. There were \$4.6 million of outstanding standby letters of credit at December 31, 2011, December 31, 2010 and September 30, 2011. The Term Loan requires amortization of 1% per year, payable in quarterly installments of approximately \$0.8 million, and the remainder is due in 2013. The Credit Facility may also be expanded by up to an additional \$200 million under certain conditions. There are mandatory prepayments under the Credit Facility under certain conditions, including the following cash flow condition:

*Excess Cash Flow*

By May 15 of each fiscal year, we must pay an amount equal to 50% of the Excess Cash Flow (as defined in the Credit Facility) for the prior fiscal year, not to exceed \$7.0 million with respect to any fiscal year. Based on our results for fiscal year 2011, a required payment of \$7.0 million was due by May 2012. A payment of \$7.0 million was made in January 2012 for fiscal year 2011 and in January 2011 for fiscal year 2010. The amount payable under this provision as of December 31, 2011, December 31, 2010 and September 30, 2011 was classified as short-term debt.

*Interest*

Interest on borrowings under the U.S. credit facility is payable at our election at either of the following rates:

· the base rate (that is the higher of (a) the base rate for corporate loans quoted in The Wall Street Journal or (b) the Federal Reserve overnight rate plus 1/2 of 1%) plus a margin of 0.75% for the Term Loan, or

· the current LIBOR Rate plus a margin of 1.00% (for U.S. Revolver loans) or 2.00% (for Term Loan).

Interest under the Canadian credit facility is payable at our election at either of the following rates:

· an index rate (that is the higher of (1) the Canadian prime rate as quoted in The Globe and Mail and (2) the 30-day BA Rate plus 0.75%), or

· the BA rate as described in the Canadian facility plus 1.00%.

The US Revolver currently carries an interest rate at the base rate (3.25% at December 31, 2011), while the Canada revolver carries an interest rate of the 30-day BA Rate plus 0.75% (3.00% at December 31, 2011), and the Term Loan carries an interest rate of LIBOR plus 2% (approximately 2.35% at December 31, 2011). Unused fees on the revolving credit facilities are 0.25% per annum. Availability under the revolving credit facilities is limited to 85% of eligible accounts receivable, increasing to 90% from January through April of each year.

Financial covenants, which apply only to the Term Loan, are limited to a leverage ratio and a yearly capital expenditure limitation as follows:

*Maximum Consolidated Leverage Ratio*

On the last day of each fiscal quarter, our Consolidated Leverage Ratio (the ratio of our outstanding debt, net of cash on hand, to our trailing twelve-month earnings before interest, income taxes, depreciation, amortization and stock-based compensation), as more fully defined in the Credit Facility, must not be greater than 4.00:1.0. At December 31, 2011, this ratio was 1.16:1.

*Capital Expenditures*

We cannot incur aggregate Capital Expenditures, as defined, in excess of three percent (3.00%) of consolidated gross revenue for any fiscal year.

As of December 31, 2011, we were in compliance with these covenants.

Substantially all of our assets, including the capital stock and assets of wholly-owned subsidiaries secure obligations under the Credit Facility.

*Equipment Financing Facilities*

As of December 31, 2011, there was a total of \$10.9 million outstanding under prior equipment financing facilities, with fixed interest rates ranging from 3.6% to 7.1% and payments due through March 2016. No further amounts can be drawn on the prior facilities. Our current facility provides financing for up to \$5.5 million of purchased transportation and material handling equipment through May 15, 2012 at an interest rate approximately 2.75% above the 3-year term swap rate at the time of the advances. No amounts were outstanding under the current facility at December 31, 2011.

**Cautionary Statement for Purposes of the "Safe Harbor" Provisions of the Private Securities Litigation Reform Act of 1995**

Our disclosure and analysis in this report contains forward-looking information that involves risks and uncertainties. Our forward-looking statements express our current expectations or forecasts of possible future results or events, including projections of future performance, statements of management's plans and objectives, future contracts, and forecasts of trends and other matters. You can identify these statements by the fact that they do not relate strictly to historic or current facts and often use words such as "anticipate," "estimate," "expect," "believe," "will likely result," "outlook," "project" and other words and expressions of similar meaning. No assurance can be given that the results in any forward-looking statements will be achieved and actual results could be affected by one or more factors, which could cause them to differ materially. For these statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act.

