

NCI BUILDING SYSTEMS INC  
Form 10-Q  
September 07, 2007  
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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: July 29, 2007

Commission file number: 1-14315

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**NCI BUILDING SYSTEMS, INC.**

(Exact name of registrant as specified in its charter)

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<b>Delaware</b> (State or other jurisdiction of incorporation or organization)	<b>76-0127701</b> (I.R.S. Employer Identification No.)
<b>10943 N. Sam Houston Parkway W.</b>  <b>Houston, TX</b> (Address of principal executive offices)	<b>77064</b> (Zip Code)
<b>(281) 897-7788</b>	
<b>Registrant's telephone number, including area code</b>	

Former name, former address and former fiscal year, if changed since last report.

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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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

### APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, \$.01 Par Value 20,074,596 shares as of August 27, 2007

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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements.****NCI BUILDING SYSTEMS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands)

	July 29, 2007 (Unaudited)	October 29, 2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 7,454	\$ 25,038
Accounts receivable, net	145,473	163,814
Inventories, net	170,290	160,208
Deferred income taxes	22,980	22,864
Prepaid expenses and other	13,014	11,054
<b>Total current assets</b>	<b>359,211</b>	<b>382,978</b>
Property, plant and equipment, net	268,933	252,580
Goodwill	616,384	614,461
Intangible assets, net	43,078	41,647
Other assets	12,884	12,577
<b>Total assets</b>	<b>\$ 1,300,490</b>	<b>\$ 1,304,243</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$ 934	\$ 947
Accounts payable	101,780	116,028
Accrued compensation and benefits	41,865	53,024
Accrued interest	1,561	3,095
Other accrued expenses	66,122	77,818
<b>Total current liabilities</b>	<b>212,262</b>	<b>250,912</b>
Long-term debt	496,340	497,037
Deferred income taxes	51,492	52,168
Other long-term liabilities	5,046	5,717
<b>Total long-term liabilities</b>	<b>552,878</b>	<b>554,922</b>
Stockholders' equity:		
Common stock	221	218
Additional paid-in capital	188,590	175,121
Retained earnings	441,416	403,125
Accumulated other comprehensive loss	(1,247)	(1,804)
Treasury stock, at cost	(93,630)	(78,251)

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Total stockholders' equity	535,350	498,409
Total liabilities and stockholders' equity	\$ 1,300,490	\$ 1,304,243

*See accompanying notes to condensed consolidated financial statements.*

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**Table of Contents****NCI BUILDING SYSTEMS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(In thousands, except per share data)

(Unaudited)

	<b>Fiscal Three Months Ended</b>	
	<b>July 29, 2007</b>	<b>July 30, 2006</b>
Sales	\$ 433,844	\$ 449,393
Cost of sales	324,053	335,731
Gross profit	109,791	113,662
Selling, general and administrative expenses	67,781	72,187
Income from operations	42,010	41,475
Interest income	7	799
Interest expense	(7,206)	(8,026)
Other income, net	362	82
Income before income taxes	35,173	34,330
Provision for income taxes	13,846	12,655
Net income	\$ 21,327	\$ 21,675
Earnings per share:		
Basic	\$ 1.09	\$ 1.08
Diluted	\$ 1.02	\$ 1.00
Weighted average shares outstanding:		
Basic	19,655	20,065
Diluted	20,881	21,718

*See accompanying notes to condensed consolidated financial statements.*

**Table of Contents****NCI BUILDING SYSTEMS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(In thousands, except per share data)

(Unaudited)

	<b>Fiscal Nine Months Ended</b>	
	<b>July 29,</b>	<b>July 30, 2006</b>
	<b>2007</b>	<b>2006</b>
Sales	\$ 1,160,874	\$ 1,072,007
Cost of sales	878,009	810,386
<b>Gross profit</b>	<b>282,865</b>	<b>261,621</b>
Selling, general and administrative expenses	199,530	175,574
<b>Income from operations</b>	<b>83,335</b>	<b>86,047</b>
Interest income	246	4,806
Interest expense	(21,918)	(17,627)
Other income, net	1,411	614
<b>Income before income taxes</b>	<b>63,074</b>	<b>73,840</b>
Provision for income taxes	24,783	28,093
<b>Net income</b>	<b>\$ 38,291</b>	<b>\$ 45,747</b>
<b>Earnings per share:</b>		
Basic	\$ 1.95	\$ 2.28
Diluted	\$ 1.82	\$ 2.13
<b>Weighted average shares outstanding:</b>		
Basic	19,661	20,079
Diluted	21,022	21,479

*See accompanying notes to condensed consolidated financial statements.*

**Table of Contents****NCI BUILDING SYSTEMS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

	<b>Fiscal Nine Months Ended</b>	
	<b>July 29, 2007</b>	<b>July 30, 2006</b>
<b>Cash flows from operating activities:</b>		
Net cash provided by operating activities	\$ 42,725	\$ 54,544
<b>Cash flows from investing activities:</b>		
Acquisitions, net of cash acquired	(18,859)	(366,490)
Capital expenditures	(33,440)	(19,364)
Other, net	(401)	(203)
<b>Net cash used in investing activities</b>	<b>(52,700)</b>	<b>(386,057)</b>
<b>Cash flows from financing activities:</b>		
Payments on revolving line of credit	(90,500)	
Borrowings on revolving line of credit	90,500	
Issuance of long-term debt		200,000
Payments on long-term debt	(710)	(2,264)
Payment of financing costs	(75)	(594)
Proceeds from stock options exercised	3,787	5,492
Excess tax benefits from share-based compensation arrangements	1,459	3,361
Purchase of treasury stock	(12,286)	(17,580)
<b>Net cash (used in) provided by financing activities</b>	<b>(7,825)</b>	<b>188,415</b>
Effect of exchange rate changes on cash and cash equivalents	216	126
<b>Net decrease in cash and cash equivalents</b>	<b>(17,584)</b>	<b>(142,972)</b>
Cash and cash equivalents at beginning of period	25,038	200,716
<b>Cash and cash equivalents at end of period</b>	<b>\$ 7,454</b>	<b>\$ 57,744</b>

*See accompanying notes to condensed consolidated financial statements.*



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**NCI BUILDING SYSTEMS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**JULY 29, 2007**

(Unaudited)

**NOTE 1 BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, which consist of normal recurring entries except as otherwise disclosed, considered necessary for a fair presentation have been made. Operating results for the fiscal three month and fiscal nine month periods ended July 29, 2007 are not necessarily indicative of the results that may be expected for the fiscal year ending October 28, 2007. Among the factors that could cause actual results to differ materially are industry cyclical and seasonality.

We use a four-four-five week calendar each quarter with year end on the Sunday closest to October 31. The year end for fiscal 2007 is October 28, 2007.

Certain reclassifications have been made to prior period amounts in our condensed consolidated statements of cash flows to conform to the current presentation.

For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the fiscal year ended October 29, 2006 filed with the Securities and Exchange Commission (the SEC).

**NOTE 2 ACQUISITIONS**

On January 31, 2007, we completed the purchase of substantially all of the assets of Garco Building Systems, Inc. ( Garco ), which designs, manufactures and distributes steel building systems primarily for markets in the northwestern United States and western Canada. Garco is now a division of our Company and the results of Garco's operations beginning January 31, 2007 are included in our condensed consolidated financial statements. Garco is headquartered in Spokane, Washington, where it operates a manufacturing facility for steel building systems for industrial, commercial, institutional and agricultural applications. The aggregate purchase price for this acquisition was \$16.3 million, comprised of \$14.5 million in cash and \$1.8 million in restricted common stock (35,448 shares). In addition, we finalized, paid and recorded a working capital adjustment of \$0.6 million and incurred estimated transaction costs of \$0.2 million. At the date of purchase, there was no excess of cost over fair value of the acquired assets. We obtained third-party valuations of certain tangible and intangible assets. As a result of the valuation work, we recorded \$5.6 million in intangible assets which includes \$2.4 million in customer relationships. The \$1.8 million in restricted NCI common stock relates to 5-year non-compete agreements with certain of the sellers of Garco. We will expense the fair value of the restricted stock ratably over the terms of the agreements. In addition, we recorded \$6.4 million in property, plant and equipment and \$5.0 million in working capital. Garco's results of operations are included in the engineered building systems segment. This acquisition was not material to the financial statements as a whole, and accordingly, pro forma information has not been provided.

On April 7, 2006, we closed our acquisition of Robertson-Ceco Corporation ( RCC ). We acquired 100% of the issued and outstanding shares of RCC. RCC is now a wholly owned subsidiary and the results of RCC's operations beginning April 7, 2006 are included in our condensed consolidated financial statements. RCC operates the Ceco Building Systems, Star Building Systems and Robertson Building Systems divisions and is a leader in the metal buildings industry. This transaction resulted in goodwill of \$277.3 million as it has created an organization with greater product and geographic diversification, a stronger customer base and a more extensive distribution network than either company had separately.

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The aggregate consideration paid for the RCC acquisition was as follows (in thousands):

Cash consideration	\$ 371,014
Transaction costs	5,128
	<b>\$ 376,142</b>

The purchase price was subject to a post-closing adjustment based on net working capital, as defined in the stock purchase agreement, of RCC at the closing date. This adjustment was finalized in March 2007 and resulted in an additional purchase price of \$4.5 million.

Upon acquisition of RCC, we began to assess RCC's manufacturing operations in Ontario, Canada and formulate a plan to exit these activities. In the second quarter of fiscal 2007, we finalized our RCC integration plans to shut-down, exit and dispose of this manufacturing facility. Our plan calls for the sales, marketing, engineering, drafting and customer service capabilities in Ontario to continue, but in accordance with our plan, manufacturing activities have ceased and the manufacturing facility is being sold. The liquidation plans call for a small portion of the manufacturing equipment to be transferred to existing manufacturing facilities and the remainder, including the real estate and buildings, to be sold to third parties. In the second quarter of fiscal 2007, we established a reserve of \$1.2 million, and through July 29, 2007 have incurred expenses of \$0.3 million, for certain severance and exit costs relating to the closure of this manufacturing facility, which has been recognized as a liability at the date of acquisition and is included in other accrued expenses in the Condensed Consolidated Balance Sheet at July 29, 2007. Accrued severance costs related to the terminated employees will primarily be paid in the fourth quarter of fiscal 2007. Additionally, the preliminary carrying value of the plant and equipment in Ontario has been reduced by \$2.5 million to reflect its estimated fair market value upon disposition. Costs associated with these actions have not impacted current earnings and have been recognized as a component of purchase accounting, resulting in an adjustment to increase goodwill by \$2.8 million, net of tax effects.

