BORGWARNER INC
Form 10-Q
October 28, 2011
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549
FORM 10-Q
QUARTERLY REPORT
(Mark One)

R	Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended September 30, 2011
OR	
o	Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from to

Commission file number: 1-12162
BORGWARNER INC.

(Exact name of registrant as specified in its charter)

Delaware	13-3404508
State or other jurisdiction of Incorporation or organization	(I.R.S. Employer Identification No.)
3850 Hamlin Road, Auburn Hills, Michigan	48326
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (248) 754-9200
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 R NO o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES R NO o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer R Accelerated filer o Non-accelerated filer o Smaller reporting company o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES o NO R
As of October 24, 2011, the registrant had 109,720,448 shares of voting common stock outstanding.

BORGWARNER INC.
FORM 10-Q
THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2011
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PART I. FINANCIAL INFORMATION
BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(millions of dollars)	September 30, 2011	December 31, 2010
ASSETS		
Cash	$377.0	$449.9
Receivables, net	1,237.9	1,023.9
Inventories, net	482.4	430.6
Deferred income taxes	80.0	75.8
Prepayments and other current assets	90.4	79.7
Total current assets	2,267.7	2,059.9
Property, plant and equipment, net	1,637.2	1,542.6
Investments and advances	354.8	307.9
Goodwill	1,203.5	1,113.5
Other non-current assets	631.1	531.1
Total assets	$6,094.3	$5,555.0
LIABILITIES AND EQUITY		
Notes payable and other short-term debt	$157.9	$122.4
Current portion of long-term debt	367.4	6.1
Accounts payable and accrued expenses	1,346.5	1,224.1
Income taxes payable	52.3	39.7
Total current liabilities	1,924.1	1,392.3
Long-term debt	867.2	1,051.9
Other non-current liabilities:		
Retirement-related liabilities	435.2	438.1
Other	402.1	362.9
Total other non-current liabilities	837.3	801.0
Common stock	1.2	1.2
Capital in excess of par value	1,119.6	1,100.4
Retained earnings	1,988.1	1,560.2
Accumulated other comprehensive loss	(85.0)	(53.7)
Treasury stock	(618.4)	(349.5)
Total BorgWarner Inc. stockholders' equity	2,405.5	2,258.6
Noncontrolling interest	60.2	51.2
Total equity	2,465.7	2,309.8
Total liabilities and equity	$6,094.3	$5,555.0

See accompanying Notes to Condensed Consolidated Financial Statements.

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BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions, except per share amounts)	2011	2010	2011	2010
Net sales	$1,791.8	$1,410.9	$5,341.0	$4,119.4
Cost of sales	1,441.0	1,137.6	4,290.3	3,332.2
Gross profit	350.8	273.3	1,050.7	787.2
Selling, general and administrative expenses	151.4	150.2	474.2	418.3
Other (income) expense	0.6	0.1	(29.9)	22.0
Operating income	198.8	123.0	606.4	346.9
Equity in affiliates' earnings, net of tax	(11.5)	(10.5)	(28.0)	(29.8)
Interest income	(1.3)	(0.6)	(3.5)	(1.8)
Interest expense and finance charges	18.5	18.4	57.4	46.8
Earnings before income taxes and noncontrolling interest	193.1	115.7	580.5	331.7
Provision for income taxes	46.4	4.2	137.1	51.1
Net earnings	146.7	111.5	443.4	280.6
Net earnings attributable to the noncontrolling interest, net of tax	5.1	4.8	15.3	14.9
Net earnings attributable to BorgWarner Inc.	$141.6	$106.7	$428.1	$265.7
Earnings per share — basic	$1.30	$0.95	$3.91	$2.31
Earnings per share — diluted	$1.15	$0.87	$3.45	$2.18
Weighted average shares outstanding:				
Basic	108.779	112.757	109.391	114.831
Diluted	127.940	127.804	128.769	128.535

See accompanying Notes to Condensed Consolidated Financial Statements.

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BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended September 30,	
(millions of dollars)	2011	2010
OPERATING		
Net earnings	$443.4	$280.6
Adjustments to reconcile net earnings to net cash flows from operations:		
Non-cash charges (credits) to operations:		
Depreciation and tooling amortization	187.0	171.2
Amortization of intangible assets and other	23.1	21.0
Environmental litigation settlement, net of cash paid	—	28.0
Bond amortization	15.1	13.6
Stock-based compensation expense	16.4	15.6
Deferred income tax benefit	(24.1)	(39.9)
BERU - Eichenauer equity investment gain	—	(8.0)
Equity in affiliates' earnings, net of dividends received, and other	(21.8)	(11.2)
Net earnings adjusted for non-cash charges to operations	639.1	470.9
Changes in assets and liabilities:		
Receivables	(192.3)	(270.7)
Inventories	(47.5)	(85.9)
Prepayments and other current assets	(12.1)	(1.2)
Accounts payable and accrued expenses	84.8	164.5
Income taxes payable	9.1	42.6
Other non-current assets and liabilities	(8.0)	(7.5)
Net cash provided by operating activities	473.1	312.7
INVESTING		
Capital expenditures, including tooling outlays	(274.1)	(187.8)
Net proceeds from asset disposals	6.9	5.4
Payments for business acquired, net of cash acquired	(203.7)	(164.7)
Net proceeds from sale of business	2.1	5.0
Net cash used in investing activities	(468.8)	(342.1)
FINANCING		
Net increase (decrease) in notes payable	29.4	(5.0)
Additions to long-term debt, net of debt issuance costs	357.9	361.9
Repayments of long-term debt, including current portion	(196.3)	(115.3)
Proceeds from receivables securitization facility	—	30.0
Payment for purchase of treasury stock	(268.8)	(197.3)
Proceeds from stock options exercised, including the tax benefit	43.7	40.4
Taxes paid on restricted stock award vestings	(14.4)	—
Purchase of noncontrolling interest	(29.4)	—
Capital contribution from noncontrolling interest	19.5	—
Dividends paid to noncontrolling stockholders	(10.1)	(8.2)
Net cash (used in) provided by financing activities	(68.5)	106.5
Effect of exchange rate changes on cash	(8.7)	(2.3)
Net (decrease) increase in cash	(72.9)	74.8

Cash at beginning of year	449.9	357.4
Cash at end of period	$377.0	$432.2
SUPPLEMENTAL CASH FLOW INFORMATION		
Net cash paid during the period for:		
Interest	$49.2	$34.5
Income taxes	116.6	45.3
Non-cash investing transactions:		
Liabilities assumed from business acquired	5.3	—
Non-cash financing transactions:		
Performance share plans	5.4	5.5
Debt assumed from business acquired	5.9	—

See accompanying Notes to Condensed Consolidated Financial Statements.

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BORGWARNER INC. AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(1) Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements of BorgWarner Inc. and Consolidated Subsidiaries (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes necessary for a comprehensive presentation of financial position, results of operations and cash flow activity required by GAAP for complete financial statements. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of results have been included. Operating results for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. The balance sheet as of December 31, 2010 was derived from the audited financial statements as of that date. For further information, refer to the Consolidated Financial Statements and Footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

Management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and accompanying notes, as well as, the amounts of revenues and expenses reported during the periods covered by those financial statements and accompanying notes. Actual results could differ from these estimates.

(2) Research and Development

The Company's net Research & Development ("R&D") expenditures are included in selling, general and administrative expenses of the Condensed Consolidated Statements of Operations. Customer reimbursements are netted against gross R&D expenditures as they are considered a recovery of cost. Customer reimbursements for prototypes are recorded based on customer contracts, typically either when the prototype is shipped or when it is accepted by the customer. Customer reimbursements for engineering services are recorded when performance obligations are satisfied in accordance with the contract and accepted by the customer. Financial risks and rewards transfer upon shipment, acceptance of a prototype component by the customer or upon completion of the performance obligation as stated in the respective customer agreement.

The following table presents the Company's gross and net expenditures on R&D activities:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(millions of dollars)	2011	2010	2011	2010
Gross R&D expenditures	$69.5	$60.5	$214.7	$168.9
Customer reimbursements	(11.1)	(14.7)	(30.6)	(34.7)
Net R&D expenditures	$58.4	$45.8	$184.1	$134.2

The Company has contracts with several customers at the Company's various R&D locations. No such contract exceeded $6.0 million in any of the periods presented.

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(3) Other (Income) Expense

Items included in other (income) expense consist of:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(millions of dollars)	2011	2010	2011	2010
Patent infringement settlement, net of legal costs incurred	$—	$—	$(29.1)	$—
Environmental litigation settlement	—	—	—	28.0
BERU - Eichenauer equity investment gain	—	—	—	(8.0)
Other	0.6	0.1	(0.8)	2.0
Other (income) expense	$0.6	$0.1	$(29.9)	$22.0

On May 16, 2011, BorgWarner and Honeywell settled a lawsuit resolving BorgWarner's patent infringement claims. As a result of the settlement, Honeywell paid $32.5 million for a paid up license to use the asserted BorgWarner patents. During 2011, the Company incurred $3.4 million in legal costs related to this lawsuit and after deducting these costs, the Company recorded a net gain of $29.1 million.

On May 1, 2010, the Company completed the acquisition of BERU-Eichenauer GmbH by acquiring the shares of its former joint venture partner, Eichenauer Heizelemente GmbH & Co. KG. The former 50/50 joint venture was formed in 2000 to develop and manufacture electric cabin heaters. As a result of adjusting the Company's fifty percent investment to fair value under Accounting Standards Codification ("ASC") Topic 805, the Company recorded a pre-tax gain of $8.0 million.

See Note 14 to the Condensed Consolidated Financial Statements for more information regarding the Company's 2010 environmental litigation settlement.

(4) Income Taxes

The Company's provision for income taxes is based upon an estimated annual tax rate for the year applied to federal, state and foreign income. On a quarterly basis, the annual effective tax rate is adjusted, as appropriate, based upon changed facts and circumstances, if any, as compared to those forecasted at the beginning of the fiscal year and each interim period thereafter.

At September 30, 2011, the Company's effective tax rate is estimated to be 23.6%, which includes $11.0 million of additional tax expense associated with the Company's patent infringement settlement and a tax benefit of $6.2 million resulting from other tax adjustments. These other tax adjustments related to a change in state corporate income tax legislation as well as an adjustment of the Company's tax accounts as a result of the closure of certain tax audits. This rate differs from the U.S. statutory rate primarily due to foreign rates, which differ from those in the U.S., the realization of certain business tax credits including foreign tax credits and favorable permanent differences between book and tax treatment for items, including equity in affiliates' earnings.

The Company's effective tax rate in the third quarter of 2010 was estimated to be 3.6%, which included a favorable impact of $21.2 million from the reversal of the Company's valuation allowance on U.S. based foreign tax credit carryforwards. At September 30, 2010, the Company's projected annual effective tax rate for 2010 was estimated to be 17.3%, which included the impact of the reversal of the Company's valuation allowance on U.S. based foreign tax credit carryforwards, the impact of the change in tax legislation related to Medicare Part D subsidies of $2.5 million, the additional tax expense associated with the BERU - Eichenauer equity investment gain and the tax benefit associated with the Company's environmental litigation settlement.

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In addition to the impact of the items noted above, the estimated annual effective tax rate for 2011 is higher than the estimated annual effective tax rate for 2010 primarily due to the Company's increased profitability in higher taxed jurisdictions.

(5) Inventories, net

Inventories are valued at the lower of cost or market. The cost of U.S. inventories is determined by the last-in, first-out (“LIFO”) method, while the operations outside the U.S. use the first-in, first-out (“FIFO”) or average-cost methods. Inventories consisted of the following:

(millions of dollars)	September 30, 2011	December 31, 2010
Raw material and supplies	$283.0	$244.0
Work in progress	96.2	88.1
Finished goods	120.2	111.7
FIFO inventories	499.4	443.8
LIFO reserve	(17.0)	(13.2)
Inventories, net	$482.4	$430.6

(6) Property, Plant and Equipment, net

(millions of dollars)	September 30, 2011	December 31, 2010
Land and buildings	$690.9	$669.3
Machinery and equipment	2,016.8	1,961.2
Capital leases	2.3	2.3
Construction in progress	194.6	128.2
Total property, plant & equipment	2,904.6	2,761.0
Less: accumulated depreciation	(1,367.6)	(1,308.0)
	1,537.0	1,453.0
Tooling, net of amortization	100.2	89.6
Property, plant and equipment, net	$1,637.2	$1,542.6

As of September 30, 2011 and December 31, 2010, accounts payable of $25.3 million and $28.9 million, respectively, were related to property, plant and equipment purchases.

As of September 30, 2011 and December 31, 2010, specific assets of $3.6 million and $3.4 million, respectively, were pledged as collateral under certain of the Company’s long-term debt agreements.

As of September 30, 2011 and December 31, 2010, the Company's conditional asset retirement obligation relating to 45 of its manufacturing locations was $1.1 million and $1.2 million, respectively. This obligation represents the Company's liability to remove hazardous building materials from certain facilities.

Interest costs capitalized for the nine months ended September 30, 2011 and September 30, 2010 were $9.0 million and $8.4 million, respectively.