Certain factors that may affect our business and could cause actual results to differ materially from those expressed in any forward-looking statements include those set forth under the heading "Risk Factors" in our Form 10-K for the fiscal year ended September 30, 2011.

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

**Interest Rate Risk**

Our interest rate risk relates primarily to the variable-rate borrowings under our Credit Facility. The following discussion of our interest rate swaps (see "Financial Derivatives" below) is based on a 10% change in interest rates. These changes are hypothetical scenarios used to calibrate potential risk and do not represent our view of future market changes. As the hypothetical figures discussed below indicate, changes in fair value based on the assumed change in rates generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. The effect of a variation in a particular assumption is calculated without changing any other assumption. In reality, changes in one factor may result in changes in another, which may magnify or counteract the sensitivities.

At December 31, 2011, we had \$311.0 million of term loans outstanding under our Credit Facility, less than \$0.1 million of borrowings under revolving lines of credit, and \$10.9 million of equipment financing outstanding. Our weighted-average effective interest rate on that debt, after considering the effect of the interest rate swaps, was 4.03% at December 31, 2011 (3.99% at December 31, 2010). At December 31, 2011, a hypothetical 10% increase in interest rates in effect at that date would have increased annual interest expense by only \$0.3 million, since the majority of the interest expense was fixed by the financial derivatives.

We enter into interest rate swaps to minimize the risks and costs associated with financing activities, as well as to maintain an appropriate mix of fixed-and floating-rate debt. The swap agreements discussed below are contracts to exchange variable-rate for fixed-interest rate payments over the life of the agreements. The aggregate fair value of these swaps represented an unrealized loss of \$5.7 million at December 31, 2011. A hypothetical increase (or decrease) of 10% in interest rates from the level in effect at December 31, 2011, would result in an aggregate unrealized gain or (loss) in value of the swaps of approximately \$0.1 million or (\$0.1) million, respectively.

## **Financial Derivatives**

As discussed above, we use interest rate derivative instruments to manage our exposure related to fluctuating cash flows from changes in interest rates by converting a portion of our variable-rate borrowings into fixed-rate borrowings. As of December 31, 2011, we had the following interest rate derivative instruments outstanding: a) a \$100 million interest rate swap with interest payments at a fixed rate of 2.72%; b) a \$50 million interest rate swap with interest payments at a fixed rate of 3.12%; and c) a \$50 million interest rate swap with interest payments at a fixed rate of 3.11%. These interest rate swaps expire in April 2013.

## **Foreign Exchange Risk**

There have been no material changes from what we reported in our Form 10-K for the year ended September 30, 2011.

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

As of December 31, 2011, management, including the CEO and CFO, performed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the "Act")). Based on that evaluation, management, including the CEO and CFO, concluded that as of December 31, 2011, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms, and to ensure that information required to be disclosed by us in the reports that we file or submit under the Act is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. We maintain a system of internal control over financial reporting that is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States. Based on the most recent evaluation, we have concluded that no significant change in our internal control over financial reporting occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



## Part II. Other Information

Items 1-5 are not applicable and have been omitted.

### Item 6. Exhibits

#### (a) Exhibits required by Item 601 of Regulation S-K

##### Exhibit

| Exhibit Number | Document Description   |
|----------------|--|
| 10             | Description of CEO Relocation Assistance Arrangement.*   |
| 31.1           | Certification by Paul M. Isabella pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.              |
| 31.2           | Certification by David R. Grace pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                |
| 32.1           | Certification by Paul M. Isabella and David R. Grace pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS        | XBRL Instance Document.**  |
| 101.SCH        | XBRL Taxonomy Extension Schema Document.**   |
| 101.CAL        | XBRL Taxonomy Extension Calculation Linkbase Document.**   |
| 101.DEF        | XBRL Taxonomy Extension Definition Linkbase Document.**  |
| 101.LAB        | XBRL Taxonomy Extension Label Linkbase Document.**   |
| 101.PRE        | XBRL Taxonomy Extension Presentation Linkbase Document.**  |

\* Compensatory plan or arrangement.

\*\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not

filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.



**Signature Page**

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 on February 9, 2012.

BEACON ROOFING SUPPLY, INC.

BY: /s/ DAVID R. GRACE

David R. Grace,

*Executive Vice President & Chief Financial Officer, and duly*

*authorized signatory on behalf of the Registrant*

**Index to Exhibits**

**Exhibit**

Document Description

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