**NOTE 3 INVENTORIES**

The components of inventory are as follows (in thousands):

	July 29, 2007	October 29, 2006
Raw materials	\$ 119,063	\$ 121,024
Work in process and finished goods	51,227	39,184
	<b>\$ 170,290</b>	<b>\$ 160,208</b>

**NOTE 4 BUSINESS SEGMENTS**

We have aggregated our operations into three reportable segments based upon similarities in product lines, manufacturing processes, marketing and management of our businesses: metal components, engineered building systems and metal coil coating. Products of all three segments use similar basic raw materials. The metal components segment products include metal roof and wall panels, doors, metal partitions, metal trim and other related accessories. The engineered building systems segment includes the manufacturing of main frames, Long Bay® Systems and value-added engineering and drafting, which are typically not part of metal components or metal coil coating products or services. The metal coil coating segment consists of cleaning, treating, painting and slitting continuous steel coils before the steel is fabricated. The reporting segments follow the same accounting policies used for our consolidated financial statements. We evaluate a segment's performance based primarily upon operating income before corporate expenses. Intersegment sales are recorded based on standard material costs plus a standard markup to cover labor and overhead and consist of: (i) building components provided by the metal components segment to the engineered building systems segment, (ii) structural framing provided by the engineered building systems segment to the metal components segment, and (iii) hot rolled, light gauge painted and slit material and other services provided by the metal coil coating segment to both the engineered building systems and metal components segments. We are not dependent on any one customer or group of customers. Substantially all of our sales are made within the United States. For the fiscal nine months



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ended July 29, 2007, steel represented approximately 73% of our cost of goods sold. We are not dependent on any single source for our supply of steel, but approximately 39% of our steel purchases came from our two largest suppliers.

The following table represents sales, operating income and total assets attributable to these business segments for the periods indicated (in thousands):

	Fiscal Three Months Ended		Fiscal Nine Months Ended	
	July 29, 2007	July 30, 2006	July 29, 2007	July 30, 2006
<b>Total sales:</b>				
Metal components	\$ 193,140	\$ 206,270	\$ 511,257	\$ 555,167
Engineered building systems	256,086	250,907	692,393	524,221
Metal coil coating	72,275	74,813	195,338	199,169
Intersegment sales	(87,657)	(82,597)	(238,114)	(206,550)
Total sales	\$ 433,844	\$ 449,393	\$ 1,160,874	\$ 1,072,007
<b>External sales:</b>				
Metal components	\$ 166,291	\$ 181,215	\$ 438,194	\$ 486,551
Engineered building systems	244,291	239,561	662,162	494,931
Metal coil coating	23,262	28,617	60,518	90,525
Total sales	\$ 433,844	\$ 449,393	\$ 1,160,874	\$ 1,072,007
<b>Operating income:</b>				
Metal components	\$ 16,852	\$ 28,663	\$ 38,060	\$ 68,203
Engineered building systems	30,639	19,396	66,682	39,386
Metal coil coating	8,166	8,435	18,570	18,421
Corporate	(13,647)	(15,019)	(39,977)	(39,963)
Total operating income	\$ 42,010	\$ 41,475	\$ 83,335	\$ 86,047
Unallocated other expense	6,837	7,145	20,261	12,207
Income before income taxes	\$ 35,173	\$ 34,330	\$ 63,074	\$ 73,840

	July 29, 2007	October 29, 2006
<b>Total assets:</b>		
Metal components	\$ 365,020	\$ 374,233
Engineered building systems	698,489	684,213
Metal coil coating	202,970	193,050
Corporate	34,011	52,747
Total assets	\$ 1,300,490	\$ 1,304,243

Corporate assets consist primarily of cash but also include deferred financing costs and property, plant and equipment associated with our headquarters in Houston, Texas. These items (and income and expenses related to these items) are not allocated to the segments.

**NOTE 5 SHARE-BASED COMPENSATION**

Our 2003 Long-Term Stock Incentive Plan is an equity-based compensation plan that allows us to grant a variety of types of awards, including stock options, restricted stock, restricted stock units, stock appreciation rights, performance share awards, phantom stock awards and cash awards. As of July 29, 2007 and for all periods presented, our share-based awards under this plan have consisted of restricted stock grants and

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stock option grants, neither of which can be settled through cash payments. We account for these restricted stock grants and stock option grants in accordance with Statement of Financial Accounting Standards 123(Revised), *Share-Based Payment*.

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During the nine months ended July 29, 2007, we granted 151,456 shares of restricted stock awards with a fair value of \$8.2 million. The restricted stock awards granted during the three months ended July 29, 2007 were insignificant. The total pre-tax share-based compensation cost that has been recognized in results of operations was \$2.3 million and \$2.1 million for the three months ended July 29, 2007 and July 30, 2006, respectively, and \$6.4 million and \$6.1 million for the nine months ended July 29, 2007 and July 30, 2006, respectively. Of these amounts, \$2.1 million and \$1.8 million for the three months ended July 29, 2007 and July 30, 2006, respectively, and \$5.8 million and \$5.4 million for the nine months ended July 29, 2007 and July 30, 2006, respectively, were included in selling, general and administrative expense, with the remaining costs in each period in cost of goods sold. As of July 29, 2007 and October 29, 2006, we do not have any amounts capitalized for share-based compensation cost in inventory or similar assets. The total income tax benefit recognized in results of operations for share-based compensation arrangements was \$0.9 million and \$0.8 million for the three months ended July 29, 2007 and July 30, 2006, respectively, and \$2.4 million and \$2.3 million for the nine months ended July 29, 2007 and July 30, 2006, respectively. As of July 29, 2007 and July 30, 2006, there was approximately \$16.3 million and \$16.7 million, respectively, of total unrecognized compensation cost related to share-based compensation arrangements. That cost is expected to be recognized over a weighted-average remaining period of 4.3 years and 4.6 years, respectively.

Cash received from option exercises was \$2.3 million and \$5.5 million during the first nine months of fiscal 2007 and 2006, respectively. The actual tax benefit realized for the tax deductions from option exercises totaled \$0.9 million and \$2.1 million for the first nine months of fiscal 2007 and 2006, respectively.

**NOTE 6 EARNINGS PER SHARE**

Basic earnings per common share is computed by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per common share considers the effect of common stock equivalents. The reconciliation of the numerator and denominator used for the computation of basic and diluted earnings per share is as follows (in thousands, except per share data):

	Fiscal Three Months Ended		Fiscal Nine Months Ended	
	July 29, 2007	July 30, 2006	July 29, 2007	July 30, 2006
<b>Numerator for Basic and Diluted Earnings Per Share</b>				
Net income	\$ 21,327	\$ 21,675	\$ 38,291	\$ 45,747
<b>Denominator for Diluted Earnings Per Share</b>				
Weighted average common shares outstanding for basic earnings per share	19,655	20,065	19,661	20,079
Common stock equivalents:				
Employee stock options	216	274	232	263
Unvested restricted stock awards	84	88	83	85
Convertible Notes	926	1,291	1,046	1,052
Adjusted weighted average shares and assumed conversions for diluted earnings per share	20,881	21,718	21,022	21,479
Earnings per share:				
Basic	\$ 1.09	\$ 1.08	\$ 1.95	\$ 2.28
Diluted	\$ 1.02	\$ 1.00	\$ 1.82	\$ 2.13

During the fiscal three and nine months ended July 29, 2007, our average stock price traded above the initial conversion price (approximately \$40.14) of our Notes (see Note 9). The indenture under which the Notes were issued contains a net share settlement provision as described in EITF 04-08, *The Effect of Contingently Convertible Instruments on Diluted Earnings Per Share*, whereby conversions are settled for a combination of

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cash and shares, and shares are only issued to the extent the conversion value exceeds the principal amount. The incremental shares that we would have been required to issue had the Notes been converted at the average trading price during the period have been included in the number of diluted shares outstanding for the three and nine months ended July 29, 2007.

**NOTE 7 WARRANTY**

We sell weathertightness warranties to our customers for protection from leaks in our roofing systems related to weather. These warranties range from two years to 20 years. We sell two types of warranties, standard and Single Source, and three grades of coverage for each. The type and grade of coverage determines the price to the customer. For standard warranties, our responsibility for leaks in a roofing system begins after 24 consecutive leak-free months. For Single Source warranties, the roofing system must pass our inspection before warranty coverage will be issued. Inspections are typically performed at three stages of the roofing project: (i) at the project start-up; (ii) at the project mid-point and (iii) at the project completion. These inspections are included in the cost of the warranty. If the project requires or the customer requests additional inspections, those inspections are billed to the customer. Upon the sale of a warranty, we record the resulting revenue as deferred warranty revenue, which is included in other accrued expenses in our consolidated balance sheets. We recognize this deferred warranty revenue over the warranty coverage period in a manner that matches our estimated expenses relating to the warranty. Additionally, we assumed a warranty obligation relating to our acquisition of RCC of \$7.6 million which represents the fair value of the future warranty obligation. RCC's accrued warranty programs have similar terms and characteristics to our other warranty programs.

The following table represents our rollforward of accrued warranty and deferred warranty revenue activity for the nine months ended July 29, 2007 (in thousands):

<b>Beginning balance at October 29, 2006</b>	<b>\$ 14,863</b>
Warranties issued	1,728
Revenue recognized	(720)
Other	(171)
<b>Ending balance at July 29, 2007</b>	<b>\$ 15,700</b>

**NOTE 8 EMPLOYEE BENEFIT PLANS**

*Deferred Compensation Plan* On October 23, 2006, our board of directors approved an Amended and Restated Deferred Compensation Plan for NCI (as amended and restated, the Deferred Compensation Plan). The Deferred Compensation Plan allows our officers and key employees to defer up to 80% of their annual salary and up to 90% of their bonus until a specified date in the future, including at or after retirement and allows our directors to defer up to 100% of their annual fees and meeting attendance fees until a specified date in the future, including at or after retirement. The Deferred Compensation Plan also permits us to make contributions on behalf of our key employees who are impacted by the federal tax compensation limits under the NCI 401(k) plan, and to receive a restoration matching amount which, under the current NCI 401(k) terms, will be at 4% and up to 6% of compensation in excess of those limits, based on our Company's performance. In addition, the Deferred Compensation Plan provides for us to make discretionary contributions to employees who have elected to defer compensation under the plan. Deferred Compensation Plan participants will vest in our discretionary contributions ratably over three years from the date of each of our discretionary contributions. As of July 29, 2007, the liability balance of the Deferred Compensation Plan is \$1.3 million and is included in other long-term liabilities in the Condensed Consolidated Balance Sheet. We have not made any discretionary contributions to the Deferred Compensation Plan.

The Deferred Compensation Plan became effective for compensation beginning in calendar 2007. Our board of directors also approved the establishment of a rabbi trust to fund the Deferred Compensation Plan and the formation of an administrative committee to manage the Deferred Compensation Plan and its assets. The investments in the rabbi trust are \$1.3 million at July 29, 2007 and are included primarily in prepaid expenses and other current assets in the Condensed Consolidated Balance Sheet.