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(7) Product Warranty

The Company provides warranties on some, but not all, of its products. The warranty terms are typically from one to three years. Provisions for estimated expenses related to product warranty are made at the time products are sold. These estimates are established using historical information about the nature, frequency and average cost of warranty claim settlements as well as product manufacturing and industry developments and recoveries from third parties. Management actively studies trends of warranty claims and takes action to improve product quality and minimize warranty claims. Management believes that the product warranty accrual is appropriate; however, actual claims incurred could differ from the original estimates, requiring adjustments to the accrual. The following table summarizes the activity in the product warranty accrual accounts:

	Nine Months Ended September 30,	
(millions of dollars)	2011	2010
Beginning balance	$66.8	$61.7
Acquisition	4.5	3.0
Provisions	38.6	30.2
Payments	(33.2)	(25.6)
Translation adjustment	(1.2)	(1.0)
Ending balance	$75.5	$68.3

The product warranty liability is classified in the Condensed Consolidated Balance Sheets as follows:

	September 30,	December 31,
(millions of dollars)	2011	2010
Accounts payable and accrued expenses	$38.4	$37.0
Other non-current liabilities	37.1	29.8
Total product warranty liability	$75.5	$66.8

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(8) Notes Payable and Long-Term Debt

As of September 30, 2011 and December 31, 2010, the Company had short-term and long-term debt outstanding as follows:

(millions of dollars)	September 30, 2011	December 31, 2010
Short-term debt		
Short-term borrowings	$77.9	$42.4
Receivables securitization	80.0	80.0
Total short-term debt	$157.9	$122.4
Long-term debt		
3.50% Convertible senior notes due 04/15/12	$363.3	$348.5
5.75% Senior notes due 11/01/16 ($150 million par value)	149.4	149.4
8.00% Senior notes due 10/01/19 ($134 million par value)	133.9	133.9
4.625% Senior notes due 09/15/20 ($250 million par value)	247.7	247.5
7.125% Senior notes due 02/15/29 ($121 million par value)	119.3	119.3
Multi-currency revolving credit facility	175.0	—
Term loan facilities & other	21.0	31.6
Unamortized portion of debt derivatives	25.0	27.8
Total long-term debt	1,234.6	1,058.0
Less: current portion	367.4	6.1
Long-term debt, net of current portion	$867.2	$1,051.9

The weighted average interest rate on all borrowings outstanding as of September 30, 2011 and December 31, 2010 was 5.6% and 6.4%, respectively.

On June 30, 2011, the Company amended and extended its $550 million multi-currency revolving credit facility (which included a feature that allowed the Company's borrowings to be increased to $600 million) to a $650 million multi-currency revolving credit facility (which includes a feature that allows the Company's borrowings to be increased to $1 billion). The facility provides for borrowings through June 30, 2016 and is guaranteed by the Company's material domestic subsidiaries. The Company has two key financial covenants as part of the credit agreement. These covenants are a debt compared to EBITDA ("Earnings Before Interest, Taxes, Depreciation and Amortization") test and an interest coverage test. The Company was in compliance with all covenants at September 30, 2011 and expects to remain compliant in future periods. At September 30, 2011, the Company had outstanding borrowings of $175.0 million under this facility. There were no outstanding borrowings under this facility at December 31, 2010.

On September 16, 2010, the Company issued $250 million in 4.625% senior notes due in 2020. Interest is payable semi-annually on March 15 and September 15 of each year, beginning on March 15, 2011.

On September 8, 2010, the Company amended its December 21, 2009 Receivable Purchase Agreement, which increased the accounts receivable securitization facility from $50 million to $80 million. This facility matures on December 21, 2012. The Company paid servicing fees related to these receivables of $0.4 million and $1.1 million for the three and nine months ended September 30, 2011, respectively, and $0.4 million and $0.9 million for the three and nine months ended September 30, 2010, respectively. These amounts are recorded in interest expense and finance charges in the Condensed Consolidated Statements of Operations.

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On April 9, 2009, the Company issued $373.8 million in convertible senior notes due April 15, 2012. Under ASC Topic 470, "Accounting for Convertible Debt Instruments That May be Settled in Cash Upon Conversion (Including Partial Cash Settlement)," the Company must account for the convertible senior notes by bifurcating the instruments between their liability and equity components. The value of the debt component is based on the fair value of issuing a similar nonconvertible debt security. The equity component of the convertible debt security is calculated by deducting the value of the liability from the proceeds received at issuance. The Company's September 30, 2011 Condensed Consolidated Balance Sheet includes current debt of $363.3 million due April 15, 2012 and capital in excess of par value of $36.5 million. Additionally, ASC Topic 470 requires the Company to accrete the discounted carrying value of the convertible notes to their face value over the term of the notes. The Company's interest expense associated with this amortization is based on the effective interest rate of the convertible senior notes of 9.365%. The total interest expense related to the convertible senior notes in the Company's Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2011 and 2010 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(millions of dollars)	2011	2010	2011	2010
Interest expense	$8.3	$7.9	$24.6	$23.3
Non-cash portion	$5.0	$4.6	$14.8	$13.5

The notes pay interest semi-annually of $6.5 million, which is at a coupon rate of 3.50% per year.

Holders of the notes may convert their notes at their option at any time prior to the close of business on the second scheduled trading day immediately preceding the maturity date of the notes, in multiples of $1,000 principal amount. The initial conversion rate for the notes is 30.4706 shares of the Company's common stock per $1,000 principal amount of notes (representing an initial conversion price of approximately $32.82 per share of common stock). The conversion price represents a conversion premium of 27.50% over the last reported sale price of the Company's common stock on the New York Stock Exchange on April 6, 2009 of $25.74 per share. Since the Company's stock price was above the convertible senior notes conversion price of $32.82, the if-converted value was approximately $315.6 million and $450.2 million higher than the face value of the convertible senior notes at September 30, 2011 and December 31, 2010, respectively. In conjunction with the note offering, the Company entered into a bond hedge overlay at a net pre-tax cost of $25.2 million, effectively raising the conversion premium to 50.0%, or approximately $38.61 per share. Upon conversion, the Company will pay or deliver cash, shares of its common stock or a combination thereof at our election.

As of September 30, 2011 and December 31, 2010, the estimated fair values of the Company's senior unsecured notes totaled $1,434.9 million and $1,482.3 million, respectively. The estimated fair values were $421.3 million and $483.7 million higher at September 30, 2011 and December 31, 2010, respectively, than their carrying values. Fair market values are developed by the use of estimates obtained from brokers and other appropriate valuation techniques based on information available as of quarter-end and year-end. The fair value estimates do not necessarily reflect the values the Company could realize in the current markets.

The Company had outstanding letters of credit at September 30, 2011 and December 31, 2010 of $50.0 million and $26.5 million, respectively. The letters of credit typically act as guarantees of payment to certain third parties in accordance with specified terms and conditions.

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(9) Fair Value Measurements

ASC Topic 820 emphasizes that fair value is a market-based measurement, not an entity specific measurement. Therefore, a fair value measurement should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering market participant assumptions in fair value measurements, ASC Topic 820 establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair values as follows:

Level 1: Observable inputs such as quoted prices in active markets;
Level 2: Inputs, other than quoted prices in active markets, that are observable either directly or indirectly; and
Level 3: Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Assets and liabilities measured at fair value are based on one or more of the following three valuation techniques noted in ASC Topic 820:

A. Market approach: Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
B. Cost approach: Amount that would be required to replace the service capacity of an asset (replacement cost).
C. Income approach: Techniques to convert future amounts to a single present amount based upon market expectations (including present value techniques, option-pricing and excess earnings models).

The following table classifies the assets and liabilities measured at fair value on a recurring basis as of September 30, 2011:

		Basis of Fair Value Measurements			
(millions of dollars)	Balance at September 30, 2011	Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique
Assets:					
Foreign currency contracts	$2.5	$—	$2.5	$—	A
Other non-current assets (insurance settlement agreement note receivable)	$21.2	$—	$21.2	$—	C
Liabilities:					
Foreign currency contracts	$10.5	$—	$10.5	$—	A
Commodity contracts	$0.1	$—	$0.1	$—	A
Net investment hedge contracts	$85.5	$—	$85.5	$—	A

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The following table classifies the assets and liabilities measured at fair value on a recurring basis as of December 31, 2010:

(millions of dollars)	Balance at December 31, 2010	Basis of Fair Value Measurements Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique
Assets:					
Foreign currency contracts	$2.7	$—	$2.7	$—	A
Liabilities:					
Foreign currency contracts	$6.4	$—	$6.4	$—	A
Net investment hedge contracts	$75.7	$—	$75.7	$—	A

(10) Financial Instruments

The Company's financial instruments include cash and marketable securities. Due to the short-term nature of these instruments, their book value approximates their fair value. The Company's financial instruments also include long-term debt, interest rate and cross-currency swaps, commodity derivative contracts, and foreign currency derivatives. All derivative contracts are placed with counterparties that have an S&P, or equivalent, investment grade credit rating at the time of the contracts' placement. At September 30, 2011, the Company had no derivative contracts that contained credit risk related contingent features.

The Company selectively uses cross-currency swaps to hedge the foreign currency exposure associated with our net investment in certain foreign operations (net investment hedges). Fair values of cross-currency swaps are based on observable inputs, such as interest rate, yield curves, credit risks, currency exchange rates and other external valuation methodology (Level 2 inputs under ASC Topic 820).

At September 30, 2011 and December 31, 2010, the following cross-currency swaps were outstanding:

(in millions)	Cross-Currency Swaps Notional in USD	Notional in Local Currency	Duration
Floating $ to floating €	$75.0	€58.5	Oct - 19
Floating $ to floating ¥	$150.0	¥17,581.5	Nov - 16

The Company uses certain commodity derivative contracts to protect against commodity price changes related to forecasted raw material and supplies purchases. The Company primarily utilizes forward and option contracts, which are designated as cash flow hedges.

At September 30, 2011 and December 31, 2010, the following commodity derivative contracts were outstanding:

Commodity	Commodity Derivative Contracts Volume Hedged September 30, 2011	Volume Hedged December 31, 2010	Units of Measure	Duration
Natural gas	75,600	258,900	MMBtu	Dec - 11

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The Company uses foreign currency forward and option contracts to protect against exchange rate movements for forecasted cash flows, including purchases, operating expenses or sales transactions designated in currencies other than the functional currency of the operating unit. Foreign currency derivative contracts require the Company, at a future date, to either buy or sell foreign currency in exchange for the operating units' local currency.

As of September 30, 2011 and December 31, 2010, the following foreign currency derivative contracts were outstanding:

Foreign Currency Derivatives (in millions)

Functional Currency	Traded Currency	Notional in Traded Currency September 30, 2011	Notional in Traded Currency December 31, 2010	Duration
British pound	Euro	75.4	107.3	Dec - 13
Euro	British pound	1.4	—	Dec - 11
Euro	Hungarian forint	6,720.0	—	Dec - 12
Euro	Polish zloty	30.5	—	Dec - 12
Euro	US dollar	7.9	20.2	Dec - 11
Indian rupee	US dollar	0.5	1.9	Dec - 11
Japanese yen	US dollar	8.9	—	Dec - 12
Korean won	Euro	35.9	45.7	Dec - 12
Mexican peso	Euro	12.0	13.5	Dec - 11
Mexican peso	US dollar	50.6	—	Dec - 12
Swedish Krona	Euro	7.5	—	Dec - 12
US dollar	Indian rupee	33.8	141.5	Dec - 11
US dollar	Euro	—	1.7	Sep - 11

At September 30, 2011 and December 31, 2010, the following amounts were recorded in the Company's Condensed Consolidated Balance Sheets as being payable to or receivable from counterparties under ASC Topic 815:

	Assets			Liabilities		
(millions of dollars)	Location	September 30, 2011	December 31, 2010	Location	September 30, 2011	December 31, 2010
Foreign currency contracts	Prepayments and other current assets	$2.3	$2.7	Accounts payable and accrued expenses	$7.3	$3.3
	Other non-current assets	0.2	—	Other non-current liabilities	3.2	3.1
Commodity contracts	Prepayments and other current assets	—	—	Accounts payable and accrued expenses	0.1	—
Net investment hedge contracts	Other non-current assets	—	—	Other non-current liabilities	85.5	75.7

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Effectiveness for cash flow and net investment hedges is assessed at the inception of the hedging relationship and quarterly, thereafter. To the extent that derivative instruments are deemed to be effective as defined by ASC Topic 815, gains and losses arising from these contracts are deferred in accumulated other comprehensive income (loss) (AOCI). Such gains and losses will be reclassified into income as the underlying operating transactions are realized. Gains and losses not qualifying for deferral treatment have been credited/charged to income as they are recognized.

The table below shows deferred gains and losses at the end of the period reported in AOCI and amounts expected to be reclassified to income or loss within the next twelve months. The gain or loss expected to be reclassified to income or loss in one year or less assumes no change in the current relationship of the hedged item at September 30, 2011 market rates.

(millions of dollars)	Deferred gain (loss) in AOCI at		Gain (Loss) expected to be reclassified to income in one year or less
Contract Type	September 30, 2011	December 31, 2010	
Foreign currency	$(8.3)	$(3.7)	$(5.4)
Commodity	(0.1)	1.6	(0.1)
Net investment hedges	(81.1)	(69.3)	—
Total	$(89.5)	$(71.4)	$(5.5)

Net investment hedges are derivative contracts entered into to hedge against changes in exchange rates that affect the overall value of net investments in foreign entities. Gains and losses on net investment hedges are recorded in AOCI and are used to offset equivalent gains or losses in the value of net investments that are recorded in translation gains and losses which is also a component of AOCI. Net investment hedges, designated under ASC Topic 815, held during the period resulted in the following gains or losses recorded in income:

(millions of dollars)		Gain (Loss) reclassified from AOCI to income (effective portion) Three Months Ended			Gain (Loss) recognized in income (ineffective portion) Three Months Ended	
Contract Type	Location	September 30, 2011	September 30, 2010	Location	September 30, 2011	September 30, 2010
Cross-currency swap	Interest expense	$—	$—	Interest expense	$0.3	$(1.9)

(millions of dollars)		Gain (Loss) reclassified from AOCI to income (effective portion) Nine Months Ended			Gain (Loss) recognized in income (ineffective portion) Nine Months Ended	
Contract Type	Location	September 30, 2011	September 30, 2010	Location	September 30, 2011	September 30, 2010
Cross-currency swap	Interest expense	$—	$—	Interest expense	$2.1	$1.0

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Cash flow hedges are derivative contracts entered into to hedge against fluctuations in foreign exchange rates and commodity prices. The effective portion of gains or losses exactly offset gains or losses in the underlying transaction that they were designated to hedge, and are recorded on the same line in the statement of operations. Ineffectiveness resulting from imperfect matches between changes in value of hedge contracts and changes in value of the underlying transaction are immediately recognized in income. Cash flow hedges, designated under ASC Topic 815, held during the period resulted in the following gains and losses recorded in income:

		Gain (Loss) reclassified from AOCI to income (effective portion)			Gain (Loss) recognized in income (ineffective portion)	
(millions of dollars)		Three Months Ended			Three Months Ended	
Contract Type	Location	September 30, 2011	September 30, 2010	Location	September 30, 2011	September 30, 2010
Foreign currency	Sales	$(0.8)	$(0.4)	SG&A expense	$—	$(0.4)
Foreign currency	Cost of goods sold	(0.1)	(0.4)	SG&A expense	—	—
Foreign currency	SG&A expense	0.4	(0.2)	SG&A expense	—	—
Commodity	Cost of goods sold	(0.1)	2.2	Cost of goods sold	—	0.8

		Gain (Loss) reclassified from AOCI to income (effective portion)			Gain (Loss) recognized in income (ineffective portion)	
(millions of dollars)		Nine Months Ended			Nine Months Ended	
Contract Type	Location	September 30, 2011	September 30, 2010	Location	September 30, 2011	September 30, 2010
Foreign currency	Sales	$(1.6)	$(0.5)	SG&A expense	$—	$0.9
Foreign currency	Cost of goods sold	(0.7)	(1.0)	SG&A expense	—	—
Foreign currency	SG&A expense	1.0	(0.4)	SG&A expense	—	—
Commodity	Cost of goods sold	(0.1)	6.2	Cost of goods sold	—	(0.2)

At September 30, 2011, derivative instruments that were not designated as hedging instruments as defined by ASC Topic 815 were immaterial.