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**Defined Benefit Plan** As a result of the closing of the RCC acquisition on April 7, 2006, we assumed a defined benefit plan (the RCC Benefit Plan). Benefits under the RCC Benefit Plan are primarily based on years of service and the employee's compensation. The RCC Benefit Plan is frozen and therefore employees do not accrue additional service benefits. Plan assets of the RCC Benefit Plan are invested in broadly diversified portfolios of government obligations, hedge funds, mutual funds, partnerships, stocks, bonds and fixed income securities.

The following table sets forth the components of the net periodic benefit cost (in thousands):

	Fiscal Three Months Ended		Fiscal Nine Months Ended	
	July 29, 2007	July 30, 2006	July 29, 2007	July 30, 2006
Interest cost	\$ 723	\$ 754	\$ 2,169	\$ 942
Expected return on assets	(897)	(934)	(2,691)	(1,167)
Net periodic benefit cost	\$ (174)	\$ (180)	\$ (522)	\$ (225)

During the three months and nine months ended July 29, 2007, we contributed \$0.2 million and \$0.3 million, respectively, to the RCC Benefit Plan. We expect to contribute approximately \$0.9 million to the RCC Benefit Plan during the remainder of fiscal 2007. During the three months and nine months ended July 30, 2006, we contributed \$1.0 million and \$2.0 million, respectively, to the RCC Benefit Plan.

**NOTE 9 LONG-TERM DEBT**

Debt is comprised of the following (in thousands):

	July 29, 2007	October 29, 2006
\$400 Million Term Loan, due June 2010 (6.8% at July 29, 2007 and 6.8% - 6.9% at October 29, 2006)	\$ 315,000	\$ 315,000
2.125% Convertible Senior Subordinated Notes, due November 2024	180,000	180,000
Industrial Revenue Bond	2,260	2,950
Capital lease commitments	14	34
	497,274	497,984
Current portion of long-term debt	(934)	(947)
Total long-term debt	\$ 496,340	\$ 497,037

The scheduled maturity of our debt is as follows (in thousands):

July 30, 2007 to October 28, 2007	\$ 237
2008	927
2009	920
2010	315,190
2011 and thereafter	180,000
	\$ 497,274

Our senior secured credit facility includes a \$125 million five-year revolving credit facility maturing on June 18, 2009 with a sub-facility for letters of credit of a maximum of \$50 million and a \$400 million term loan maturing on June 18, 2010, of which \$315 million is outstanding at July 29, 2007. At July 29, 2007 and October 29, 2006, there were no balances outstanding under the revolving credit facility and letters of credit totaling approximately \$15.7 million and \$15.9 million, respectively, were outstanding on the revolving credit facility.





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In November 2004, we completed an offering of \$180.0 million aggregate principal amount 2.125% convertible senior subordinated notes due 2024 (the Notes) with interest payable semi-annually. Interest on the Notes is not deductible for income tax purposes, which creates a permanent tax difference that is reflected in our effective tax rate. The Notes are general unsecured obligations and are subordinated to our present and future senior indebtedness.

We have the right to redeem the Notes, beginning on November 20, 2009, for a price equal to 100% of the principal amount plus accrued and unpaid interest, if any. Each holder has the right to require that we repurchase the Notes after five, 10 and 15 years at 100% of the principal amount plus accrued and unpaid interest, if any, beginning November 15, 2009. Upon the occurrence of certain designated events, holders of the Notes will also have the right to require that we purchase all or some of their Notes at a redemption price equal to 100% of the principal amount plus accrued and unpaid interest, if any, and, in certain circumstances, a make whole premium. We must pay the repurchase price of the aggregate principal amount of the Notes in cash unless prohibited by limitations imposed by our existing or future senior credit facilities. The Notes are convertible into cash or, in certain circumstances, a combination of cash and shares of our common stock, at a ratio of 24.9121 shares of common stock per \$1,000 principal amount notes, which is equivalent to an initial conversion price of approximately \$40.14 per common share. The ratio is subject to adjustments if certain events take place, and holders may convert only if the closing sale price per common share exceeds 120% of the conversion price for at least 20 trading days in the 30 consecutive trading day period ending on the last trading day of the preceding calendar quarter. As of July 29, 2007 and October 29, 2006, \$180.0 million principal amount of the Notes was outstanding. Our stock price exceeded the conversion threshold of the Notes for at least 20 trading days in each of the 30 consecutive trading day periods ended September 30, 2006 and June 30, 2007; therefore, our Notes may be converted by the holders, at their option, after June 30, 2007. As a result, the outstanding \$180.0 million obligation included in long-term debt, is by its terms, a current obligation. However, because we have sufficient capacity under existing long-term facilities, the senior secured credit facility, to fund the conversion of the full principal of the Notes if converted, and expect to continue to have that capacity through at least one year from the current balance sheet date, we have thus classified our obligation as long term in our Condensed Consolidated Balance Sheet in accordance with SFAS No. 6, *Classification of Short-Term Obligations Expected to Be Refinanced*. In addition, as the Notes are convertible into shares of our common stock, they are common stock equivalents in our earnings per share calculation. See Note 6 for further information.

**NOTE 10 INTEREST RATE SWAP**

On June 15, 2006, we entered into a forward interest rate swap agreement (the Swap Agreement) hedging a portion of our \$400 million variable rate term loan due June 2010 with a notional amount of \$160 million beginning October 11, 2006. The notional amount will decrease on each of October 11, 2007, October 14, 2008 and October 13, 2009 to \$145 million, \$105 million and \$65 million, respectively. The term of the Swap Agreement is four years. Under the Swap Agreement, we will pay a fixed rate of 5.55% on a quarterly basis in exchange for receiving floating rate payments based on the three-month LIBOR rate.

We utilize interest rate swaps to manage our risk associated with changing interest rates and account for them under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended (SFAS 133). SFAS 133 requires that all derivatives be marked to market (fair value). We do not purchase or hold any derivative instruments for trading purposes.

We designated our Swap Agreement as a cash flow hedge, as defined by SFAS 133. The fair value of the Swap Agreement, excluding accrued interest, as of July 29, 2007 and October 29, 2006, was a liability of approximately \$1.6 million and \$2.3 million, respectively. The fair value of the Swap Agreement is recorded in other long-term liabilities in the Condensed Consolidated Balance Sheet and the unrealized loss is recorded in other comprehensive income.

Fair value estimates presented for the Swap Agreement were determined based on the present value of all future cash flows, the fixed rate in the contract and assumptions regarding forward interest rates from a yield curve.

We are exposed to credit loss in the event of nonperformance by the counterparty on the Swap Agreement. If the counterparty fails to meet the terms of the agreement, our exposure is limited to the net amount that would have

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been received, if any, over the remaining life of the Swap Agreement. We do not anticipate nonperformance as the contract is with a creditworthy counterparty and no material loss would be expected from nonperformance by the counterparty.

**NOTE 11 COMPREHENSIVE INCOME**

Comprehensive income consists of the following (in thousands):

	Fiscal Three Months Ended		Fiscal Nine Months Ended	
	July 29, 2007	July 30, 2006	July 29, 2007	July 30, 2006
Net income	\$ 21,327	\$ 21,675	\$ 38,291	\$ 45,747
Foreign exchange translation gain (loss), net of tax	160	(68)	140	126
Change in fair value of interest rate swap, net of tax	264	(677)	416	(677)
	\$ 21,751	\$ 20,930	\$ 38,847	\$ 45,196

Accumulated other comprehensive income consists of the following (in thousands):

	July 29, 2007	October 29, 2006
Foreign exchange translation adjustments	\$ 226	\$ 86
Unrecognized actuarial loss on pension obligation	(454)	(454)
Unrealized losses on interest rate swap	(1,019)	(1,436)
	\$ (1,247)	\$ (1,804)

**NOTE 12 RECENT ACCOUNTING PRONOUNCEMENTS**

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* ( SFAS 159 ). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective for our fiscal year that begins November 3, 2008. We are currently evaluating the impact of adopting SFAS 159.

In September 2006, the FASB issued SFAS 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R)* ( SFAS 158 ). SFAS 158, which is effective for us on October 28, 2007, requires employers to recognize the funded status of defined benefit postretirement plans as an asset or liability on the balance sheet and to recognize changes in that funded status through comprehensive income. SFAS 158 also establishes the measurement date of plan assets and obligations as the date of the employer's fiscal year end, and provides for additional annual disclosures. We currently use our fiscal year end as the measurement date for our defined benefit plan. We do not believe that the adoption of this pronouncement will have a material impact on our financial statements.

In September 2006, the FASB issued SFAS 157, *Fair Value Measurement* ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective for our fiscal year that begins November 3, 2008. We are currently evaluating the impact of adopting SFAS 157.

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In June 2006, the FASB issued FASB Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109, Accounting for Income Taxes*, which clarifies the accounting for uncertainty in income taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 requires that we recognize in the financial statements the impact of a tax position only if that position is more likely than not of being sustained upon examination, based on the technical merits of the position. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. We will implement this interpretation in the fiscal year starting October 29, 2007. We do not believe that the adoption of this pronouncement will have a material impact on our financial statements.

**NOTE 13 CONTINGENCIES**

In September 2003, Bethlehem Steel Corporation and several of its related entities (collectively, Bethlehem ) filed a preference-avoidance lawsuit against us and several of our operating subsidiaries in the United States Bankruptcy Court for the Southern District of New York. The lawsuit was filed as part of the Bethlehem consolidated bankruptcy proceedings, seeking reimbursement of allegedly preferential transfers made by the respective debtors in the 90-day period preceding their bankruptcy filings. Bethlehem alleges that it made preferential payments to our subsidiaries of approximately \$7.7 million. We have denied the allegations in the Bethlehem lawsuit and are vigorously defending against this claim. We do not believe these legal proceedings will have a material adverse effect on our business, consolidated financial condition or results of operations.

We discovered the existence of polychlorinated biphenyls ( PCBs ) and heavy metals at our Metal Prep Houston site, which is located in an industrial area in Houston, Texas. Soil borings were sampled and analyzed to determine the impact on the soil at this site, and the findings indicated that remediation of the site was necessary. We began implementation of our remedial action plan in the second quarter of fiscal 2006 and completed excavation and transportation of the contaminated materials to an approved offsite location in July 2006. Through July 29, 2007, we spent \$3.4 million related to this matter. On November 10, 2006, the TCEQ issued its Voluntary Cleanup Program Final Certificate of Completion, stating that necessary response actions have been completed on the subject property as of October 30, 2006.

Over a period of 25 months beginning in March 2003 and ending in April 2005, our engineered building systems segment received shipments of flat bar steel and related materials from a third-party steel mill in Mexico that were below specifications. We identified a total of 57 projects, out of approximately 20,150 projects that were processed by our engineered building systems segment during this time period, which will require some level of repairs. Beginning in June 2006, we implemented a plan to inspect each of these 57 projects to determine the use of the flat bar steel in the buildings and coordinate all necessary repairs. We have substantially completed our inspections. Additionally, we have substantially completed the repairs for the 57 projects identified and have incurred expenses through July 29, 2007 of \$1.6 million. Additionally, as of July 29, 2007, we have a remaining accrual in other accrued liabilities of \$0.2 million. To date, we have received \$0.7 million in settlement funds from the related steel mill in Mexico.

We have discovered the existence of trichloroethylene in the ground water at our Southlake, Texas facility. Concentrations in excess of applicable residential assessment levels have not been fully identified. We have filed an application with the Texas Commission of Environmental Quality ( TCEQ ) for entry into the voluntary cleanup program. Upon completion of expected further testing in the fourth quarter of fiscal 2007, we will prepare and submit a proposed remedial action plan to TCEQ. The cost of required remediation, if any, will vary depending on the nature and extent of the contamination which is expected to be determined in the fourth quarter of fiscal 2007. Based on facts currently available, management does not know what the financial impact will be on our consolidated financial position or results of operations.

From time to time, we are involved in various other legal proceedings and contingencies, including environmental matters, considered to be in the ordinary course of business. While we are not able to predict whether we will incur any liability in excess of insurance coverages or to accurately estimate the damages, or the range of damages, if any, we might incur in connection with these legal proceedings, we believe these legal proceedings and claims will not have a material adverse effect on our business, consolidated financial position or results of operations.

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**NCI BUILDING SYSTEMS, INC.**

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

The following information should be read in conjunction with the unaudited condensed consolidated financial statements included herein under Item 1. Financial Statements and the audited consolidated financial statements and the notes thereto and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended October 29, 2006.

**OVERVIEW**

NCI Building Systems, Inc. (the Company, we or our ) is one of North America's largest integrated manufacturers and marketers of metal products for the non-residential construction industry. We design, engineer, manufacture and market metal components and engineered building systems and provide metal coil coating services primarily for non-residential construction use. We manufacture and distribute extensive lines of metal products for the non-residential construction market under multiple brand names through a nationwide network of plants and distribution centers. We sell our products for both new construction and repair and retrofit applications.

Metal components offers builders, designers, architects and end-users several advantages, including lower long-term costs, longer life, attractive aesthetics and design flexibility. Similarly, engineered building systems offers a number of advantages over traditional construction alternatives, including shorter construction time, more efficient use of materials, lower construction costs, greater ease of expansion and lower maintenance costs.

The third quarter of fiscal 2007 marked a strengthening in demand for our products as compared to the second quarter of fiscal 2007. This improvement was reflected by a 21% sequential-quarter increase in third-party sales for our metal components business, which, because of short lead times, is more immediately affected by current industry conditions. Greater capacity utilization contributed to growth in the metal components operating margin to 10% of sales for the third quarter from 7% for the second quarter, as well as an 85% sequential-quarter increase in operating income. Metal component's sales and margins did not match those for the third quarter of fiscal 2006, which had the strongest low-rise, non-residential construction activity in over four years.

NCI's engineered building systems segment also benefited from firmer industry conditions during the third quarter. Having entered the quarter with a record backlog of \$449 million, engineered building systems third-party sales increased 17% sequentially from the second quarter and 2% from the third quarter of fiscal 2006. In spite of this sales growth, strong quote activity during the quarter enabled us to expand our engineered building systems backlog to \$453 million at the quarter's end, compared with \$436 million at the end of the third quarter of fiscal 2006.

The growth in the engineered building systems segment's sales drove an expansion in the segment's operating margin to 13% from 7% for the second quarter. Compared with the 8% engineered building systems operating margin for the third quarter of fiscal 2006, our performance for the latest quarter also reflected greater synergies from the RCC acquisition completed in April 2006.

The operating leverage potential in our metal coil coating business was evident in the third quarter of fiscal 2007, as 13% sequential-quarter growth in total segment sales compared with the second quarter produced a 42% increase in operating income to 35% of external sales from 28%. The RCC acquisition again had a positive impact on the metal coil coating segment, accounting for much of the 14% increase in intersegment sales and base-loading the segment's manufacturing capacity. In addition, improved product mix within our third-party sales, which increased 12% sequentially, contributed to the expansion in operating margin versus both the second quarter of fiscal 2007 and the third quarter of fiscal 2006.

***Business Strategy***

In late 2003, we conducted a comprehensive review of our business and growth strategy, which resulted in a strategic

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plan that was approved by our board of directors in early 2004. Our primary goal under the strategic plan is to materially increase our market value by increasing our earnings per share over a five-year period beginning in fiscal 2004, utilizing a combination of accretive acquisitions, organic growth and information technology upgrades.

*Acquisitions.* Our goal is to increase our existing markets and penetrate new markets through strategic acquisitions. We have a history of successfully completing strategic acquisitions in our industry. In late 2004, we made an inroad into the potentially growing segment of the non-residential construction market referred to as rural and agricultural through our purchase of Heritage and Steelbuilding.com. As a result of this acquisition, we believe we have strengthened our ability to compete in the rural and agricultural sub-segments of our market utilizing our existing manufacturing facilities.

Further, in April 2006, we acquired 100% of the issued and outstanding stock of RCC for a purchase price of \$371.0 million, excluding transaction costs. The RCC acquisition provides expansion of our geographic footprint in the United States and Canada with the addition of seven metal building manufacturing plants. RCC operates the Ceco Building Systems, Star Building Systems and Robertson Building Systems divisions and is a leader in the metal buildings industry. Furthermore, we have identified between \$6.0 and \$25.0 million in potential synergies that should enhance the accretive earnings potential from the acquisition. We believe this transaction has created an organization with greater product and geographic diversification, a stronger customer base and a more extensive distribution network than either company had separately.

In the second quarter of 2007, we finalized our RCC integration plans to shut-down, exit and dispose of the manufacturing facility in Ontario, Canada. Management's plan calls for the sales, marketing, engineering, drafting and customer service capabilities in Ontario to continue, but in accordance with management's plan, manufacturing activities have ceased and the manufacturing facility is being sold.

On January 31, 2007, we completed the purchase of substantially all the assets of Garco Building Systems, Inc. ( Garco ), which designs, manufactures and distributes steel building systems primarily for markets in the northwestern United States and western Canada. Garco is headquartered in Spokane, Washington, where it operates a manufacturing facility for steel building systems for industrial, commercial, institutional and agricultural applications. The aggregate purchase price for this acquisition was \$16.3 million, comprised of \$14.5 million in cash and \$1.8 million in restricted common stock.

We expect that the addition of Garco will strengthen our presence in growth markets in the northwestern United States and western Canada. In addition to an established distribution and builders network, Garco has built a well-respected brand name. We also gain an advanced manufacturing facility, which is our first in the Northwest, a highly experienced operating team and a 33 acre site suitable for future expansion.

*Organic Growth.* In addition to growth through strategic acquisitions, we have identified several potential areas for organic growth. We have initiated several actions to further this goal, including increasing our metal coil coating segment's sales to third parties, expanding our retail customer sales channels, expanding our builder network and expanding our share of the retrofit and repair markets.

*Information Technology.* An important component of our growth strategy is the development of an Enterprise Resources Platform ( ERP ), engineering systems and web-based order entry systems. We have selected Oracle 11i as our ERP system, and have completed its installation in our metal coil coating business. We are continuing to implement Oracle 11i in our other business units and corporate functions, and we expect to complete the installation by 2010.

## ***Industry Conditions***

Our sales and earnings are influenced by general economic conditions, interest rates, the price of steel relative to other building materials, the level of non-residential construction activity, roof repair and retrofit demand and the availability and cost of financing for construction projects.

One of the primary challenges we face both short and long term is the volatility in the price of steel. Our business is heavily dependent on the prices and supply of steel, which is the principal raw material used in our products.

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For the fiscal nine months ended July 29, 2007, steel represented approximately 73% of our cost of goods sold. The steel industry is highly cyclical in nature, and steel prices have been volatile in recent years and may remain volatile in the future. Steel prices are influenced by numerous factors beyond our control, including general economic conditions, competition, labor costs, production costs, import duties and other trade restrictions.

We do not have any long-term contracts for the purchase of steel and normally do not maintain an inventory of steel in excess of our current production requirements. However, from time to time, we may purchase steel in advance of announced steel price increases. We can give no assurance that steel will remain available or that prices will not continue to be volatile. While most of our contracts have escalation clauses that allow us, under certain circumstances, to pass along all or a portion of increases in the price of steel after the date of the contract but prior to delivery, we may, for competitive or other reasons, not be able to pass such price increases along. If the available supply of steel declines, we could experience price increases that we are not able to pass on to our customers, a deterioration of service from our suppliers or interruptions or delays that may cause us not to meet delivery schedules to our customers. Any of these problems could adversely affect our results of operations and financial condition. For additional discussion please see [Liquidity and Capital Resources](#) [Steel Prices](#) and [Item 3. Quantitative and Qualitative Disclosures About Market Risk](#) [Steel Prices](#).

In assessing the state of the metal construction market, we rely upon various industry associations, third party research, and various government reports such as industrial production and capacity utilization. One such industry association is the Metal Building Manufacturers Association ( MBMA ), which provides summary member sales information and promotes the design and construction of metal buildings and metal roofing systems. Another is McGraw-Hill Construction Information Group, which we look to for reports of actual and forecasted growth in various construction related industries, including the overall non-residential construction market. McGraw-Hill Construction's forecast for 2007 expects a total non-residential construction growth of 4% in dollar value. Additionally, we review the American Institute of Architects survey for inquiry and billing activity for the industrial, commercial and institutional sectors.

We assess performance across our business segments by analyzing and evaluating (i) gross profit, operating income and whether or not each segment has achieved its projected sales goals, and (ii) non-financial efficiency indicators such as revenue per employee, man hours per ton of steel produced and shipped tons per employee. In assessing our overall financial performance, we regard return on adjusted operating assets, as well as growth in earnings per share, as key indicators of shareholder value.

## **RESULTS OF OPERATIONS**

We have aggregated our operations into three reportable segments based upon similarities in product lines, manufacturing processes, marketing and management of our businesses: metal components, engineered building systems and metal coil coating. All segments operate primarily in the non-residential construction market. Sales and earnings are influenced by general economic conditions, the level of non-residential construction activity, metal roof repair and retrofit demand and the availability and terms of financing available for construction.