(11) Retirement Benefit Plans

The Company has a number of defined benefit pension plans and other post employment benefit plans covering eligible salaried and hourly employees and their dependents. The estimated contributions to the Company’s defined benefit pension plans for 2011 range from $30 million to $40 million, of which $16.7 million has been contributed through the first nine months of the year. The other post employment benefit plans, which provide medical and life insurance benefits, are unfunded plans.

On March 24, 2010, the Company finalized its settlement agreement regarding the closure of the BorgWarner Diversified Transmission Products Plant in Muncie, Indiana ("Muncie Plant") with the Pension Benefit Guaranty Corporation in which the Company will make certain payments directly to the Muncie Plant's defined benefit pension plan (the “Plan”). On December 23, 2009, the Company made an initial cash contribution of $23 million for the 2009 Plan year, consistent with the settlement agreement. Also under the settlement agreement for each of the 2011, 2012 and 2013 Plan years, the Company will make a cash contribution to the Plan in the amount of $15 million, unless this contribution exceeds the maximum amounts deductible under the applicable U.S. tax regulations. The Company provided $35 million in the form of a surety bond and will waive a credit balance valued at up to $8 million in 2014. In the second quarter of 2011, the Company replaced the original surety bond with $35 million in letters of credit.

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The components of net periodic benefit cost recorded in the Company's Condensed Consolidated Statements of Operations are as follows:

	Pension benefits				Other post employment benefits	
(millions of dollars)	2011		2010		2011	2010
Three Months Ended September 30,	US	Non-US	US	Non-US		
Service cost	$—	$2.7	$—	$2.3	$0.2	$0.2
Interest cost	4.0	4.3	4.4	3.7	2.9	3.6
Expected return on plan assets	(5.2)	(2.8)	(5.0)	(2.4)	—	—
Amortization of unrecognized prior service benefit	(0.2)	—	(0.1)	—	(1.7)	(1.7)
Amortization of unrecognized loss	1.7	0.2	1.6	0.2	2.0	2.3
Net periodic benefit cost	$0.3	$4.4	$0.9	$3.8	$3.4	$4.4

	Pension benefits				Other post employment benefits	
(millions of dollars)	2011		2010		2011	2010
Nine Months Ended September 30,	US	Non-US	US	Non-US		
Service cost	$—	$7.9	$—	$7.1	$0.5	$0.6
Interest cost	12.1	13.3	13.1	11.1	8.8	10.9
Expected return on plan assets	(15.6)	(8.5)	(14.8)	(7.1)	—	—
Amortization of unrecognized prior service benefit	(0.6)	—	(0.5)	—	(5.1)	(5.2)
Amortization of unrecognized loss	4.9	0.6	4.9	0.6	6.0	6.8
Net periodic benefit cost	$0.8	$13.3	$2.7	$11.7	$10.2	$13.1

(12) Stock-Based Compensation

Under the Company's 1993 Stock Incentive Plan ("1993 Plan"), the Company granted options to purchase shares of the Company's common stock at the fair market value on the date of grant. The options vest over periods up to three years and have a term of ten years from date of grant. As of December 31, 2003, there were no options available for future grants under the 1993 Plan. The 1993 Plan expired at the end of 2003 and was replaced by the Company's 2004 Stock Incentive Plan, which was amended at the Company's 2009 Annual Stockholders Meeting, among other things, to increase the number of stock options or restricted shares available for issuance under the Plan. Under the BorgWarner Inc. Amended and Restated 2004 Stock Incentive Plan ("2004 Stock Incentive Plan"), 12.5 million shares were authorized for grant, of which 2,228,183 shares are available for future award.

A summary of the Plans' shares under option for the nine months ended September 30, 2011 is as follows:

	Shares Under Option (thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in millions)
Outstanding and exercisable at December 31, 2010	3,253	$28.64	4.9	$142.2
Exercised	(476)	$28.40		
Outstanding and exercisable at March 31, 2011	2,777	$28.69	4.7	$141.6
Exercised	(208)	$25.83		
Outstanding and exercisable at June 30, 2011	2,569	$28.91	4.5	$133.3
Exercised	(147)	$26.34		

Outstanding and exercisable at September 30, 2011	2,422	$29.09	4.3	$76.2

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At its November 2007 meeting, the Company's Compensation Committee decided that restricted common stock awards and stock units ("restricted stock") would be awarded in place of stock options for long-term incentive award grants to employees. Restricted stock granted to employees vests fifty percent after two years and the remainder after three years from the date of grant. Restricted stock granted to non-employee directors generally vests on the anniversary date of the grant.

The value of restricted stock is determined by the market value of the Company’s common stock at the date of grant. In February 2011, restricted stock in the amount of 270,144 was granted to employees under the 2004 Stock Incentive Plan. In April 2011, restricted stock in the amount of 3,288 was granted to non-employee directors under the 2004 Stock Incentive Plan. The value of the awards is recorded as unearned compensation within capital in excess of par value in equity and is amortized as compensation expense over the restricted periods.

Restricted stock compensation expense reduced earnings before income taxes and noncontrolling interest, net earnings and earnings per share for the three and nine months ended September 30, 2011 and 2010 by:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(millions of dollars, except per share data)	2011	2010	2011	2010
Earnings before income taxes and noncontrolling interest	$3.4	$5.0	$11.0	$15.4
Net earnings	$2.6	$3.7	$8.4	$12.0
Earnings per share — basic	$0.02	$0.03	$0.08	$0.10
Earnings per share — diluted	$0.02	$0.03	$0.07	$0.09

A summary of the Company’s nonvested restricted stock for the nine months ended September 30, 2011 is as follows:

	Shares Subject to Restriction (thousands)	Weighted Average Price
Nonvested at December 31, 2010	1,870.6	$30.55
Granted	270.1	$70.47
Vested	(572.0)	$27.00
Forfeited	(12.4)	$30.14
Nonvested at March 31, 2011	1,556.3	$38.79
Granted	3.3	$78.47
Vested	(25.2)	$33.69
Forfeited	(27.3)	$38.03
Nonvested at June 30, 2011	1,507.1	$38.98
Granted	1.0	$71.66
Vested	(3.4)	$44.38
Forfeited	(58.4)	$37.75
Nonvested at September 30, 2011	1,446.3	$39.04

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(13) Comprehensive Income (Loss)

The amounts presented as changes in accumulated other comprehensive income (loss), net of related taxes, are added to (deducted from) net earnings resulting in comprehensive income (loss). The following table summarizes the components of comprehensive income (loss) on an after-tax basis for the three and nine months ended September 30, 2011 and 2010:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(millions of dollars)	2011	2010	2011	2010
Foreign currency translation adjustments	$(147.5)	$175.7	$(16.2)	$(39.5)
Market value change in hedge instruments	(3.1)	(21.9)	(13.7)	(11.8)
Unrealized gain on available-for-sale securities	—	—	0.2	—
Defined benefit post employment plans	3.8	—	(0.2)	—
Change in accumulated other comprehensive income (loss)	(146.8)	153.8	(29.9)	(51.3)
Net earnings attributable to BorgWarner Inc.	141.6	106.7	428.1	265.7
Comprehensive income (loss)	(5.2)	260.5	398.2	214.4
Comprehensive income (loss) attributable to the noncontrolling interest	(4.1)	0.1	(1.4)	(2.8)
Comprehensive income (loss) attributable to BorgWarner Inc.	$(9.3)	$260.6	$396.8	$211.6

(14) Contingencies

In the normal course of business, the Company is party to various commercial and legal claims, actions and complaints, including matters involving warranty claims, intellectual property claims, general liability and various other risks. It is not possible to predict with certainty whether or not the Company will ultimately be successful in any of these commercial and legal matters or, if not, what the impact might be. The Company's environmental and product liability contingencies are discussed separately below. The Company's management does not expect that the results in any of these commercial and legal claims, actions and complaints will have a material adverse effect on the Company's results of operations, financial position or cash flows.

Litigation

In January 2006, BorgWarner Diversified Transmission Products Inc. ("DTP"), a subsidiary of the Company, filed a declaratory judgment action in United States District Court, Southern District of Indiana (Indianapolis Division) against the United Automobile, Aerospace, and Agricultural Implements Workers of America (“UAW”) Local No. 287 and Gerald Poor, individually and as the representative of a defendant class. DTP sought the Court's affirmation that DTP did not violate the Labor-Management Relations Act or the Employee Retirement Income Security Act (ERISA) by unilaterally amending certain medical plans effective April 1, 2006 and October 1, 2006, prior to the expiration of the then-current collective bargaining agreements. On September 10, 2008, the Court found that DTP's reservation of the right to make such amendments reducing the level of benefits provided to retirees was limited by its collectively bargained health insurance agreement with the UAW, which did not expire until April 24, 2009. Thus, the amendments were untimely. In 2008, the Company recorded a charge of $4.0 million as a result of the Court's decision.

DTP filed a declaratory judgment action in the United States District Court, Southern District of Indiana (Indianapolis Division) against the UAW Local No. 287 and Jim Barrett and others, individually and as representatives of a defendant class, on February 26, 2009 again seeking the Court's affirmation that DTP will not violate the Labor - Management Relations Act or ERISA by modifying the level of benefits provided retirees to make them comparable to other Company retiree benefit plans after April 24, 2009. Certain retirees, on behalf of themselves and others, filed a mirror-image action in the United States District Court, Eastern District of Michigan (Southern Division) on March 11, 2009, for which a class has been certified.

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During the last quarter of 2009 the action pending in Indiana was dismissed, while the action in Michigan is continuing and in the discovery phase. The Company is vigorously defending against the suit. This contingency is subject to many uncertainties, therefore based on the information available to date, the Company cannot reasonably estimate the amount or the range of potential loss, if any.

Environmental

The Company and certain of its current and former direct and indirect corporate predecessors, subsidiaries and divisions have been identified by the United States Environmental Protection Agency and certain state environmental agencies and private parties as potentially responsible parties ("PRPs") at various hazardous waste disposal sites under the Comprehensive Environmental Response, Compensation and Liability Act ("Superfund") and equivalent state laws and, as such, may presently be liable for the cost of clean-up and other remedial activities at 40 such sites. Responsibility for clean-up and other remedial activities at a Superfund site is typically shared among PRPs based on an allocation formula.

The Company believes that none of these matters, individually or in the aggregate, will have a material adverse effect on its results of operations, financial position or cash flows. Generally, this is because either the estimates of the maximum potential liability at a site are not material or the liability will be shared with other PRPs, although no assurance can be given with respect to the ultimate outcome of any such matter.

Based on information available to the Company (which in most cases includes: an estimate of allocation of liability among PRPs; the probability that other PRPs, many of whom are large, solvent public companies, will fully pay the cost apportioned to them; currently available information from PRPs and/or federal or state environmental agencies concerning the scope of contamination and estimated remediation and consulting costs; remediation alternatives; and estimated legal fees), the Company has an accrual for indicated environmental liabilities with a balance of $11.3 million and $28.0 million at September 30, 2011 and at December 31, 2010, respectively. The accrued amounts do not exceed $3.0 million related to any individual site except for the Crystal Springs site discussed below, and we do not believe that the costs related to any of these sites will have a material adverse effect on the Company's results of operations, financial position or cash flows. The Company expects to pay out substantially all of the amounts accrued for environmental liability over the next three to five years.

In connection with the sale of Kuhlman Electric Corporation, the Company agreed to indemnify the buyer and Kuhlman Electric for certain environmental liabilities, then unknown to the Company, relating to certain operations of Kuhlman Electric that pre-date the Company's 1999 acquisition of Kuhlman Electric. During 2000, Kuhlman Electric notified the Company that it discovered potential environmental contamination at its Crystal Springs, Mississippi plant while undertaking an expansion of the plant. The Company worked with the Mississippi Department of Environmental Quality and Kuhlman Electric to investigate and remediate certain historical contamination at the plant and surrounding area. Kuhlman Electric and others, including the Company, were sued in numerous related lawsuits, in which multiple claimants alleged personal injury and property damage relating to the alleged environmental contamination. In 2005, the Company and other defendants entered into settlements that resolved approximately 99% of those claims and the remainder of them have since been dismissed.

In 2007 and 2008, four additional lawsuits were filed against Kuhlman Electric and others, including the Company, on behalf of approximately 340 plaintiffs, alleging personal injury relating to the alleged environmental contamination. One of the lawsuits, involving a single plaintiff, was dismissed by the trial court in April 2010 and the plaintiff's appeal of that decision was dismissed by the appellate court in August 2010. The Company entered into a settlement in July 2010 regarding the personal injury claims of the plaintiffs in the other three lawsuits and those of approximately 2,700 unfiled claimants represented by those plaintiffs' attorneys. In exchange for, among other things, the dismissal with prejudice of these lawsuits and

the release of claims by the unfiled claimants, the Company agreed to pay up to $28.0 million in settlement funds, which was expensed in the second quarter of 2010. The Company paid $13.9 million in November 2010 and made the final payment of $13.9 million in February 2011.