Products of all business segments use similar basic raw materials. The metal components segment products include metal roof and wall panels, doors, metal partitions, metal trim and other related accessories. The engineered building systems segment includes the manufacturing of main frames, Long Bay® Systems and value-added engineering and drafting, which are typically not part of metal components or metal coil coating products or services. The metal coil coating segment consists of cleaning, treating, painting and slitting continuous steel coils before the steel is fabricated. The reporting segments follow the same accounting policies used for our consolidated financial statements. We evaluate a segment's performance based primarily upon operating income before corporate expenses.

Intersegment sales are recorded based on standard material costs plus a standard markup to cover labor and overhead and consist of: (i) building components provided by the metal components segment to the engineered building systems segment, (ii) structural framing provided by the engineered building systems segment to the metal components segment, and (iii) hot rolled, light gauge painted, and slit material and other services provided by the metal coil coating segment to both the metal components and engineered building systems segments. Segment information is included in Note 4 of our condensed consolidated financial statements.

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The following table represents sales, operating income and total assets attributable to these business segments for the periods indicated (in thousands, except percentages):

	Fiscal Three Months Ended				Fiscal Nine Months Ended			
	July 29, 2007		July 30, 2006		July 29, 2007		July 30, 2006	
		%		%		%		%
<b>Sales:</b>								
Metal components	\$ 193,140	44	\$ 206,270	46	\$ 511,257	44	\$ 555,167	52
Engineered building systems	256,086	59	250,907	55	692,393	60	524,221	48
Metal coil coating	72,275	17	74,813	17	195,338	17	199,169	19
Intersegment sales	(87,657)	(20)	(82,597)	(18)	(238,114)	(21)	(206,550)	(19)
Total sales	\$ 433,844	100	\$ 449,393	100	\$ 1,160,874	100	\$ 1,072,007	100
<b>Operating income:</b>								
Metal components	\$ 16,852	9	\$ 28,663	14	\$ 38,060	7	\$ 68,203	12
Engineered building systems	30,639	12	19,396	8	66,682	10	39,386	8
Metal coil coating	8,166	11	8,435	11	18,570	10	18,421	9
Corporate	(13,647)		(15,019)		(39,977)		(39,963)	
Total operating income (% of sales)	\$ 42,010	10	\$ 41,475	9	\$ 83,335	7	\$ 86,047	8
Unallocated other expense	6,837		7,145		20,261		12,207	
Income before income taxes	\$ 35,173		\$ 34,330		\$ 63,074		\$ 73,840	
<b>Total assets:</b>								
Metal components					\$ 365,020	28	\$ 374,233	29
Engineered building systems					698,489	54	684,213	52
Metal coil coating					202,970	16	193,050	15
Corporate					34,011	2	52,747	4
Total assets					\$ 1,300,490	100	\$ 1,304,243	100

Corporate assets consist primarily of cash but also include deferred financing costs and property, plant and equipment associated with our headquarters in Houston, Texas. These items (and income and expenses related to these items) are not allocated to the segments.

**NCI BUILDING SYSTEMS, INC.****FISCAL THREE MONTHS ENDED JULY 29, 2007 COMPARED TO FISCAL THREE MONTHS ENDED JULY 30, 2006**

*Consolidated sales* for the three months ended July 29, 2007 were \$433.8 million compared with \$449.4 million for the three months ended July 30, 2006. Sales were down 3.5%, or \$15.5 million. This decrease was the result of decreased tonnage volumes in the metal components and building systems segments, partially offset by increased sales at Garco in the amount of \$10.2 million as a result of the acquisition. Lower tonnage volumes in the metal components and engineered building systems segments in the third fiscal quarter of 2007 compared with the same period in 2006 were driven by softer demand for our products.

*Consolidated cost of sales* decreased 3.5% for the three months ended July 29, 2007 to \$324.1 million compared with \$335.7 million for the three months ended July 30, 2006. Gross margins were 25.3% for both the three months ended July 29, 2007 and for the same prior year period. Lower margins in the metal components segment resulted from higher material costs, primarily steel costs, which were not entirely passed on to customers and lower sales volumes produced over a fixed cost base. The gross margins in our engineered building systems segment were higher due to higher material costs which we effectively passed on to customers and a \$2.8 million increase as a result of the Garco acquisition. The



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lower margins at the metal coil coating segment resulted from increased intersegment sales volume, partially offset by a change in product mix from package sales of coated steel products to tolling revenue for coating services.

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*Metal components* sales decreased \$13.1 million, to \$193.1 million, in the three months ended July 29, 2007 compared to \$206.3 million in the prior year's period. Sales were down primarily due to a 9.2% decrease in external tons shipped. Sales to third parties for the three months ended July 29, 2007 decreased \$14.9 million to \$166.3 million from \$181.2 million in the prior year's quarter. This decrease was partially offset by a \$1.8 million increase in intersegment sales. Metal components accounted for 44.5% of total consolidated sales in the three months ended July 29, 2007 compared to 45.9% in the three months ended July 30, 2006.

Operating income of the metal components segment decreased 41.2% in the three months ended July 29, 2007, to \$16.9 million, compared to \$28.7 million in the same prior year period. This \$11.8 million decrease resulted from a \$13.1 million decrease in gross profit, partially offset by a \$1.2 million decrease in selling and administrative expenses. The decrease in selling and administrative expenses was due to decreases of various expenses, including incentive compensation costs.

*Engineered building systems* sales increased \$5.2 million to \$256.1 million in the three months ended July 29, 2007 compared to \$250.9 million in the prior year's period. Of this increase, \$10.2 million was attributable to the Garco acquisition, partially offset by a decrease in volume shipped. Sales to third parties for the three months ended July 29, 2007 increased \$4.7 million to \$244.3 million from \$239.6 million in the prior year's period. The remaining \$0.5 million increase represents an increase in intersegment sales for the three months ended July 29, 2007 compared to the prior year's period. Engineered building systems accounted for 59.0% of total consolidated sales in the three months ended July 29, 2007 compared to 55.8% in the three months ended July 30, 2006.

Operating income of the engineered building systems segment increased 58.0% in the three months ended July 29, 2007 to \$30.6 million, compared to \$19.4 million in the prior year's period. This \$11.2 million increase resulted from a \$9.5 million increase in gross profit and a \$1.7 million decrease in selling and administrative expenses. The decrease in selling and administrative expenses was primarily related to incentive compensation costs of \$1.4 million, 401(k) and health benefits costs of \$0.8 million, workers compensation costs of \$0.3 million, remediation costs of \$0.3 million and other costs of \$0.8 million, partially offset by a \$1.9 million increase related to the recent Garco acquisition.

*Metal coil coating* sales decreased \$2.5 million to \$72.3 million in the three months ended July 29, 2007 from \$74.8 million in the prior year's period. Sales to third parties for the three months ended July 29, 2007 decreased \$5.4 million to \$23.3 million from \$28.6 million in the prior year's period partially as a result of a shift in product mix from package sales of coated steel products to tolling revenue for coating services. This decrease was partially offset by a \$2.8 million increase in intersegment sales for the three months ended July 29, 2007 compared with the prior year's period. Metal coil coating accounted for 16.7% of total consolidated sales in the three months ended July 29, 2007 compared to 16.6% in the three months ended July 30, 2006.

Operating income of the metal coil coating segment decreased 3.2%, to \$8.2 million, compared to \$8.4 million in the prior year's period primarily due to decreased gross margins. As a percentage of total segment sales, operating income in both the three months ended July 29, 2007 and July 30, 2006 were 11.3%.

*Consolidated selling, general and administrative expenses*, consisting of engineering, drafting, selling and administrative costs, decreased to \$67.8 million in the three months ended July 29, 2007 compared to \$72.2 million in the prior year's period. This \$4.4 million decrease resulted from decreases in incentive compensation costs of \$2.5 million, environmental remediation costs of \$1.4 million, 401(k) benefits costs of \$1.2 million and other costs of \$1.2 million. Partially offsetting this decrease was \$1.9 million resulting from the inclusion of Garco in the three months ended July 29, 2007 but not in the comparable period of the prior year. As a percentage of sales, selling, general and administrative expenses were 15.6% for the three months ended July 29, 2007 as compared to 16.1% for the three months ended July 30, 2006.

*Consolidated interest expense* for the three months ended July 29, 2007 decreased by 10.2%, to \$7.2 million compared to \$8.0 million for the prior year's period primarily due to decreases in our borrowings, partially offset by increases in interest rates on variable rate borrowings under our senior secured credit facility. The primary change in our borrowings related to the outstanding term loan which was \$315.0 million at July 29, 2007, compared to \$391.0 million outstanding on the term loan at July 30, 2006.

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*Consolidated provision for income taxes* for the three months ended July 29, 2007 increased 9.4%, to \$13.8 million compared to \$12.7 million for the prior year's period. The increase was primarily due to an increase in the effective tax rate from 36.9% for the three months ended July 30, 2006 to 39.4% for the three months ended July 29, 2007 and a \$0.8 million increase in pre-tax earnings. The increase in the effective tax rate was primarily due to the new Texas margin tax.

*Diluted earnings per share* for the three months ended July 29, 2007 increased 2.0%, to \$1.02 per diluted share compared to \$1.00 per diluted share for the prior year's period. The increase was primarily due to a decrease in the number of weighted average shares assumed to be outstanding in the diluted earnings per share calculation, partially offset by a \$0.3 million decrease in net income.

**FISCAL NINE MONTHS ENDED JULY 29, 2007 COMPARED TO FISCAL NINE MONTHS ENDED JULY 30, 2006**

*Consolidated sales* for the nine months ended July 29, 2007 were \$1.2 billion compared with \$1.1 billion for the nine months ended July 30, 2006. Sales were up 8.3%, or \$88.9 million. Of this increase, \$159.6 million and \$17.9 million was a result of the RCC and Garco acquisitions, respectively, partially offset by decreased tonnage volumes in metal components and engineered building systems segments. Lower tonnage volumes in the metal components and engineered building systems segments in the first nine months of fiscal 2007 compared with the same period in fiscal 2006 were driven by softer demand for our products.

*Consolidated cost of sales* increased 8.3% for the nine months ended July 29, 2007 to \$878.0 million compared with \$810.4 million for the nine months ended July 30, 2006. Gross margins were 24.4% for both the nine months ended July 29, 2007 and July 30, 2006. The gross margins in our engineered building systems segment were higher due to a \$42.8 million and \$4.8 million increase as a result of the RCC and Garco acquisitions, respectively, and higher material costs which we effectively passed on to customers. The lower margins in the metal components segment resulted from higher material costs, primarily steel costs, which were not entirely passed on to customers and lower sales volumes produced over a fixed cost base. The metal coil coating margins were slightly higher due to a change in product mix from package sales of coated steel products to tolling revenue for coating services and increased intersegment sales volume.

*Metal components* sales decreased \$43.9 million, to \$511.3 million, in the nine months ended July 29, 2007 compared to \$555.2 million in the prior year's period. Sales were down primarily due to a 12.8% decrease in tons shipped. Sales to third parties for the nine months ended July 29, 2007 decreased \$48.4 million to \$438.2 million from \$486.6 million in the prior year's period. This decrease was partially offset by a \$4.4 million increase in intersegment sales. Metal components accounted for 44.0% of total consolidated sales in the nine months ended July 29, 2007 compared to 51.8% in the nine months ended July 30, 2006.

Operating income of the metal components segment decreased 44.2% in the nine months ended July 29, 2007, to \$38.1 million compared to \$68.2 million in the same period of the prior year. This \$30.1 million decrease resulted primarily from a \$33.4 million decrease in gross profit, partially offset by a \$3.2 million decrease in selling and administrative expenses. The decrease in selling and administrative expenses was due to decreases of various expenses, including incentive compensation costs.

*Engineered building systems* sales increased \$168.2 million to \$692.4 million in the nine months ended July 29, 2007 compared to \$524.2 million in the prior year's period. Of this increase, \$159.6 million and \$17.9 million was a result of the RCC and Garco acquisitions, respectively, partially offset by a decrease in volume shipped. Sales to third parties for the nine months ended July 29, 2007 increased \$167.2 million to \$662.2 million from \$494.9 million in the prior year's period. The remaining \$0.9 million represents an increase in intersegment sales for the nine months ended July 29, 2007. Engineered building systems accounted for 59.6% of total consolidated sales in the nine months ended July 29, 2007 compared to 48.9% in the nine months ended July 30, 2006.

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Operating income of the engineered building systems segment increased 69.3% in the nine months ended July 29, 2007 to \$66.7 million, compared to \$39.4 million in the prior year's period. This \$27.3 million increase resulted from a \$54.2 million increase in gross profit, partially offset by a \$26.9 million increase in selling and administrative expenses. The recent RCC acquisition accounted for \$42.8 million of the increased gross profit and \$24.2 million of increased selling and administrative costs. The recent Garco acquisition accounted for \$4.8 million of the increased gross profit and \$3.5 million of the increased selling and administrative costs. The increase in selling and administrative expenses was partially offset by a decrease in incentive compensation costs of \$2.0 million.

*Metal coil coating* sales decreased \$3.8 million to \$195.3 million in the nine months ended July 29, 2007 from \$199.2 million in the prior year's period. Sales to third parties for the nine months ended July 29, 2007 decreased \$30.0 million to \$60.5 million from \$90.5 million in the prior year's period partially as a result of a shift in product mix from package sales of coated steel products to tolling revenue for coating services. This decrease was partially offset by an increase of \$26.2 million in intersegment sales. Metal coil coating accounted for 16.8% of total consolidated sales in the nine months ended July 29, 2007 compared with 18.6% in the nine months ended July 30, 2006.

Operating income of the metal coil coating segment increased by 0.8%, to \$18.6 million, compared to \$18.4 million in the prior year's period primarily due to increased gross margins. As a percentage of total segment sales, operating income in the nine months ended July 29, 2007 was 9.5%, compared to 9.2% in the nine months ended July 30, 2006.

*Consolidated selling, general and administrative expenses*, consisting of engineering, drafting, selling and administrative costs, increased to \$199.5 million in the nine months ended July 29, 2007 compared to \$175.6 million in the prior year's period. Of this \$24.0 million increase, \$24.2 million and \$3.5 million resulted from the recent RCC and Garco acquisitions, respectively. In addition, we experienced increases in consulting and professional costs of \$1.3 million, partially offset by a decrease of \$4.4 million in incentive compensation costs and \$1.6 million in environmental remediation costs. As a percentage of sales, selling, general and administrative expenses were 17.2% for the nine months ended July 29, 2007 as compared to 16.4% for the nine months ended July 30, 2006.

*Consolidated interest income* for the nine months ended July 29, 2007 decreased by 94.9%, to \$0.2 million compared to \$4.8 million for the prior year's period. This decrease was primarily due to excess cash being used for acquisitions and to pay down our borrowings and our purchase of common stock on the open market.

*Consolidated interest expense* for the nine months ended July 29, 2007 increased by 24.3%, to \$21.9 million compared to \$17.6 million for the prior year's period. This increase was primarily due to the increase in borrowings of \$200.0 million to complete the RCC acquisition and increases in interest rates on variable rate borrowings under our senior secured credit facility. In addition, during the nine months ended July 29, 2007, we temporarily utilized up to \$44.0 million in borrowings on the revolving credit facility as compared to no amounts utilized during the same period in fiscal 2006.

*Consolidated provision for income taxes* for the nine months ended July 29, 2007 decreased 11.8%, to \$24.8 million compared to \$28.1 million for the prior year's period. The decrease was primarily due to a \$10.8 million decrease in pre-tax earnings. The effective tax rate for the nine months ended July 29, 2007 was 39.3% compared to 38.0% for the nine months ended July 30, 2006. The increase in the effective tax rate was primarily due to the new Texas margin tax.

*Diluted earnings per share* for the nine months ended July 29, 2007 decreased 14.6%, to \$1.82 per diluted share compared to \$2.13 per diluted share for the prior year's period. The decrease was primarily due to a \$7.5 million decrease in net income, partially offset by a decrease in the number of weighted average shares assumed to be outstanding in the diluted earnings per share calculation.

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**Table of Contents****LIQUIDITY AND CAPITAL RESOURCES*****General***

On July 29, 2007 we had working capital of \$146.9 million compared to \$132.1 million at the end of fiscal 2006, a \$14.8 million increase. Our cash and cash equivalents decreased \$17.6 million to \$7.5 million compared to \$25.0 million at October 29, 2006. The decrease in the fiscal nine months ended July 29, 2007 primarily resulted from \$52.7 million of cash used in investing activities and \$7.8 million of cash used in financing activities due to the borrowings and repayments on the revolving line of credit and stock repurchases. These decreases were partially offset by \$42.7 million of cash provided by operating activities. The cash provided by operating activities was negatively impacted by a \$45.2 million decrease in current liabilities, partially offset by a \$19.1 million decrease in current assets from the end of fiscal 2006. The decrease in current liabilities is related to the decrease in accounts payable and other current liabilities. The decrease in current assets is related to decreases in accounts receivable, partially offset by an increase in inventory purchased in anticipation of increased sales volume. The cash used in investing activities was primarily related to \$33.4 million used for capital expenditures primarily related to land and building, an equipment lease buyout, computer software and equipment. In addition, we paid \$18.9 million in cash for acquisitions which was primarily related to Garco.

We invest our excess cash in commercial paper with maturities up to 90 days and with a rating of not less than A-1 or P-1.

***Debt***

*Credit Facility.* Our senior secured credit facility includes a \$125 million five-year revolving credit facility maturing on June 18, 2009 with a sub-facility for letters of credit of a maximum of \$50 million and a \$400 million term loan maturing June 18, 2010. The term loan requires principal payments of \$1.0 million each quarter and a final payment of \$374.7 million at maturity. However, we made additional payments during fiscal 2006 and, as a result, will not be required to make any more principal payments until the maturity date. In addition, the credit facility provides for an incremental facility of \$180 million to fund the payment of the cash position of the conversion price from any future conversions of our 2.125% convertible senior subordinated notes due 2024. At July 29, 2007 and October 29, 2006, letters of credit totaling approximately \$15.7 million and \$15.9 million, respectively, were outstanding under the revolving loan facility. At July 29, 2007 and October 29, 2006, \$315.0 million was outstanding under the term loan.

Loans under the senior secured credit facility bear interest, at our option, as follows: (1) base rate loans at the base rate plus a margin, which for term loans is 0.5% and for revolving loans fluctuates based on our leverage ratio and ranges from 0.25% to 1.25%, and (2) LIBOR loans at LIBOR plus a margin, which for term loans is 1.50% and for revolving loans fluctuates based on our leverage ratio and ranges from 1.25% to 2.25%. Base rate is defined as the higher of the Wachovia Bank, National Association prime rate or the overnight Federal Funds rate and LIBOR is defined as the applicable London interbank offered rate adjusted for reserves. Based on our current leverage ratios, we will pay a margin of 0.75% on base rate loans and 1.75% on LIBOR loans under the revolving facility and a margin of 0.50% on base rate loans and 1.50% on LIBOR loans under the term loan facility during the fourth quarter of fiscal 2007.

The senior secured credit facility is secured by (1) 100% of our accounts receivable, inventory and equipment and related assets such as our software, chattel paper, instruments and contract rights (excluding foreign operations) and (2) 100% of the capital stock and other equity interests in each of our direct and indirect operating domestic subsidiaries and 65% of the capital stock in each of our foreign subsidiaries.

The senior secured credit facility requires compliance with various covenants and provisions customary for agreements of this nature, including a restricted payments test, a minimum ratio of Consolidated EBITDA (as defined in the senior secured credit facility) to interest expense of 4.0 to 1 and maximum ratios of total debt and senior debt to Consolidated EBITDA of 4.0 to 1 and 3.0 to 1, respectively. At July 29, 2007, our interest coverage, leverage, and senior debt ratios were 6.30, 2.87 and 1.85, respectively, and we were in compliance with all ratio requirements and covenants in our senior credit facility. At October 29, 2006, our interest coverage, leverage, and senior debt ratios were 8.19, 2.55 and 1.64, respectively, and we were in compliance with all ratio requirements and covenants in our senior credit facility. The senior secured credit facility also restricts our ability to undertake additional debt and/or equity financing.

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At July 29, 2007 and October 29, 2006, we had approximately \$109.3 million and \$109.1 million, respectively, in unused borrowing capacity (net of letters of credit outstanding of approximately \$15.7 million and \$15.9 million, respectively) under the revolving credit facility, of which a total of \$50.0 million may be utilized for standby letters of credit. In addition, we have \$180.0 million of borrowing capacity under the incremental facility.

During June 2006, we entered into an interest rate swap agreement relating to \$160 million of the \$400 million term loan due June 2010 to manage our risk associated with changing interest rates. The interest rate swap agreement resulted in \$0.3 million additional interest expense during the first nine months of fiscal 2007.

*Notes.* In November 2004, we completed an offering of the \$180.0 million aggregate principal amount of Notes with interest payable semi-annually. Interest on the Notes is not deductible for income tax purposes, which creates a permanent tax difference that is reflected in our effective tax rate. The Notes are general unsecured obligations and are subordinated to our present and future senior indebtedness.