Product Liability

Like many other industrial companies who have historically operated in the U.S., the Company (or parties the Company is obligated to indemnify) continues to be named as one of many defendants in asbestos-related personal injury actions. We believe that the Company's involvement is limited because, in general, these claims relate to a few types of automotive friction products that were manufactured many years ago and contained encapsulated asbestos. The nature of the fibers, the encapsulation and the manner of use lead the Company to believe that these products are highly unlikely to cause harm. As of September 30, 2011 and December 31, 2010, the Company had approximately 16,000 and 17,000 pending asbestos-related product liability claims, respectively. Of the approximately 16,000 outstanding claims at September 30, 2011, approximately half were pending in jurisdictions that have undergone significant tort and judicial reform activities subsequent to the filing of these claims.

The Company's policy is to vigorously defend against these lawsuits and the Company has been successful in obtaining dismissal of many claims without any payment. The Company expects that the vast majority of the pending asbestos-related product liability claims where it is a defendant (or has an obligation to indemnify a defendant) will result in no payment being made by the Company or its insurers. In 2011, of the approximately 1,500 claims resolved, 216 (14.4%) resulted in any payment being made to a claimant by or on behalf of the Company. In the full year of 2010, of the approximately 7,700 claims resolved, only 245 (3.2%) resulted in any payment being made to a claimant by or on behalf of the Company.

Prior to June 2004, the settlement and defense costs associated with all claims were paid by the Company's primary layer insurance carriers under a series of funding arrangements. In addition to the primary insurance available for asbestos-related claims, the Company has substantial excess insurance coverage available for potential future asbestos-related product claims. In June 2004, primary layer insurance carriers notified the Company of the alleged exhaustion of their policy limits.

A declaratory judgment action was filed in January 2004 in the Circuit Court of Cook County, Illinois by Continental Casualty Company and related companies (“CNA”) against the Company and certain of its other historical general liability insurers. The court has issued a number of interim rulings and discovery is continuing. CNA and the Company have entered into a settlement agreement resolving their coverage disputes, pursuant to which CNA will pay amounts over the next four years to the Company. The Company is vigorously pursuing the litigation against the remaining insurers.

Although it is impossible to predict the outcome of pending or future claims or the impact of tort reform legislation that may be enacted at the state or federal levels, due to the encapsulated nature of the products, the Company's experience in vigorously defending and resolving claims in the past, and the Company's significant insurance coverage with solvent carriers as of the date of this filing, management does not believe that asbestos-related product liability claims are likely to have a material adverse effect on the Company's results of operations, financial position or cash flows.

To date, the Company has paid and accrued $181.7 million in defense and indemnity in advance of insurers' reimbursement and has received $81.1 million in cash and notes from insurers, including CNA. The net balance of $100.6 million, is expected to be fully recovered, of which approximately $30.0 million is expected to be recovered within one year. Timing of recovery is dependent on final resolution of the declaratory judgment action referred to above or additional negotiated settlements. At December 31, 2010, insurers owed $120.6 million in association with these claims.

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In addition to the $100.6 million net balance relating to past settlements and defense costs, the Company has estimated a liability of $57.8 million for claims asserted, but not yet resolved and their related defense costs at September 30, 2011. The Company also has a related asset of $57.8 million to recognize proceeds from the insurance carriers. Insurance carrier reimbursement of 100% is expected based on the Company's experience, its insurance contracts and decisions received to date in the declaratory judgment action referred to above. At December 31, 2010, the comparable value of the insurance asset and accrued liability was $50.6 million.

The amounts recorded in the Condensed Consolidated Balance Sheets related to the estimated future settlement of existing claims are as follows:

(millions of dollars)	September 30, 2011	December 31, 2010
Assets:		
Prepayments and other current assets	$27.8	$25.8
Other non-current assets	30.0	24.8
Total insurance assets	$57.8	$50.6
Liabilities:		
Accounts payable and accrued expenses	$27.8	$25.8
Other non-current liabilities	30.0	24.8
Total accrued liabilities	$57.8	$50.6

The Company cannot reasonably estimate possible losses, if any, in excess of those for which it has accrued, because it cannot predict how many additional claims may be brought against the Company (or parties the Company has an obligation to indemnify) in the future, the allegations in such claims, the possible outcomes, or the impact of tort reform legislation that may be enacted at the State or Federal levels.

(15) Earnings Per Share

The Company presents both basic and diluted earnings per share of common stock (“EPS”) amounts. Basic EPS is calculated by dividing net earnings attributable to BorgWarner Inc. by the weighted average shares of common stock outstanding during the reporting period. The Company has 390 million common shares authorized, of which 109,720,466 were outstanding at September 30, 2011. Diluted EPS is calculated by dividing net earnings attributable to BorgWarner Inc. by the weighted average shares of common stock and common equivalent stock outstanding during the reporting period.

The dilutive impact of stock based compensation is calculated using the treasury stock method. The treasury stock method assumes that the Company uses the proceeds from the exercise of awards to repurchase common stock at the average market price during the period. The assumed proceeds under the treasury stock method include the purchase price that the grantee will pay in the future, compensation cost for future service that the Company has not yet recognized and any windfall/(shortfall) tax benefits that would be credited/(debited) to capital in excess of par value when the award generates a tax deduction. Options are only dilutive when the average market price of the underlying common stock exceeds the exercise price of the options.

The potential common shares associated with the Company's 3.50% convertible notes due April 15, 2012 are reflected in diluted EPS using the “if-converted” method. Under this method, if dilutive, the common stock is assumed issued as of the beginning of the reporting period and included in calculating diluted EPS. In addition, if dilutive, interest expense, net of tax, related to the convertible notes is added back to the numerator in calculating diluted EPS.

Separately and concurrently with the issuance of the Company's 3.50% convertible notes, the Company entered into a bond hedge overlay, including warrants and options. If the Company's weighted-average

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share price exceeds $38.61 per share, the warrants will be dilutive to the Company's earnings. If the Company's weighted average share price exceeds $32.82 per share, the offsetting bond hedge will be anti-dilutive.

The following table reconciles the numerators and denominators used to calculate basic and diluted earnings per share of common stock:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions, except per share amounts)	2011	2010	2011	2010
Basic earnings per share:				
Net earnings attributable to BorgWarner Inc.	$141.6	$106.7	$428.1	$265.7
Weighted average shares of common stock outstanding	108.779	112.757	109.391	114.831
Basic earnings per share of common stock	$1.30	$0.95	$3.91	$2.31
Diluted earnings per share:				
Net earnings attributable to BorgWarner Inc.	$141.6	$106.7	$428.1	$265.7
Adjustment for net interest expense on convertible notes	5.4	5.0	16.0	15.1
Diluted net earnings attributable to BorgWarner Inc.	$147.0	$111.7	$444.1	$280.8
Weighted average shares of common stock outstanding	108.779	112.757	109.391	114.831
Effect of 3.50% convertible notes	11.389	11.389	11.389	11.389
Effect of warrant	5.158	1.596	5.332	0.584
Effect of stock-based compensation	2.614	2.062	2.657	1.731
Total dilutive effect on weighted average shares of common stock outstanding	19.161	15.047	19.378	13.704
Weighted average shares of common stock outstanding including dilutive shares	127.940	127.804	128.769	128.535
Diluted earnings per share of common stock	$1.15	$0.87	$3.45	$2.18
Total anti-dilutive shares:				
Bond hedge	6.092	3.064	6.240	2.037

(16) Reporting Segments

The Company's business is comprised of two reporting segments: Engine and Drivetrain. These segments are strategic business groups, which are managed separately as each represents a specific grouping of related automotive components and systems.

The Company allocates resources to each segment based upon the projected after-tax return on invested capital ("ROIC") of its business initiatives. ROIC is comprised of Adjusted EBIT after deducting notional taxes compared to the projected average capital investment required. Adjusted EBIT is comprised of earnings before interest, income taxes and noncontrolling interest (“EBIT") adjusted for restructuring, goodwill impairment charges, affiliates' earnings and other items not reflective of on-going operating profit or loss.

Adjusted EBIT is the measure of segment profit or loss used by the Company. The Company believes Adjusted EBIT is most reflective of the operational profitability or loss of our reporting segments.

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The following tables show segment information, including Adjusted EBIT, for the Company's reporting segments:

Net Sales by Reporting Segment

	Three Months Ended September 30,		Nine Months Ended September 30,	
(millions of dollars)	2011	2010	2011	2010
Engine	$1,258.2	$1,018.8	$3,805.5	$2,942.4
Drivetrain	538.7	397.1	1,550.8	1,191.6
Inter-segment eliminations	(5.1)	(5.0)	(15.3)	(14.6)
Net sales	$1,791.8	$1,410.9	$5,341.0	$4,119.4

Adjusted Earnings Before Interest, Income Taxes and Noncontrolling Interest ("Adjusted EBIT")

	Three Months Ended September 30,		Nine Months Ended September 30,	
(millions of dollars)	2011	2010	2011	2010
Engine	$188.2	$136.4	$571.5	$375.9
Drivetrain	43.5	31.1	114.4	105.1
Adjusted EBIT	231.7	167.5	685.9	481.0
Patent infringement settlement, net of legal costs incurred	—	—	(29.1)	—
Environmental litigation settlement	—	—	—	28.0
BERU - Eichenauer equity investment gain	—	—	—	(8.0)
Corporate, including equity in affiliates' earnings and stock-based compensation	21.4	34.0	80.6	84.3
Interest income	(1.3)	(0.6)	(3.5)	(1.8)
Interest expense and finance charges	18.5	18.4	57.4	46.8
Earnings before income taxes and noncontrolling interest	193.1	115.7	580.5	331.7
Provision for income taxes	46.4	4.2	137.1	51.1
Net earnings	146.7	111.5	443.4	280.6
Net earnings attributable to the noncontrolling interest, net of tax	5.1	4.8	15.3	14.9
Net earnings attributable to BorgWarner Inc.	$141.6	$106.7	$428.1	$265.7

Total Assets

(millions of dollars)	September 30, 2011	December 31, 2010
Engine	$3,436.7	$3,277.7
Drivetrain	1,579.0	1,230.5
Total	5,015.7	4,508.2
Corporate (a)	1,078.6	1,046.8
Total assets	$6,094.3	$5,555.0

(a) Corporate assets include equity in affiliates, investments and advances and deferred income taxes.

(17) New Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board ("FASB") amended ASC Topic 350, "Intangibles - Goodwill and Other," allowing companies to first assess qualitative factors to determine whether it is more-likely-than-not the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in ASC Topic 350. This guidance is effective for fiscal years beginning after December 15, 2011 with early adoption

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permitted. The Company plans to adopt this standard for the year ending December 31, 2011. The Company anticipates the adoption of this guidance will not have a material impact on the Company’s financial statements.

In June 2011, the FASB amended ASC Topic 220, "Comprehensive Income," which requires the presentation of the components of net income and comprehensive income in one continuous statement or two consecutive statements and requires companies to separately disclose reclassifications from other comprehensive income into net income on the face of the financial statements. This guidance requires retrospective application and is effective for interim and annual periods beginning after December 15, 2011. The Company will reflect the change in presentation in all periods presented in future filings beginning with the period ending March 31, 2012.

In May 2011, the FASB amended ASC Topic 820, “Fair Value Measurements and Disclosures,” which clarifies the application of existing fair value measurement guidance and amends the guidance to include increased transparency around valuation inputs and investment categorization. This guidance is effective for interim and annual periods beginning after December 15, 2011. The Company anticipates the adoption of this guidance will not have a material impact on the Company’s financial statements.

In October 2009, the FASB amended ASC Topic 605, "Revenue Recognition," which amends the criteria for separating consideration in multiple-deliverable arrangements and expands the disclosure requirements related to these arrangements. On January 1, 2011, the Company adopted this amendment to ASC Topic 605. The adoption of this guidance did not have a material impact on the Company's financial statements.

(18) Recent Transactions

Traction Systems division of Haldex Group

On January 31, 2011, the Company acquired 100% of the stock of Haldex Traction Holding II AB. ("Haldex Traction Systems"). Haldex Traction Systems has operations in Sweden, Hungary, and Mexico. The consideration for the acquisition, net of cash acquired, was $214.9 million (1.38 billion Swedish Krona).

The acquisition is expected to accelerate BorgWarner's growth in the global all-wheel drive (AWD) market as it continues to shift toward front-wheel drive (FWD) based vehicles. The acquisition will add industry leading FWD/AWD technologies, with a strong European customer base, to BorgWarner's existing portfolio of front and rear-wheel drive based products. This enables BorgWarner to provide global customers a broader range of all-wheel drive solutions to meet their vehicle needs.

The operating results are reported within the Company's Drivetrain reporting segment as of the date of acquisition. The Company paid $203.7 million which is recorded as an investing activity in the Company's Condensed Consolidated Statement of Cash Flows. Additionally, the Company assumed retirement-related liabilities of $5.3 million and assumed debt of $5.9 million, which are reflected as non-cash transactions in the Company's Condensed Consolidated Statement of Cash Flows.

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The following table summarizes the aggregated estimated fair value of the assets acquired and liabilities assumed on January 31, 2011, the date of acquisition:

(millions of dollars)	
Receivables, net	$31.8
Inventories, net	10.4
Property, plant and equipment, net	26.4
Goodwill	96.2
Other intangible assets, net of tax	86.4
Other assets and liabilities	3.8
Accounts payable and accrued expenses	(40.1)
Total consideration, net of cash acquired	214.9
Less: Assumed retirement-related liabilities	5.3
Less: Assumed debt	5.9
Cash paid, net of cash acquired	$203.7

In connection with the acquisition, the Company capitalized $96.7 million for customer relationships, $17.5 million for patented and unpatented technology and $3.0 million for trade names. Customer relationships, patented and unpatented technology and trade names will be amortized over 12, 11 and 2 year lives, respectively.