We have the right to redeem the Notes, beginning on November 20, 2009, for a price equal to 100% of the principal amount plus accrued and unpaid interest, if any. Each holder has the right to require that we repurchase the Notes after five, 10 and 15 years at 100% of the principal amount plus accrued and unpaid interest, if any, beginning November 15, 2009. Upon the occurrence of certain designated events, holders of the Notes will also have the right to require that we purchase all or some of their Notes at a redemption price equal to 100% of the principal amount plus accrued and unpaid interest, if any, and, in certain circumstances, a make whole premium. We must pay the repurchase price of the aggregate principal amount of the Notes in cash unless prohibited by limitations imposed by our existing or future senior credit facilities. The Notes are convertible into cash or, in certain circumstances, a combination of cash and shares of our common stock, at a ratio of 24.9121 shares of common stock per \$1,000 principal amount notes, which is equivalent to an initial conversion price of approximately \$40.14 per common share. The ratio is subject to adjustments if certain events take place, and holders may convert only if the closing sale price per common share exceeds 120% of the conversion price for at least 20 trading days in the 30 consecutive trading day period ending on the last trading day of the preceding calendar quarter. As of July 29, 2007 and October 29, 2006, \$180.0 million principal amount of the Notes was outstanding. Our stock price exceeded the conversion threshold of the Notes for at least 20 trading days in each of the 30 consecutive trading day periods ended September 30, 2006 and June 30, 2007; therefore, our Notes may be converted by the holders, at their option, after June 30, 2007.

In August 2007, the FASB issued for comment an exposure draft of a proposed FASB Staff Position APB 14-a ( Proposed FSP ) that would change the accounting for certain convertible debt instruments, including our 2.125% Convertible Senior Subordinated Notes. Under the proposed new rules, for convertible debt instruments that may be settled entirely or partially in cash upon conversion, an entity should separately account for the liability and equity components of the instrument in a manner that reflects the issuer's economic interest cost. The effect of the proposed new rules for our 2.125% Convertible Senior Subordinated Notes is that the equity component would be included in the paid-in-capital section of stockholders' equity on our balance sheet and the value of the equity component would be treated as an original issue discount for purposes of accounting for the debt component of the 2.125% Convertible Senior Subordinated Notes. Higher interest expense would result by recognizing the accretion of the discounted carrying value of the 2.125% Convertible Senior Subordinated Notes to their face amount as interest expense over the term of the 2.125% Convertible Senior Subordinated Notes using an effective interest rate method of amortization. We believe the FASB plans to issue final guidance in late 2007. This Proposed FSP is expected to be effective for our fiscal year ended 2009, would not permit early application and would be applied retrospectively to all periods presented.

We are currently evaluating the proposed new rules and are evaluating the impact at this time. However, if the Proposed FSP is adopted as it is proposed we expect to have higher interest expense starting in fiscal 2009 due to the interest expense accretion and the prior period interest expense associated with our 2.125% Convertible Senior Subordinated Notes. The 2.125% Convertible Senior Subordinated Notes would also reflect higher than previously reported interest expense due to retrospective application.

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### ***Cash Flow***

We periodically evaluate our liquidity requirements, capital needs and availability of resources in view of inventory levels, expansion plans, debt service requirements and other operating cash needs. To meet our short- and long-term liquidity requirements, including payment of operating expenses and repaying debt, we rely primarily on cash from operations. However, we have recently, as well as in the past, sought to raise additional capital and may do so again in the future.

We expect that, for the foreseeable future, cash generated from operations and the available borrowings under our senior secured credit facility will be sufficient to provide us the ability to fund our operations, provide the increased working capital necessary to support expected growth, fund our revised planned capital expenditures of approximately \$15 million for the remainder of fiscal 2007 and expansion when needed, and pay scheduled interest and principal payments on our indebtedness along with our goal to pay down a significant portion of our debt during fiscal 2007.

We expect that, to the extent we are unable to pay in full any outstanding balance of the revolving portion of our senior secured credit facility by its maturity date in June 2009, the \$315.0 million remaining installment on our term loan by its maturity date in June 2010, or the \$180.0 million convertible senior subordinated notes upon conversion or maturity, we will refinance any then outstanding balance by means of a new senior credit facility or other public or private equity or debt financings. There can be no assurance that any of these external sources of funds will be available to us at the time they are needed or that any of those financings can be arranged on acceptable terms, or terms as favorable as those now enjoyed by us under our existing indebtedness.

We have used available funds to repurchase shares of our common stock under our stock repurchase program. During the fiscal nine months ended July 29, 2007, we repurchased 295,100 shares for an aggregate cost of \$14.5 million. Of these repurchased shares, \$3.1 million was in transit and, therefore, accrued as a liability at July 29, 2007. In August 2007, subsequent to July 29, 2007, we repurchased 155,000 shares for an aggregate cost of \$7.2 million.

Our corporate strategy points to the synergistic value of potential acquisitions in our metal components, engineered building systems and metal coil coating segments. From time to time, we may enter into letters of intent or agreements to acquire assets or companies in these business lines. The consummation of these transactions could require cash payments and/or issuance of additional debt.

On January 31, 2007, we completed the purchase of substantially all the assets of Garco Building Systems, Inc. ( Garco ), which designs, manufactures and distributes steel building systems primarily for markets in the northwestern United States and western Canada. Garco is headquartered in Spokane, Washington, where it operates a manufacturing facility for steel building systems for industrial, commercial, institutional and agricultural applications. The aggregate purchase price for this acquisition was \$16.3 million, comprised of \$14.5 million in cash and \$1.8 million in common stock.

### **OFF-BALANCE SHEET ARRANGEMENTS**

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities ( SPEs ), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of July 29, 2007, we were not involved in any unconsolidated SPE transactions.

### **CRITICAL ACCOUNTING POLICIES**

Critical accounting policies are those that are most important to the portrayal of our financial position and results of operations. These policies require our most subjective judgments, often employing the use of estimates about the effect of matters that are inherently uncertain. Our most critical accounting policies include those that pertain to revenue recognition, insurance accruals, share-based compensation, income taxes, accounting for acquisitions, intangible assets and goodwill, allowance for doubtful accounts and contingencies, which are described in Item 7 of our Annual Report on Form 10-K for the year ended October 29, 2006.

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**RECENT ACCOUNTING PRONOUNCEMENTS**

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* ( SFAS 159 ). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective for our fiscal year that begins November 3, 2008. We are currently evaluating the impact of adopting SFAS 159.

In September 2006, the FASB issued SFAS 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R)* ( SFAS 158 ). SFAS 158, which is effective for us on October 28, 2007, requires employers to recognize the funded status of defined benefit postretirement plans as an asset or liability on the balance sheet and to recognize changes in that funded status through comprehensive income. SFAS 158 also establishes the measurement date of plan assets and obligations as the date of the employer's fiscal year end, and provides for additional annual disclosures. We currently use our fiscal year end as the measurement date for our defined benefit plan. We do not believe that the adoption of this pronouncement will have a material impact on our financial statements.

In September 2006, the FASB issued SFAS 157, *Fair Value Measurement* ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective for our fiscal year that begins November 3, 2008. We are currently evaluating the impact of adopting SFAS 157.

In June 2006, the FASB issued FASB Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, Accounting for Income Taxes*, which clarifies the accounting for uncertainty in income taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 requires that we recognize in the financial statements the impact of a tax position only if that position is more likely than not of being sustained upon examination, based on the technical merits of the position. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. We will implement this interpretation in the fiscal year starting October 29, 2007. We do not believe that the adoption of this pronouncement will have a material impact on our financial statements.

**FORWARD LOOKING STATEMENTS**

This Quarterly Report includes statements concerning our expectations, beliefs, plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements that are not historical facts. These statements are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those expressed or implied by these statements. In some cases, our forward-looking statements can be identified by the words anticipate, believe, continue, could, estimate, expect, forecast, goal, intend, may, objective, plan, potential, predict, projection, should, will or other similar words. We have based our statements on our management's beliefs and assumptions based on information available to our management at the time the statements are made. We caution that assumptions, beliefs, expectations, intentions and projections about future events may and often do vary materially from actual results. Therefore, we cannot assure you that actual results will not differ materially from those expressed or implied by our forward-looking statements. Accordingly, investors are cautioned not to place undue reliance on any forward-looking information, including any earnings guidance. Although we believe that the expectations reflected in the forward-looking statements are reasonable, these expectations and the related statements are subject to risks, uncertainties, and other factors that could cause the actual results to differ materially from those projected. These risks, uncertainties, and other factors include, but are not limited to:

industry cyclicality and seasonality and adverse weather conditions;

fluctuations in customer demand and other patterns;

raw material availability and pricing;



financial condition of our raw material suppliers;

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competitive activity and pricing pressure;

the ability to make strategic acquisitions accretive to earnings;

general economic conditions affecting the construction industry; and

other risks detailed under the caption **Risk Factors** in our Annual Report on Form 10-K as filed with the SEC.

We expressly disclaim any obligations to release publicly any updates or revisions to these forward-looking statements to reflect any changes in our expectations.

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

*Steel Prices*

We are subject to market risk exposure related to volatility in the price of steel. For the fiscal nine months ended July 29, 2007, steel constituted approximately 73% of our cost of sales. Our business is heavily dependent on the price and supply of steel, which is the principal raw material used in our products. The steel industry is highly cyclical in nature, and steel prices have been volatile in recent years and may remain volatile in the future. Steel prices are influenced by numerous factors beyond our control, including general economic conditions, the availability of raw materials, competition, labor costs, freight and transportation costs, production costs, import duties and other trade restrictions. In fiscal 2006, we believe steel prices increased due to the consolidation of steel mills and other market dynamics. Overall, our weighted average cost of steel increased 4.6% in first nine months of fiscal 2007 compared with the first nine months of fiscal 2006. Although transaction prices have recently moderated, we believe steel prices will average modestly higher for all of fiscal 2007 compared to fiscal 2006 based on demand for nonresidential construction materials and dynamics of the world steel market. Because we have periodically adjusted our contract prices, particularly in the engineered building systems segment, we have generally been able to pass increases in our raw materials costs through to our customers.

We do not have any long-term contracts for the purchase of steel and normally do not maintain an inventory of steel in excess of our current production requirements. However, from time to time, we may purchase steel in advance of announced steel price increases. We can give no assurance that steel will remain available or that prices will not continue to be volatile. While most of our contracts have escalation clauses that allow us, under certain circumstances, to pass along all or a portion of increases in the price of steel after the date of the contract but prior to delivery, we may, for competitive or other reasons, not be able to pass such price increases along. If the available supply of steel declines, we could experience price increases that we are not able to pass on to our customers, a deterioration of service from our suppliers or interruptions or delays that may cause us not to meet delivery schedules to our customers. Any of these problems could adversely affect our results of operations and financial position.