BorgWarner Vikas Emissions Systems India Private Limited

On August 2, 2011, the Company purchased the noncontrolling interests' 40% share of BorgWarner Vikas Emissions Systems India Private Limited for $29.4 million in cash, which has been classified as a financing activity within the Condensed Consolidated Statement of Cash Flows. In accordance with ASC Topic 810, the Company reduced its noncontrolling interest balance by $2.8 million and reduced capital in excess of par value by $26.6 million. As a result of this transaction, the Company owns 100% of BorgWarner Vikas Emissions Systems India Private Limited.

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

BorgWarner Inc. and Consolidated Subsidiaries (the “Company”) is a leading global supplier of highly engineered automotive systems and components primarily for powertrain applications. Our products help improve vehicle performance, fuel efficiency, stability and air quality. These products are manufactured and sold worldwide, primarily to original equipment manufacturers (“OEMs”) of light vehicles (passenger cars, sport-utility vehicles, vans and light-trucks). The Company's products are also sold to other OEMs of commercial trucks, buses and agricultural and off-highway vehicles. We also manufacture and sell our products to certain Tier One vehicle systems suppliers and into the aftermarket for light and commercial vehicles. The Company operates manufacturing facilities serving customers in the Americas, Europe and Asia, and is an original equipment supplier to every major automotive OEM in the world.

The Company's products fall into two reporting segments: Engine and Drivetrain. The Engine segment's products include turbochargers, timing devices and chain products, emissions systems, thermal systems, diesel coldstart, gas ignition technology and cabin heaters. The Drivetrain segment's products include transmission components and systems and all-wheel drive torque management systems.

RESULTS OF OPERATIONS

Three Months Ended September 30, 2011 vs. Three Months Ended September 30, 2010

Net sales for the three months ended September 30, 2011 totaled $1,791.8 million, a 27.0% increase from the three months ended September 30, 2010. This increase occurred while light vehicle production was up 5% worldwide, including a 5% increase in North America, a 5% increase in Asia and a 4% increase in Europe from the previous year's third quarter. The net sales increase included the first quarter 2011 acquisition of Haldex Traction Holding II AB ("Haldex Traction Systems"), as well as the impact of strengthening foreign currencies, primarily the Euro, of approximately $102 million. Currency fluctuations impacted all of the Company’s product lines. Without the acquisition of Haldex Traction Systems and the impact of foreign currency, the increase in global net sales would have been approximately 16%. The industry's focus on fuel economy and lower emissions continued to drive the adoption of BorgWarner technology and above-market growth for the Company.

Cost of sales as a percentage of net sales decreased to 80.4% in the third quarter of 2011 from 80.6% in the third quarter 2010. The Company's material cost of sales was approximately 50% of net sales in both the third quarter of 2011 and 2010. The Company's remaining cost to convert raw material to finished product (conversion cost) improved compared to the third quarter of 2010. Gross profit and gross margin were $350.8 million and 19.6% for the third quarter of 2011 as compared to $273.3 million and 19.4% for the third quarter 2010.

Third quarter selling, general and administrative (“SG&A”) costs increased $1.2 million to $151.4 million from $150.2 million, and decreased as a percentage of net sales to 8.4% from 10.6% from the third quarter 2010. The third quarter of 2011 SG&A costs were impacted by higher research and development ("R&D") costs, which were largely offset by a reduction in equity-based compensation expense. R&D costs, increased $12.6 million, or 27.5%, to $58.4 million from $45.8 million as compared to the third quarter of 2010. As a percentage of net sales, R&D costs increased to 3.3% from 3.2% in the third quarter 2010. Our continued investment in a number of cross-business R&D programs, as well as other key programs, is necessary for the Company’s short and long-term growth.

Equity in affiliates’ earnings of $11.5 million increased $1.0 million as compared with the third quarter of 2010 primarily due to improved earnings from the Company's 50% interest in NSK-Warner.

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Interest expense and finance charges were $18.5 million and $18.4 million for the third quarter of 2011 and 2010, respectively.

The Company's effective tax rate in the third quarter of 2011 is estimated to be 24.0%. This rate differs from the U.S. statutory rate primarily due to foreign rates, which differ from those in the U.S., the realization of certain business tax credits including foreign tax credits and favorable permanent differences between book and tax treatment for items, including equity in affiliates' earnings.

The Company's effective tax rate in the third quarter of 2010 was estimated to be 3.6%, which included a favorable impact of $21.2 million from the reversal of the Company's valuation allowance on U.S. based foreign tax credit carryforwards. Excluding the impact of this item, the Company's annual effective tax rate for 2010 associated with ongoing business operations was estimated to be 22%.

The Company's estimated annual effective tax rate associated with ongoing operations for 2011 is higher than the estimated annual effective tax rate for 2010 primarily due to the Company's increased profitability in higher taxed jurisdictions.

The Company’s earnings per diluted share were $1.15 and $0.87 in the third quarter of 2011 and 2010, respectively. The Company believes the following table is useful in highlighting non-recurring or non-comparable items that impacted its earnings per diluted share:

	Three Months Ended September 30,	
	2011	2010
Non-recurring or non-comparable item:		
Reversal of foreign tax credit valuation allowance	$—	$0.17
Total impact of non-recurring or non-comparable item per share — diluted	$—	$0.17

Nine Months Ended September 30, 2011 vs. Nine Months Ended September 30, 2010

Net sales for the nine months ended September 30, 2011 totaled $5,341.0 million, a 29.7% increase from the nine months ended September 30, 2010. This increase occurred while light vehicle production was up 4% worldwide, including increases of 7% and 8% in North America and Europe, respectively, while Asia remained flat from the nine months ended September 30, 2010. The net sales increase included the first quarter 2011 acquisition of Haldex Traction Systems and the second quarter 2010 acquisition of Dytech Ensa S.L. ("Dytech"), as well as the impact of strengthening foreign currencies, primarily the Euro, of approximately $243 million. Currency fluctuations impacted all of the Company’s product lines. Without the acquisitions of Haldex Traction Systems and Dytech and the impact of foreign currency, the increase in global net sales would have been approximately 19%. The industry's focus on fuel economy and lower emissions continued to drive the adoption of BorgWarner technology and above-market growth for the Company.

Cost of sales as a percentage of net sales decreased to 80.3% in the first nine months of 2011 from 80.9% in the first nine months of 2010. The Company's material cost of sales was approximately 50% of net sales in both the first nine months of 2011 and 2010. The Company's remaining cost to convert raw material to finished product (conversion cost) improved compared to the first nine months of 2010. Gross profit and gross margin were $1,050.7 million and 19.7% for the first nine months of 2011 as compared to $787.2 million and 19.1% for the first nine months of 2010. The improvements in cost of sales and gross profit margin, as a percentage of net sales, were primarily due to the Company's ability to leverage manufacturing costs as sales volumes improved, and our continued focus on managing our manufacturing cost structure.

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SG&A costs increased $55.9 million to $474.2 million from $418.3 million, and decreased as a percentage of net sales to 8.9% from 10.2% during the first nine months of 2011 from the first nine months of 2010. R&D costs, which are included in SG&A expenses, increased $49.9 million, or 37.2%, to $184.1 million from $134.2 million as compared to the first nine months of 2010. As a percentage of net sales, R&D costs increased to 3.4% from 3.3% in the first nine months of 2010. Our continued investment in a number of cross-business R&D programs, as well as other key programs, is necessary for the Company’s short and long-term growth.

Other income of $29.9 million for the first nine months of 2011 is primarily comprised of the second quarter 2011 Honeywell patent infringement settlement. As a result of the settlement, Honeywell paid $32.5 million for a paid up license to use the asserted BorgWarner patents. During 2011, the Company incurred $3.4 million in legal costs related to this lawsuit and after deducting these costs, the Company recorded a net gain of $29.1 million. Other expense of $22.0 million for the first nine months of 2010 is primarily comprised of the Company's $28.0 million environmental litigation settlement, offset by an $8.0 million gain on the acquisition of BERU - Eichenauer GmbH related to adjusting the Company's fifty percent investment to fair value under Accounting Standards Codification ("ASC") Topic 805.

Equity in affiliates’ earnings of $28.0 million decreased $1.8 million as compared with the first nine months of 2010 primarily due to lower production volumes in Japan.

Interest expense and finance charges of $57.4 million increased $10.6 million as compared with the first nine months of 2010 primarily due to higher debt levels.

At September 30, 2011, the Company's effective tax rate is estimated to be 23.6%, which includes $11.0 million of additional tax expense associated with the Company's patent infringement settlement and a tax benefit of $6.2 million resulting from other tax adjustments. These other tax adjustments related to a change in state corporate income tax legislation as well as an adjustment of the Company's tax accounts as a result of the closure of certain tax audits. This rate differs from the U.S. statutory rate primarily due to foreign rates, which differ from those in the U.S., the realization of certain business tax credits including foreign tax credits and favorable permanent differences between book and tax treatment for items, including equity in affiliates' earnings. Excluding the impact of the patent infringement settlement and the other tax adjustments mentioned above, the Company's annual effective tax rate associated with ongoing operations for 2011 is estimated to be 24%.

At September 30, 2010, the Company's projected annual effective tax rate for 2010 was estimated to be 17.3%, which included the impact of $21.2 million from the reversal of the Company's valuation allowance on U.S. based foreign tax credit carryforwards, the impact of the change in tax legislation related to Medicare Part D subsidies of $2.5 million, the additional tax expense associated with the BERU - Eichenauer equity investment gain and the tax benefit associated with the Company's environmental litigation settlement. Excluding the impact of these items, the Company's annual effective tax rate for 2010 associated with ongoing business operations was estimated to be 22%.

The Company's estimated annual effective tax rate associated with ongoing operations fore-space:nowrap;">

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(2

)

(1,034

)

—

—

(1,036

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Comprehensive loss:

Net loss

—

—

—

(42,691

)

—

(42,691

)

Total comprehensive loss

—

—

—

—

—

(42,691

)

Balance at December 31, 2013

97,905

973

373,418

(359,023

)

—

15,368

Vesting of restricted stock

—

6

(6

)

—

—

—

Stock compensation expense

—

—

6,157

—

—

6,157

Exercise of stock options

492

5

1,826

—

—

1,831

Repurchase of common stock

(171

)

(2

)

(1,304

)

—

—

(1,306

)

Comprehensive loss:

Net income

—

—

—

18,150

—

18,150

Total comprehensive income

—

—

—

—

—

18,150

Balance at December 31, 2014

98,226

$

982

$

380,091

$

(340,873

)

$

—

$

40,200

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

BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Description of the Business

Builders FirstSource, Inc., a Delaware corporation formed in 1998, is a leading supplier and manufacturer of structural and related building products for residential new construction in the United States. We serve 34 markets in 9 states, principally in the southern and eastern United States. We have 56 distribution centers and 55 manufacturing facilities, many of which are located on the same premises as our distribution centers. We serve a broad customer base ranging from production homebuilders to small custom homebuilders.

In this annual report, references to the “company,” “we,” “our,” “ours” or “us” refer to Builders FirstSource, Inc. and its consolidated subsidiaries, unless otherwise stated or the context otherwise requires.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements present the results of operations, financial position, and cash flows of Builders FirstSource, Inc. and its wholly-owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation.

Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles (“GAAP”) in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from those estimates.

Estimates are used when accounting for items such as revenue, vendor rebates, allowance for returns, discounts and doubtful accounts, employee compensation programs, depreciation and amortization periods, income taxes, inventory values, insurance programs, goodwill, other intangible assets and long-lived assets.

Sales Recognition

We recognize sales of building products upon delivery to the customer. For contracts with service elements, sales are generally recognized on the completed contract method as these contracts are usually completed within 30 days. Contract costs include all direct material and labor, equipment costs and those indirect costs related to contract performance. Provisions for estimated losses on uncompleted contracts are recognized in the period in which such losses are determined. Prepayments for materials or services are deferred until such materials have been delivered or services have been provided. All sales recognized are net of allowances for discounts and estimated returns, based on historical experience. We present all sales tax on a net basis in our consolidated financial statements.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand and all highly liquid investments with an original maturity date of three months or less.

Restricted Cash

Restricted cash consists of amounts used to collateralize outstanding letters of credit and other potential casualty insurance obligations and is classified as a current or non-current asset based on its designated purpose.

Financial Instruments

We use financial instruments in the normal course of business as a tool to manage our assets and liabilities. We do not hold or issue financial instruments for trading purposes.

We issued detachable warrants in 2011, which are measured at fair value on a recurring basis as discussed in Note 9.

Accounts Receivable

We extend credit to qualified professional homebuilders and contractors, in many cases on a non-collateralized basis. The allowance for doubtful accounts is based on management's assessment of the amount which may become uncollectible in the future and is estimated using specific review of problem accounts, overall portfolio quality, current economic conditions that may affect the borrower's ability to pay, and historical experience. Accounts receivable are written off when deemed uncollectible. Other receivables consist primarily of vendor rebates receivable.

Accounts receivable consisted of the following at December 31:

	2014	2013
	(In thousands)	
Trade receivables	$142,204	$136,359
Other	9,301	10,282
Accounts receivable	151,505	146,641
Less: allowance for returns and doubtful accounts	3,153	3,605
Accounts receivable, net	$148,352	$143,036

The following table shows the changes in our allowance for doubtful accounts:

	2014	2013	2012
	(In thousands)		
Balance at January 1,	$2,413	$1,864	$1,441
Additions charged to expense	(274)	900	751
Deductions (write-offs, net of recoveries)	(405)	(351)	(328)
Balance at December 31,	$1,734	$2,413	$1,864

We also establish reserves for credit memos and customer returns. The reserve balance was $1.4 million, $1.2 million, and $1.0 million at December 31, 2014, 2013, and 2012, respectively. The activity in this reserve was not significant for each year presented.

Inventories

Inventories consist principally of materials purchased for resale, including lumber, sheet goods, windows, doors and millwork, as well as certain manufactured products and are stated at the lower of cost or market. Cost is determined using the weighted average method, the use of which approximates the first-in, first-out method. We accrue for shrinkage based on the actual historical shrinkage results of our most recent physical inventories adjusted, if necessary, for current economic conditions. These estimates are compared with actual results as physical inventory counts are taken and reconciled to the general ledger.

During the year, we monitor our inventory levels by market and record provisions for excess inventories based on slower moving inventory. We define potential excess inventory as the amount of inventory on hand in excess of the historical usage, excluding special order items purchased in the last three months. We then apply our judgment as to forecasted demand and other factors, including liquidation value, to determine the required adjustments to net realizable value. Our inventories are generally not susceptible to technological obsolescence.

Our arrangements with vendors provide for rebates of a specified amount of consideration, payable when certain measures, generally related to a stipulated level of purchases, have been achieved. We account for estimated rebates as a reduction of the prices of the vendor’s inventory until the product is sold, at which time such rebates reduce cost of sales in the accompanying consolidated statements of operations and comprehensive loss. Throughout the year we estimate the amount of the rebates based upon the expected level of purchases. We continually revise these estimates based on actual purchase levels.

Shipping and Handling Costs

Handling costs incurred in manufacturing activities are included in cost of sales. All other shipping and handling costs are included in selling, general and administrative expenses in the accompanying consolidated statements of operations and comprehensive income (loss) and totaled $79.7 million, $71.1 million and $58.5 million in 2014, 2013 and 2012, respectively.

Income Taxes

We account for income taxes utilizing the liability method described in the Income Taxes topic of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("Codification"). Deferred income taxes are recorded to reflect consequences on future years of differences between the tax basis of assets and liabilities and their financial reporting amounts at each year-end based on enacted tax laws and statutory tax rates applicable to the periods in which differences are expected to affect taxable earnings. We record a valuation allowance to reduce deferred tax assets if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Warranty Expense

We have warranty obligations with respect to most manufactured products; however, the liability for the warranty obligations is not significant as a result of third-party inspection and acceptance processes.

Deferred Loan Costs and Debt Discount

Loan costs are capitalized upon the issuance of long-term debt and amortized over the life of the related debt. Loan costs incurred are amortized using either the straight-line method or the effective interest method. Debt discount is amortized over the life of the related debt using the effective interest method. Amortization of deferred loan costs and the debt discount are included in interest expense. Upon changes to our debt structure, we evaluate debt issuance costs in accordance with the Debt topic of the Codification. We adjust debt issuance costs as necessary based on the results of this evaluation, as discussed in Note 9.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the assets. The estimated lives of the various classes of assets are as follows:

Buildings and improvements	20 to 40 years
Machinery and equipment	3 to 10 years
Furniture and fixtures	3 to 5 years
Leasehold improvements	The shorter of the estimated useful life or the remaining lease term

Major additions and improvements are capitalized, while maintenance and repairs that do not extend the useful life of the property are charged to expense as incurred. Gains or losses from dispositions of property, plant and equipment are recorded in the period incurred. We also capitalize certain costs of computer software developed or obtained for internal use, including interest, provided that those costs are not research and development, and certain other criteria are met.

We periodically evaluate the commercial and strategic operation of the land, related buildings and improvements of our facilities. In connection with these evaluations, some facilities may be consolidated, and others may be sold or leased. Net gains or losses related to the sale of real estate and equipment are recorded as selling, general and administrative expenses.

Long-Lived Assets

We evaluate our long-lived assets, other than goodwill, for impairment when events or changes in circumstances indicate, in our judgment, that the carrying value of such assets may not be recoverable. The determination of whether or not impairment exists is based on our estimate of undiscounted future cash flows before interest attributable to the assets as compared to the net carrying value of the assets. If impairment is indicated, the amount of the impairment recognized is determined by estimating the fair value of the assets based on estimated discounted future cash flows and recording a provision for loss if the carrying value is greater than estimated fair value. The net carrying value of assets identified to be disposed of in the future is compared to their estimated fair value, usually the quoted market price obtained from an independent third-party less the cost to sell, to determine if impairment exists. Until the assets are disposed of, an estimate of the fair value is reassessed when related events or circumstances change. Asset impairment charges are presented in the consolidated statements of operations and comprehensive income (loss) for the respective years.

Insurance

We have established insurance programs to cover certain insurable risks consisting primarily of physical loss to property, business interruptions resulting from such loss, workers' compensation, employee healthcare, and comprehensive general and auto liability. Third party insurance coverage is obtained for exposures above predetermined deductibles as well as for those risks required to be insured by law or contract. Provisions for losses are developed from valuations that rely upon our past claims experience, which considers both the frequency and settlement of claims. We discount our workers' compensation liability based upon estimated future payment streams at our risk-free rate.

Net Loss per Common Share

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

The table below presents a reconciliation of weighted average common shares used in the calculation of basic and diluted EPS for the years ended December 31:

	2014	2013	2012
	(In thousands)		
Weighted average shares for basic EPS	98,050	96,449	95,463
Dilutive effect of options	2,472	—	—
Weighted average shares for diluted EPS	100,522	96,449	95,463

Our restricted stock shares include rights to receive dividends that are not subject to the risk of forfeiture even if the underlying restricted stock shares on which the dividends were paid do not vest. In accordance with the Earnings Per Share topic of the Codification, unvested share-based payment awards that contain non-forfeitable rights to dividends are deemed participating securities and should be considered in the calculation of basic EPS. Since the restricted stock shares do not include an obligation to share in losses, they will be included in our basic EPS calculation in periods of net income and excluded from our basic EPS calculation in periods of net loss. Accordingly, there were 27,000 restricted stock shares included in our basic EPS calculation for 2014 as we generated net income. There were 610,000 and 1,229,000 restricted stock shares excluded from the computation of basic EPS in 2013, and 2012, respectively, because we generated a net loss.

For the purpose of computing diluted EPS, weighted average shares outstanding have been adjusted for common shares underlying 6,246,000 options, 700,000 warrants, and 1,855,000 restricted stock units ("RSUs") for 2014. In addition, $0.5 million of income due to fair value adjustments related to the warrants was excluded from net income in the computation of diluted EPS for 2014. Options to purchase 4,933,000, and 5,514,000 shares of common stock were not included in the computations of diluted EPS in 2013, and 2012, respectively, because their effect was anti-dilutive. Warrants to purchase 700,000 and 1,600,000 shares of common stock were not included in the computations of diluted EPS in 2013 and 2012 because their effect was anti-dilutive.

Goodwill and Other Intangible Assets

Intangibles subject to amortization

We recognize an acquired intangible asset apart from goodwill whenever the intangible asset arises from contractual or other legal rights, or whenever it can be separated or divided from the acquired entity and sold, transferred, licensed, rented, or exchanged, either individually or in combination with a related contract, asset or liability. Impairment losses are recognized if the carrying value of an intangible asset subject to amortization is not recoverable from expected future cash flows and its carrying amount exceeds its estimated fair value.

Goodwill

We recognize goodwill as the excess cost of an acquired entity over the net amount assigned to assets acquired and liabilities assumed. Goodwill is tested for impairment on an annual basis and between annual tests whenever impairment is indicated. This annual test takes place as of December 31 each year. Impairment losses are recognized whenever the implied fair value of goodwill is less than its carrying value.

Stock-based Compensation

We have four stock-based employee compensation plans, which are described more fully in Note 10. We issue new common stock shares upon exercises of stock options, grants of restricted stock, and vesting of RSUs.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions for the year ended December 31:

	2014	2012
Expected life	5.8 years	6.0 years
Expected volatility	92.1%	94.4%
Expected dividend yield	0.00%	0.00%
Risk-free rate	1.83%	1.18%

The expected life represents the period of time the options are expected to be outstanding. We used the simplified method for determining the expected life assumption due to limited historical exercise experience on our stock options. The expected volatility is based on the historical volatility of our common stock over the most recent period equal to the expected life of the option. The expected dividend yield is based on our history of not paying regular dividends in the past and our current intention to not pay regular dividends in the foreseeable future. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant and has a term equal to the expected life of the options. We did not grant any stock option awards in 2013.

Recently Issued Accounting Pronouncements

In January 2015 the FASB issued an update to the existing guidance under the Income Statement topic of the Codification. This update eliminates the concept of extraordinary items and the requirement to assess whether an event or transaction is both unusual in nature and infrequent in occurrence and to separately present any such items on the statement of operations after income from continuing operations. Under the updated guidance such items will either be presented as a separate component of income from continuing operations or disclosed in the notes to the financial statements. This guidance is effective for interim and annual periods beginning after December 15, 2015. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption, but not required. The guidance allows either prospective or retrospective methods of adoption. We do not currently expect that the adoption of this update will have an impact on our financial statements.

In November 2014 the FASB issued an update to the existing guidance under the Business Combinations topic of the Codification. This update allows, but does not require, an acquired entity to apply pushdown accounting in its stand-alone financial statements upon occurrence of an event in which an acquirer obtains control of the acquired entity. The decision to apply pushdown accounting may be made independently for each change in control event. This new guidance was effective on November 18, 2014 and can be applied retrospectively. This updated guidance did not have an impact on our financial statements. We will assess the need to apply pushdown accounting for future acquisitions on an individual basis, when necessary.

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

In May 2014, the FASB issued an update to the existing guidance under the Revenue Recognition topic of the Codification which is a comprehensive new revenue recognition model requiring a company to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This new guidance is effective for annual reporting periods beginning after December 15, 2016. Accordingly, we will adopt this guidance beginning January 1, 2017. Early adoption of this guidance is not permitted. This guidance allows either full retrospective or modified retrospective methods of adoption. We are currently evaluating the impact of this guidance on our financial statements.

In April 2014, the FASB issued an update to the existing guidance under the Presentation of Financial Statements and Property, Plant, and Equipment topics of the Codification. This update changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. Under the previous guidance any component of an entity that was a reportable segment, an operating segment, a reporting unit, a subsidiary, or an asset group was eligible for discontinued operations presentation. The revised guidance only allows disposals of components of entity that represent a strategic shift that has, or will have, a major effect on an entity's operations and financial results to be presented as a discontinued operation. This update is effective for fiscal years, and interim periods beginning after December 15, 2014. Early adoption is permitted, but not required. The guidance applies prospectively to new disposals and new classifications of disposal groups as held for sale after the effective date. We do not expect that the adoption of this update will have an impact on our financial statements.

Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity (net assets) of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. It consists of net income (loss) and other gains and losses affecting stockholders' equity that, under GAAP, are excluded from net income. We had no items of other comprehensive income (loss) for the years ended December 31, 2014, 2013, and 2012.

3. Property, Plant and Equipment

Property, plant and equipment consisted of the following at December 31:

	2014	2013
	(In thousands)	
Land	$17,334	$14,437
Buildings and improvements	64,776	58,974
Machinery and equipment	113,609	100,109
Furniture and fixtures	18,936	17,734
Construction in progress	13,341	4,978
Property, plant and equipment	227,996	196,232
Less: accumulated depreciation	152,317	146,840
Property, plant and equipment, net	$75,679	$49,392

Depreciation expense was $8.5 million, $8.9 million and $10.7 million, of which $2.5 million, $2.4 million and $3.1 million was included in cost of sales, in 2014, 2013, and 2012, respectively.

4. Discontinued Operations

In the second quarter of 2009, we announced our intent to exit the entire Ohio market based upon several factors, including the unfavorable conditions that affected our industry and a poor competitive position which prevented us from generating profitable results. We completed our exit plan in the second quarter of 2009 and have no further significant, continuing involvement in these operations. The cessation of operations in these markets was treated as discontinued operations as they had distinguishable cash flow and operations that have been eliminated from our ongoing operations. As a result, the operating results of the Ohio market for the current and prior periods have been aggregated and reclassified as discontinued operations in the consolidated statements of operations and comprehensive income (loss) for the years ended December 31, 2014, 2013, and 2012.

We recognized $0.4 million, $0.4 million, and $1.3 million of expense in 2014, 2013 and 2012, respectively, which was primarily related to future minimum lease obligations on closed facilities, and revisions to sub-rental income estimates. These amounts are included in loss from discontinued operations in the accompanying consolidated statement of operations and comprehensive income (loss) for the years ended December 31, 2014, 2013, and 2012, respectively.

In December 2012, an Ohio facility met the criteria for held for sale classification. As such, it was reclassified from property, plant, and equipment to other assets. We recorded a $1.1 million impairment charge to adjust the value of this property to its fair value. This amount was included in loss from discontinued operations in the accompanying consolidated statement of operations and comprehensive income (loss) for the year ended December 31, 2012. In April 2013, this facility was sold and the resulting gain of approximately $0.2 million was included in loss from discontinued operations in the accompanying consolidated statement of operations and comprehensive income (loss) for the year ended December 31, 2013.

An analysis of our facility closure reserves related to our discontinued operations for the periods reflected is as follows:

	2012	Additions	Payments	2013	Additions	Payments	2014
	(In thousands)						
Facility and other exit costs, net of estimated sub-lease rental income	$2,611	$ 373	$ (867)	$2,117	$ 417	$ (772)	$1,762

The facility and other exit cost reserves related to our discontinued operations at December 31, 2014 were $1.8 million, of which $1.0 million is recorded as other long-term liabilities. The reserves are primarily related to future minimum lease payments on vacated facilities.

Our loss before income taxes attributable to our discontinued operations were $0.4 million, $0.3 million, and $2.4 million for the years ended December 31, 2014, 2013, and 2012, respectively.

5. Acquisitions

On June 30, 2014 the Company acquired certain assets and the operations of Slone Lumber Company, Inc. (“Slone”) for $8.7 million in cash (including certain adjustments). Based in Houston, Texas, Slone is a full-line building materials supplier. Slone’s product offerings include lumber, engineered beams, interior and exterior door units, moulding, trim, and cabinets. Slone also offers installation services on exterior doors, shutters, and cabinets.

On July 31, 2014 the Company acquired certain assets and the operations of West Orange Lumber Company, Inc. (“West Orange”) for $9.8 million in cash (including certain adjustments). Based in Groveland, Florida, West Orange supplies lumber, roof and floor trusses, custom windows and doors, as well as installation services, to both residential homebuilders and commercial contractors in central Florida.

On August 6, 2014 the Company acquired certain assets and the operations of Truss Rite, LLC (“Truss Rite”) for $14.6 million in cash (including certain adjustments). Based in Sherman, Texas Truss Rite primarily manufactures wood roof and floor trusses for large multi-family and commercial projects throughout Texas and parts of Oklahoma. Truss Rite predominately serves developers and general contractors in the multi-family residential housing sector.