We rely on a few major suppliers for our supply of steel and may be adversely affected by the bankruptcy, change in control, financial condition or other factors affecting those suppliers. During 2001 and 2002, our primary steel suppliers, Bethlehem Steel Corporation and National Steel Corporation, respectively, filed for protection under federal bankruptcy laws. During the third quarter of fiscal 2003, U.S. Steel bought substantially all of the integrated steel-making assets of National Steel, and ISG acquired the assets of Bethlehem Steel. During April 2005, Mittal Steel USA purchased ISG. During the second quarter of fiscal 2007, Nucor bought substantially all of the shares of Harris Steel. We do not anticipate Nucor's acquisition of Harris Steel to have an impact on our supply of steel. During the first nine months of fiscal 2007, we purchased over 10% of our steel requirements from each of Mittal Steel USA and Nucor, or approximately 39% in the aggregate. A prolonged labor strike against one of our principal domestic suppliers, or financial or other difficulties of a principal supplier that affects its ability to produce steel, could have a material adverse effect on our operations. Alternative sources, however, including foreign steel, are currently believed to be sufficient to maintain required deliveries.

With steel accounting for approximately 73% of our cost of sales, a 1% change in the cost of steel would have resulted in a pre-tax impact of approximately \$6.4 million for the nine months ended July 29, 2007, if such costs were not passed on to our customers. The impact to our financial results of operations would be significantly dependent on the competitive environment and the costs of other alternative building products, which could impact our ability to pass on these higher costs.



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### *Interest Rates*

We are subject to market risk exposure related to changes in interest rates on our senior credit facility, which includes revolving credit notes and term notes. These instruments bear interest at an agreed upon percentage point spread from either the prime interest rate or LIBOR. Under our senior credit facility, we may, at our option, fix the interest rate for certain borrowings based on a spread over LIBOR for 30 days to six months. At July 29, 2007, we had \$315.0 million outstanding under our senior secured credit facility. Based on this balance and considering the Swap Agreement discussed below, an immediate change of one percent in the interest rate would cause a change in interest expense of approximately \$1.6 million on an annual basis. Our objective in maintaining a portion of our borrowings at a variable rate is the flexibility obtained regarding early repayment without penalties.

We may from time to time utilize interest rate swaps to manage overall borrowing costs and reduce exposure to adverse fluctuations in interest rates. We do not purchase or hold any derivative financial instruments for trading purposes. As disclosed in Note 10 to the Condensed Consolidated Financial Statements, we have effectively converted \$160 million of our \$315 million term loan outstanding on our \$400 million term loan due 2010 to fixed rate debt by entering into an interest rate swap agreement ( Swap Agreement ).

We are exposed to credit loss in the event of nonperformance by the counterparty on the Swap Agreement. If the counterparty fails to meet the terms of the agreement, our exposure is limited to the net amount that would have been received, if any, over the remaining life of the Swap Agreement. We do not anticipate nonperformance as the contract is with a creditworthy counterparty and no material loss would be expected from nonperformance by the counterparty.

See Note 9 to the Condensed Consolidated Financial Statements for more information on the material terms of our long-term debt.

### *Foreign Currency Exchange Rates*

We are exposed to the effect of exchange rate fluctuations on the U.S. dollar value of foreign currency denominated operating revenue and expenses. The functional currency for our Canada operations is the Canadian dollar. Translation adjustments resulting from translating the functional currency financial statements into U.S. dollar equivalents are reported separately in accumulated other comprehensive income in stockholders' equity. The translation gain (loss) included in other comprehensive income for the three months and nine months ended July 29, 2007 were \$160,000 and \$140,000, respectively, and for the three months and nine months ended July 30, 2006 was \$43,000 and \$(92,800), respectively.

The functional currency for our Mexico operations is the U.S. dollar. Adjustments resulting from the re-measurement of the local currency financial statements into the U.S. dollar functional currency, which uses a combination of current and historical exchange rates, are included in net income in the current period. Net foreign currency exchange gains (losses) for the three months and nine months ended July 29, 2007 were \$(4,000) and \$(252,000), respectively, and for the three months and nine months ended July 30, 2006 were \$(68,000) and \$126,000, respectively.

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

*Disclosure Controls and Procedures.* As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon this evaluation, the CEO and the CFO concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports filed or submitted by us 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 include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

*Internal Control over Financial Reporting.* Internal control over financial reporting is a process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer, and effected by our board of

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directors, management and other personnel, 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 and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

During the third quarter of fiscal 2007, we have not made any changes to our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**NCI BUILDING SYSTEMS, INC.**

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings.**

See Part I, Item 1, Unaudited Condensed Consolidated Financial Statements, Note 13, which is incorporated herein by reference.

**Item 1A. Risk Factors.**

For further information, refer to Item 1A. Risk Factors included in our Annual Report on Form 10-K for the fiscal year ended October 29, 2006 filed with the Securities and Exchange Commission (the "SEC").

There have been no material changes in risk factors disclosed in our Annual Report on Form 10-K for the fiscal year ended October 29, 2006, except for those business risk factors discussed below.

*The accounting method for convertible debt securities with net share settlement, like the 2.125% Convertible Senior Subordinated Notes, may be subject to change.*

In August 2007, the FASB issued for comment an exposure draft of a proposed FASB Staff Position APB 14-a ( "Proposed FSP" ) that would change the accounting for certain convertible debt instruments, including our 2.125% Convertible Senior Subordinated Notes. Under the proposed new rules for convertible debt instruments that may be settled entirely or partially in cash upon conversion, an entity should separately account for the liability and equity components of the instrument in a manner that reflects the issuer's economic interest cost. The effect of the proposed new rules for our 2.125% Convertible Senior Subordinated Notes is that the equity component would be included in the paid-in-capital section of stockholders' equity on our balance sheet and the value of the equity component would be treated as original issue discount for purposes of accounting for the debt component of the 2.125% Convertible Senior Subordinated Notes. Higher interest expense would result by recognizing the accretion of the discounted carrying value of the 2.125% Convertible Senior Subordinated Notes to their face amount as interest expense over the term of the 2.125% Convertible Senior Subordinated Notes using an effective interest rate method of amortization. We believe the FASB plans to issue final guidance in late 2007. This Proposed FSP is expected to be effective for our fiscal year ended 2009, would not permit early application and would be applied retrospectively to all periods presented.

We are currently evaluating the proposed new rules and are evaluating the impact at this time. However, if the proposed FSP is adopted as it is proposed, we expect to have higher interest expense starting in fiscal 2009 due to the interest expense accretion, and prior period interest expense associated with our 2.125% Convertible Senior Subordinated Notes. The 2.125% Convertible Senior Subordinated Notes would also reflect higher than previously reported interest expense due to retrospective application.

In addition, for purposes of calculating diluted earnings per share, a convertible debt security providing for net share settlement upon conversion and meeting specified requirements under Emerging Issues Task Force, or EITF, Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," is currently accounted for similar to non-convertible debt, with the stated coupon constituting interest expense and any shares issuable upon conversion of the security accounted for under the treasury stock method. The effect of the treasury stock method is that the shares potentially issuable upon conversion of the 2.125% Convertible Senior Subordinated Notes are not included in the calculation of our earnings per share except to the extent that the conversion value of the 2.125% Convertible Senior Subordinated Notes exceeds their principal amount, in which event, for earnings per share purposes, we would account for the transaction as if we had issued the number of shares of our common stock necessary to settle the conversion. The proposed FSP does not affect the earnings per share accounting for convertible instruments such as the 2.125% Convertible Senior Subordinated Notes.

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

The following table shows our purchases of our common stock during the third quarter of fiscal 2007:

**ISSUER PURCHASES OF EQUITY SECURITIES**

<b>Period</b>	<b>(a) Total Number of Shares Purchased <sup>(1)</sup></b>	<b>(b) Average Price Paid per Share (or Unit)</b>	<b>(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>(d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet be Purchased Under the Plans or Programs <sup>(2)</sup></b>
April 30, 2007 to May 27, 2007				1,201,392
May 28, 2007 to June 24, 2007	807	\$ 51.12		1,201,392
June 25, 2007 to July 29, 2007	92,500	\$ 49.46	92,500	1,108,892
<b>Total</b>	93,307	\$ 49.48	92,500	1,108,892

<sup>(1)</sup> Includes shares of restricted stock that were withheld to satisfy tax-withholding obligations arising in connection with the vesting of awards of restricted stock. The required withholding is calculated using the closing sales price reported by the New York Stock Exchange as of the vesting date.

<sup>(2)</sup> Our board of directors has authorized a stock repurchase program. Subject to applicable federal securities law, such purchases occur at times and in amounts that we deem appropriate. Shares repurchased are used primarily for later re-issuance in connection with our stock option and 401(k) profit sharing plans. On February 28, 2007, we publicly announced that our board of directors authorized the repurchase of an additional 1.0 million shares of our common stock. There is no time limit on the duration of the program. During the first nine months of fiscal 2007, we repurchased 0.3 million shares of our common stock. At July 29, 2007, there were 1.1 million shares remaining authorized for repurchase under the program.

On January 31, 2007, pursuant to Rule 506 of the Securities Act of 1933, as amended, in connection with our acquisition of substantially all of the assets of Garco, we issued 35,448 unregistered shares of our common stock to certain shareholders of Garco in consideration for 5-year covenants not to compete entered into by such shareholders.

**Item 6. Exhibits**

## Exhibits

Those exhibits required to be filed by Item 601 of Regulation S-K are listed in the Index to Exhibits immediately preceding the exhibits filed herewith and such listing is incorporated herein by reference.

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**SIGNATURES**

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

NCI BUILDING SYSTEMS, INC.

(Registrant)

Date: September 5, 2007

By: /s/ Frances Powell Hawes  
Frances Powell Hawes  
Executive Vice President, Chief Financial Officer and  
Treasurer



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**Index to Exhibits**

- 3.1 Restated Certificate of Incorporation, as amended through September 30, 1998 (filed as Exhibit 3.1 to NCI's Annual Report on Form 10-K for the fiscal year ended November 2, 2002 and incorporated by reference herein)
- 3.2 Certificate of Amendment to Restated Certificate of Incorporation, effective as of March 12, 2007 (filed as Exhibit 3.2 to NCI's Quarterly Report on Form 10-Q for the quarter ended April 29, 2007 and incorporated by reference herein)
- 3.3 Amended and Restated By-Laws, as amended through December 7, 2006 (filed as Exhibit 10.5 to NCI's Current Report on Form 8-K dated December 7, 2006 and incorporated by reference herein)
- \*31.1 Rule 13a-14(a)/15d-14(a) Certifications (Section 302 of the Sarbanes-Oxley Act of 2002)
- \*31.2 Rule 13a-14(a)/15d-14(a) Certifications (Section 302 of the Sarbanes-Oxley Act of 2002)
- \*32.1 Certifications pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code (Section 906 of the Sarbanes-Oxley Act of 2002)
- \*32.2 Certifications pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code (Section 906 of the Sarbanes-Oxley Act of 2002)

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\* Filed herewith