On October 1, 2014 the Company acquired certain assets and the operations of Trim Tech of Austin, Inc. (“Trim Tech”) for $19.4 million in cash (including certain adjustments). Trim Tech is based in Hutto, Texas, which is approximately 30 miles north of downtown Austin. Trim Tech is a turn-key supplier of custom cabinets, interior and exterior doors, stair parts, and custom millwork and molding.

On December 22, 2014 the Company acquired certain assets and the operations of Empire Truss, Ltd. (“Empire”) for $16.8 million in cash (including certain adjustments). Empire is a Texas-based manufacturer of custom designed roof trusses and floor trusses, and a distributor of engineered wood products with its primary operations located in Huntsville, Texas, approximately 65 miles north of downtown Houston. Empire also operates a manufacturing facility in Ferris, Texas, which is 20 miles southeast of Dallas. Empire’s primary focus is on multi-family and light commercial customers.

These transactions were accounted for by the acquisition method, and accordingly the results of operations were included in the Company’s consolidated financial statements from their respective acquisition dates. The purchase price was allocated to the assets acquired based on estimated fair values at the acquisition date, with the excess of purchase price over the estimated fair value of the net assets acquired recorded as goodwill. The allocations shown in the table below are preliminary and are subject to adjustment. Pro forma results of operations are not presented as these acquisitions are not material individually or in the aggregate.

We incurred $0.6 million in acquisition related costs during the year ended December 31, 2014. These costs include due diligence costs and transaction costs to complete the acquisitions, and have been recognized in selling, general and administrative expense in the accompanying condensed consolidated statements of operations and comprehensive income (loss) for the year ended December 31, 2014.

The following table summarizes the aggregate fair values of the assets acquired and liabilities assumed at the acquisition dates for Slone, West Orange, Truss Rite, Trim Tech, and Empire (in thousands):

Accounts Receivable	$9,544
Inventory	5,417
Property, plant and equipment	8,580
Other intangible assets (Note 7)	17,467
Other assets	34
Goodwill (Note 6)	28,581
Current liabilities	(286)
Total net assets acquired	$69,337

6. Goodwill

The following table sets forth the changes in the carrying amount of goodwill for the years ended December 31, 2014 and 2013 (in thousands):

	2014	2013
Balance as of January 1,		
Goodwill	$155,829	$155,829
Accumulated impairment losses	(44,636)	(44,636)
	111,193	111,193
Acquisitions and other purchase price adjustments	28,581	—
Balance as of December 31,		
Goodwill	$184,410	$155,829
Accumulated impairment losses	(44,636)	(44,636)
	$139,774	$111,193

In 2014 the change in the carrying amount of goodwill is attributable to our acquisitions of Slone, West Orange, Truss Rite, Trim Tech, and Empire. The amounts allocated to goodwill as a result of these acquisitions is preliminary. There were no changes to the carrying amount of goodwill in 2013. The amount allocated to goodwill is attributable to the assembled workforce of the acquired companies as well as the synergies expected to arise as a result of these acquisitions. All of the goodwill recognized from these acquisitions is expected to be deductible for tax purposes. The goodwill recognized from these acquisitions will be amortized ratably over a 15 year period for tax purposes.

We closely monitor trends in economic factors and their effects on operating results to determine if an impairment trigger was present that would warrant a reassessment of the recoverability of the carrying amount of goodwill prior to the required annual impairment test in accordance with the Intangibles – Goodwill and Other topic of the Codification.

The process of evaluating goodwill for impairment involves the determination of fair value of our reporting units. Inherent in such fair value determinations are certain judgments and estimates relating to future cash flows, including our interpretation of current economic indicators and market valuations and assumptions about our strategic plans with regard to our operations. Due to the uncertainties associated with such estimates, actual results could differ from such estimates resulting in further impairment of goodwill.

In performing our impairment analysis, we developed a range of fair values for our reporting units using a discounted cash flow methodology. The discounted cash flow methodology establishes fair value by estimating the present value of the projected future cash flows to be generated from the reporting unit. The discount rate applied to the projected future cash flows to arrive at the present value is intended to reflect all risks of ownership and the associated risks of realizing the stream of projected future cash flows. The discounted cash flow methodology uses our projections of financial performance for a five-year period. The most significant assumptions used in the discounted cash flow methodology are the discount rate, the terminal value and the expected future revenues, gross margins and operating expenses, which vary among reporting units. Significant assumptions used in our financial projections include housing starts, lumber commodity prices, and market share gains.

We recorded no goodwill impairment charges in 2014, 2013, and 2012.

7. Intangible Assets

The following table presents intangible assets as of December 31:

	2014 Gross Carrying Amount	Accumulated Amortization	2013 Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Customer relationships	$18,423	$ (2,695)	$3,334	$ (2,507)
Non-compete agreements	392	(31)	—	—
Trade names	1,234	(95)	—	—
Total intangible assets	$20,049	$ (2,821)	$3,334	$ (2,507)

In connection with the acquisitions of Slone, West Orange, Truss Rite, Trim Tech, and Empire we recorded intangible assets of $17.5 million, which includes $1.2 million of trade names, $0.4 million of non-compete agreements and $15.9 million of customer relationships. The amounts allocated to intangible assets as a result of these acquisitions is preliminary. The weighted average useful lives of the acquired assets are 5.0 years for trade names and non-compete agreements, and 10.3 years for customer relationships.

During the years ended December 31, 2014, 2013, and 2012, we recorded amortization expense in relation to the above-listed intangible assets of $1.1 million, $0.4 million, and $0.4 million, respectively. The following table presents the estimated amortization expense for these intangible assets for the years ending December 31 (in thousands):

2015	$ 2,281
2016	2,162
2017	1,995
2018	1,995
2019	1,783

8. Accrued Liabilities

Accrued liabilities consisted of the following at December 31:

	2014	2013
	(In thousands)	
Accrued payroll and other employee related expenses	$18,974	$11,585
Accrued taxes	9,167	8,439
Self-insurance reserves	10,386	7,939
Accrued interest	2,329	2,227
Facility closure reserves	1,646	1,568
Casualty claims in excess of retained loss limit	11,335	2,085

Deferred revenue	4,665	5,540
Other	7,723	5,927
Total accrued liabilities	$66,225	$45,310

9. Long-Term Debt

Long-term debt consisted of the following at December 31:

	2014	2013
	(In thousands)	
2021 notes	350,000	350,000
2013 facility	30,000	—
Other long-term debt*	3,904	3,971
	383,904	353,971
Less: current portion of long-term debt	30,074	67
Total long-term debt, net of current maturities	$353,830	$353,904

* We completed construction on a new multi-purpose facility during 2006. Other long-term debt represents an unfunded lease obligation for this facility. For accounting purposes, we are deemed the owner. As a result, the building and the long-term lease obligation are included on the consolidated balance sheet as a component of fixed assets and other debt, respectively.

Second Priority Senior Secured Floating Rate Notes due 2016

As of December 31, 2012, we had $139.7 million in aggregate principal amount of Second Priority Senior Secured Floating Rate Notes due 2016 (“2016 notes”) that matured on February 15, 2016. Interest accrued on the 2016 notes at a 3-month LIBOR (subject to a 3.0% floor) plus 10.0%. LIBOR was reset at the beginning of each quarterly period. In May 2013, we repaid the full $139.7 million in outstanding notes as part of the 2013 refinancing transaction discussed below.

First-Lien Term Loan and Letter of Credit Facilities

In December 2011, we completed a $160.0 million first-lien term loan (“term loan”) that included detachable warrants that allow for the purchase of up to 1.6 million shares of our common stock at a price of $2.50 per share. These warrants were exercisable immediately upon issuance and expire in December 2018. The warrant agreement contains certain settlement adjustment features which preclude the warrants from being considered to be indexed to our stock. Specifically, it includes a “down-round” provision that requires an adjustment to be made to the exercise price and number of warrants upon the Company issuing additional common shares or convertible securities at a price that is less than the exercise price of the warrants at that time. This adjustment would be required even if the issue price of the common shares or convertible securities was at-market. As such, the outstanding warrants are considered to be derivative financial instruments and are classified as liabilities. As of December 31, 2014 there were 0.7 million warrants outstanding.

At the same time, we entered into a $20.0 million stand-alone letter of credit facility (“stand-alone facility”). The term loan and the stand-alone facility were both scheduled to mature on September 30, 2015. The term loan, which was issued at 97%, provided $119.6 million of net proceeds after repaying the $20.0 million outstanding under the existing senior secured revolving credit facility, using $14.2 million to collateralize letters of credit outstanding under the new stand-alone facility, and paying fees and expenses related to this transaction

In December of 2012, we amended our first-lien term loan to enhance our liquidity position to support both current and anticipated increases in sales volume. Terms of the amendment included increasing the principal amount by $65.0

million, reducing the minimum cash requirement from $35.0 million to $15.0 million, adding a new $15.0 million letter of credit sub-facility ("sub-facility"), and increasing the minimum specified collateral value to $225.0 million, contingent upon maintaining certain levels of qualified cash. The additional term loan amount, which was issued at 95.5%, provided $60.9 million of net proceeds after paying fees and expenses related to the transaction.

The term loan was collateralized by a first lien on substantially all of our assets, and was guaranteed by all of our subsidiaries. Interest accrued on the loan at 3-month LIBOR (subject to a 2% floor) plus 9.5%. The stand-alone facility included a commitment fee of 0.5% on any unused amount and assessed interest at a rate of 2.0% on any outstanding letters of credit. All letters of credit issued under the stand-alone facility were collateralized by cash equal to 105% of the face amount of the letters of credit. The sub-facility also included a commitment fee of 0.5% on any unused amount and assessed interest at a rate of 3.0% on any outstanding letters of credit. Letters of credit issued under the sub-facility were not required to be cash collateralized.

As of December 2012, we had outstanding letters of credit totaling $12.4 million under our stand-alone facility that principally support our self insurance programs. We collateralized these letters of credit with $13.0 million of restricted cash. In January 2013, we finalized our letter of credit sub-facility and at the same time, transferred the $12.4 million of outstanding letters of credit from our stand-alone facility over to the new sub-facility. As such, we were able to eliminate the cash collateral requirement for our outstanding letters of credit, thus increasing our liquidity by an additional $13.0 million. We also amended the stand-alone facility from $20.0 million down to $10.0 million.

In May 2013, we repaid the full $225.0 million outstanding term loan as part of the 2013 refinancing transaction discussed below. At the same time, we terminated the term loan and letter of credit sub-facility, as well as the amended stand-alone facility.

2013 Refinancing

In May 2013 we completed a private offering of $350.0 million in aggregate principal amount of 7.625% senior secured notes due 2021 (“2021 notes”) at a price equal to 100% of their face value. In conjunction with the offering, we also entered into a new 5-year $175.0 million senior secured revolving credit facility agreement (“2013 facility”) provided by a syndicate of financial institutions led by SunTrust Bank as administrative agent.

We used the net proceeds from the offering of the 2021 notes, together with cash on hand, to (i) redeem $139.7 million in aggregate outstanding principal amount of our 2016 notes at par plus accrued and unpaid interest thereon to the redemption date, (ii) repay $225.0 million in borrowings outstanding under our existing first-lien term loan plus a prepayment premium of approximately $39.5 million and accrued and unpaid interest and (iii) pay the related commissions, fees and expenses. The repayment of the 2016 notes and the term loan was considered to be an extinguishment. As such, we recognized a loss of $48.4 million, which was recorded as interest expense in the second quarter of 2013. Of this $48.4 million loss, $39.5 million was due to the prepayment premium on the term loan, $6.8 million was due to a write-off of unamortized debt discount on the term loan and $2.1 million was due to a write-off of unamortized deferred loan costs on the 2016 notes and the term loan.

Upon the repayment of the outstanding borrowings and payment of the prepayment premium and accrued interest, we terminated the term loan, which included the $15.0 million letter of credit sub-facility. The $12.7 million of outstanding letters of credit under the sub-facility at the time were transferred to the 2013 facility. At the same time, we also terminated our $10.0 million letter of credit stand-alone facility. There were no letters of credit outstanding under the stand-alone facility at the time of termination.

In connection with the issuance of the 2021 notes and entering into the 2013 facility we incurred approximately $15.6 million of various third-party fees and expenses. Of these costs, $11.2 million were allocated to the 2021 notes and $4.4 million were allocated to the 2013 facility. These costs have been capitalized and will be amortized over the respective terms of the 2021 notes and the 2013 facility. The $0.9 million in remaining unamortized deferred loan costs related to the sub-facility and stand-alone facility are being amortized over the term of the 2013 facility.

Senior Secured Notes due 2021

As of December 31, 2014, we have $350.0 million outstanding in aggregate principal amount of 2021 notes that mature on June 1, 2021. The 2021 notes were issued pursuant to an indenture, dated as of May 29, 2013 (“Indenture”), by and between us, certain of our subsidiaries, as guarantors (“Guarantors”), and Wilmington Trust, National Association, as trustee and notes collateral agent (“Trustee”). Interest accrues on the 2021 notes at a rate of 7.625% per annum and is payable semi-annually in arrears on June 1 and December 1 of each year.

The 2021 notes, subject to certain exceptions, are guaranteed, jointly and severally, on a senior secured basis, by each of the Guarantors. All obligations under the 2021 notes, and the guarantees of those obligations, will be secured by substantially all of our assets and the assets of the Guarantors subject to certain exceptions and permitted liens, including a first-priority security interest in such assets that constitute Notes Collateral (as defined therein) and a second-priority security interest in such assets that constitute ABL Collateral (as defined therein). An intercreditor agreement (“ABL/Bond Intercreditor Agreement”), dated as of May 29, 2013, among us, the Guarantors, SunTrust Bank, as ABL Collateral agent, and the Trustee, as Notes Collateral agent, will govern all arrangements in respect of the priority of the security interest in the ABL Collateral and the Notes Collateral.

“ABL Collateral” includes substantially all presently owned and after-acquired accounts receivable, inventory, rights of an unpaid vendor with respect to inventory, deposit accounts, investment property, cash and cash equivalents, and instruments and chattel paper and general intangibles, books and records and documents related to and proceeds of each of the foregoing. “Notes Collateral” includes substantially all collateral which is not ABL Collateral.

The Indenture contains certain restrictive covenants, which, among other things, relate to the payment of dividends, incurrence of indebtedness, repurchase of common stock, distributions, asset sales and investments. At any time we can redeem some or all of the 2021 notes at a redemption price equal to par plus a specified premium that declines to par by 2019. In the event of a change of control, we may be required to offer to purchase the 2021 notes at a purchase price equal to 101% of the principal, plus accrued and unpaid interest.

2013 Senior Secured Revolving Credit Facility

The 2013 facility provides for a $175.0 million revolving credit line to be used for working capital and general corporate purposes. The available borrowing capacity, or borrowing base, is derived primarily from a percentage of the Company's eligible receivables and inventory, as defined by the agreement, subject to certain reserves. The 2013 facility is scheduled to mature on May 29, 2018. At December 31, 2014, the net borrowing availability under the 2013 facility totaled $129.4 million after being reduced by outstanding letters of credit of approximately $15.6 million and $30.0 million of borrowings currently outstanding. During the third quarter of 2014 we borrowed $30.0 million under the 2013 facility at a weighted-average interest rate of 1.98%. During the second quarter of 2013 we borrowed and repaid $30.0 million under the 2013 facility at a weighted-average interest rate of 4.0%.

Borrowings under the 2013 facility bear interest, at our option, at either a base rate or eurodollar rate, plus, in each case, an applicable margin. The applicable margin ranges from 0.75% to 1.25% for base rate loans and 1.75% to 2.25% for eurodollar rate loans, in each case based on a measure of our availability under the revolver. A variable commitment fee, currently at a rate of 0.5%, is charged on the unused amount of the revolver based on quarterly average loan utilization. Letters of credit issued and outstanding under the 2013 facility are assessed a fee at a rate equal to the applicable eurodollar rate margin, currently 1.75%, and is payable quarterly in arrears at the end of March, June, September and December. They are also assessed a fronting fee at a rate of 0.125%.

All obligations under the 2013 facility will be guaranteed jointly and severally by us and all our subsidiaries that guarantee the 2021 notes. All obligations under the 2013 facility, and the guarantees of those obligations, will be secured by substantially all of our assets and the guarantors subject to certain exceptions and permitted liens, including a first-priority security interest in such assets that constitute ABL Collateral and a second-priority security interest in such assets that constitute Notes Collateral.

The 2013 facility contains certain restrictive covenants, which, among other things, relate to the incurrence of indebtedness, payment of dividends, repurchase of common stock, distributions, asset sales and investments. The agreement also contains a financial covenant requiring the satisfaction of a minimum fixed charge coverage ratio of 1.00 to 1.00 if our excess availability, defined as the sum of our net borrowing availability plus qualified cash, falls below the greater of $17.5 million or 10% of the maximum borrowing amount. Qualified cash is defined as cash on deposit that is subject to a control agreement in favor of the agent. As of December 31, 2014, our excess availability was $146.1 million, which includes $129.4 million in net borrowing availability and $16.7 million in qualified cash. The agreement governing the 2013 facility also includes customary events of default, including change of control. If an event of default occurs, the lenders under the 2013 facility would be entitled to take various actions, including the acceleration of amounts due under the revolver and all actions permitted to be taken by a secured creditor (subject to the terms of the ABL/Bond Intercreditor Agreement).

At December 31, 2014, we were not in violation of any covenants or restrictions imposed by any of our debt agreements.

Fair Value

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

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

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

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

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

The only financial instruments measured at fair value on a recurring basis were our warrants.

The tables below present the effect of our derivative financial instrument on the consolidated statements of operations and comprehensive income (loss) for the years ended December 31 (in thousands):

Derivative Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income 2014	2013	2012
Warrants	Interest expense, net	455	(1,502)	(4,992)

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

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

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

	Carrying Value As of December 31, 2014	Fair Value Measurement as of December 31, 2014	Carrying Value As of December 31, 2013	Fair Value Measurement as of December 31, 2013
Warrants (included in Other long-term liabilities)	$ 3,375	$ 3,375	$ 3,830	$ 3,830

We have elected to report the value of our 2021 Notes at amortized cost. The fair value of the 2021 Notes at December 31, 2014 was approximately $356.8 million and was determined using Level 2 inputs based on market prices.

Other Long-Term Debt

In 2006, we completed construction on a new multi-purpose facility. Based on the evaluation of the construction project in accordance with the Leases topic of the Codification, we were deemed the owner of the facility during the construction period. Effectively, a sale and leaseback of the facility occurred when construction was completed and the lease term began. This transaction did not qualify for sale-leaseback accounting. As a result, the building and the long-term lease obligation are included on the consolidated balance sheet as a component of fixed assets and other long-term debt, respectively.

Future maturities of long-term debt as of December 31, 2014 were as follows (in thousands):

Year ending December 31,	
2015	$30,074

2016	83
2017	92
2018	102
2019	113
Thereafter	353,440
Total long-term debt (including current portion)	$383,904

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10. Employee Stock-Based Compensation

2014 Incentive Plan

Under our 2014 Incentive Plan (“2014 Plan”), the Company is authorized to grant awards in the form of incentive stock options, non-qualified stock options, restricted stock shares, restricted stock units, other common stock-based awards and cash-based awards. The maximum number of common shares reserved for the grant of awards under the 2014 Plan is 5.0 million, subject to adjustment as provided by the 2014 Plan. All 5.0 million shares under the Plan may be made subject to options, stock appreciation rights (“SARs”), or stock-based awards. Stock options and SARs granted under the 2014 Plan may not have a term exceeding 10 years from the date of grant. The 2014 Plan also provides that all awards will become fully vested and/or exercisable upon a change in control (as defined in the 2014 Plan) if those awards (i) are not assumed or equitably substituted by the surviving entity or (ii) have been assumed or equitably substituted by the surviving entity, and the grantee’s employment is terminated under certain circumstances. Other specific terms for awards granted under the 2014 Plan shall be determined by our Compensation Committee (or the board of directors if so determined by the board of directors). Awards granted under the 2014 Plan generally vest ratably over a four year period. As of December 31, 2014, 3.7 million shares were available for issuance under the 2014 Plan.

2007 Incentive Plan

Under our 2007 Incentive Plan (“2007 Plan”), the Company is authorized to grant awards in the form of incentive stock options, non-qualified stock options, restricted stock, other common stock-based awards and cash-based awards. In January 2010, our shareholders approved an amendment to our 2007 Plan which increased the number of shares of common stock that may be granted pursuant to awards under the 2007 Plan from 2.5 million shares to 7.0 million shares. The maximum number of common shares reserved for the grant of awards under the 2007 Plan is 7.0 million, subject to adjustment as provided by the 2007 Plan. No more than 7.0 million shares may be made subject to options SARs granted under the 2007 Plan, and no more than 3.5 million shares may be made subject to stock-based awards other than options or SARs. Stock options and SARs granted under the 2007 Plan may not have a term exceeding 10 years from the date of grant. The 2007 Plan also provides that all awards will become fully vested and/or exercisable upon a change in control (as defined in the 2007 Plan). Other specific terms for awards granted under the 2007 Plan shall be determined by our Compensation Committee (or the board of directors if so determined by the board of directors). Historically, awards granted under the 2007 Plan generally vest ratably over a three to four-year period. As of December 31, 2014, 25,000 shares were available for issuance under the 2007 Plan, 25,000 of which may be made subject to stock-based awards other than options or SARs.

2005 Equity Incentive Plan

Under our 2005 Equity Incentive Plan (“2005 Plan”), we are authorized to grant stock-based awards in the form of incentive stock options, non-qualified stock options, restricted stock and other common stock-based awards. The maximum number of common shares reserved for the grant of awards under the 2005 Plan is 2.2 million, subject to adjustment as provided by the 2005 Plan. No more than 2.2 million shares may be made subject to options or SARs granted under the 2005 Plan, and no more than 1.1 million shares may be made subject to stock-based awards other than options or SARs. Stock options and SARs granted under the 2005 Plan may not have a term exceeding 10 years from the date of grant. The 2005 Plan also provides that all awards will become fully vested and/or exercisable upon a change in control (as defined in the 2005 Plan). Other specific terms for awards granted under the 2005 Plan shall be determined by our board of directors (or a committee of its members). Historically, awards granted under the 2005 Plan generally vest ratably over a three-year period. As of December 31, 2014, 2,700 shares were available for issuance under the 2005 Plan, 2,700 of which may be made subject to stock-based awards other than options or SARs.

1998 Stock Incentive Plan

Under the Builders FirstSource, Inc. 1998 Stock Incentive Plan ("1998 Plan"), we were authorized to issue shares of common stock pursuant to awards granted in various forms, including incentive stock options, non-qualified stock options and other stock-based awards. The 1998 Plan also authorized the sale of common stock on terms determined by our board of directors.

Stock options granted under the 1998 Plan generally cliff vest after a period of seven to nine years with certain option grants subject to acceleration if certain financial targets were met. The expiration date is generally 10 years subsequent to date of issuance. As of January 1, 2005, no further grants will be made under the 1998 Plan.

The following table summarizes our stock option activity:

	Options (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Years	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2013	4,933	$ 4.01		
Granted	1,817	$ 7.67		
Exercised	(492)	$ 3.72		
Forfeited	(12)	$ 7.05		
Outstanding at December 31, 2014	6,246	$ 5.09	6.4	$ 12,782
Exercisable at December 31, 2014	4,379	$ 4.04	5.2	$ 12,614

The outstanding options at December 31, 2014 include options to purchase 4,113,000 shares granted under the 2007 Plan, 1,319,000 shares granted under the 2005 Plan and 814,000 shares granted under the 1998 Plan. As of December 31, 2014, options to purchase 2,796,000 shares under the 2007 Plan, 769,000 shares under the 2005 Plan and 814,000 shares under the 1998 Plan awards were exercisable. The weighted average grant date fair value of options granted during the years ended December 31, 2014 and 2012 were $5.71 and $2.83, respectively. No option awards were granted during 2013. The total intrinsic value of options exercised during the years ended December 31, 2014, 2013, and 2012 were $2.0 million $1.8 million and $0.4 million, respectively. We realized no tax benefits for stock options exercised during the years ended December 31, 2014, 2013 and 2012.

Outstanding and exercisable stock options at December 31, 2014 were as follows (shares in thousands):

	Outstanding			Exercisable	
Range of Exercise Prices	Shares	Weighted Average Exercise Price	Weighted Average Remaining Years	Shares	Weighted Average Exercise Price
$3.15	814	$ 3.15	7.8	814	$ 3.15
$3.19 - $3.72	2,652	$ 3.21	5.2	2,598	$ 3.20
$6.70 - $7.15	967	$ 7.06	3.3	967	$ 7.06
$7.67	1,813	$ 7.67	9.1	—	$ —
$3.15 - $7.67	6,246	$ 5.09	6.4	4,379	$ 4.04

The following table summarizes restricted stock activity for the year ended December 31, 2014 (shares in thousands):

	Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2013	610	$ 3.42
Granted	—	$ —
Vested	(583)	$ 3.40
Forfeited	—	$ —

Nonvested at December 31, 2014	27	$ 3.72

The outstanding restricted stock units (“RSUs”) at December 31, 2014 include 1,300,000 units granted under the 2014 Plan and 555,000 units granted under the 2007 Plan. The weighted average grant date fair value of RSUs granted during the year ended December 31, 2014 was $7.48. No RSUs were granted during 2013 or 2012.

The following table summarizes restricted stock unit activity for the year ended December 31, 2014 (shares in thousands):

	Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2013	—	$ —
Granted	1,858	$ 7.48
Vested	—	$ —
Forfeited	(3)	$ 7.52
Nonvested at December 31, 2014	1,855	$ 7.48

Our results of operations included stock compensation expense of $6.2 million ($6.2 million net of taxes), $4.2 million ($4.2 million net of taxes) and $3.6 million ($3.6 million net of taxes) for the years ended December 31, 2014, 2013 and 2012, respectively. The total fair value of options vested during the years ended December 31, 2014, 2013, and 2012 were $3.0 million, $3.0 million and $3.1 million, respectively. The total fair value of restricted stock vested during the years ended December 31, 2014, 2013 and 2012 were $2.0 million, $2.1 million and $2.0 million, respectively. There were no RSUs which vested in 2014, 2013, or 2012.

As of December 31, 2014, there was $17.4 million of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Plans. That cost is expected to be recognized over a weighted-average period of 3.0 years.

11. Facility Closure Costs

In 2014, we recognized $0.5 million in expense primarily related to the minimum future lease obligations on a facility in Tennessee, which was closed in 2014, return condition obligations on a previously closed facility in South Carolina, and revised sub-rental income estimates on a previously closed facility in Tennessee. We recognized this expense in facility closure costs and interest expense, net in the accompanying consolidated statement of operations and comprehensive income (loss).

In 2013, we recognized $0.1 million in expense primarily related to revisions of sub-rental income estimates on a previously closed facility in Tennessee and future minimum lease obligations on our vacated facilities, net of estimated sub-rental income. We recognized this expense in facility closure costs and interest expense, net in the accompanying consolidated statement of operations and comprehensive income (loss). There were no new facility closures in 2013.

In 2012 we recognized $1.1 million in expense, which was primarily related to revisions of sub-rental income estimates on two previously closed facilities in South Carolina and Tennessee and future minimum lease obligations on our vacated facilities, net of estimated sub-rental income. Of the $1.1 million expense we recognized during 2012, $1.0 million was included in facility closure costs and $0.1 million was included in interest expense, net in the accompanying consolidated statement of operations and comprehensive income (loss). There were no new facility closures in 2012.

An analysis of our facility closure reserves for the periods reflected is as follows:

	2012 (In thousands)	Additions	Payments	2013	Additions	Payments	2014
Facility and other exit costs, net of estimated sub-lease rental income	$2,834	$ 82	$ (1,216)	$1,700	$ 515	$ (1,068)	$1,147

The facility and other exit cost reserves of $1.1 million at December 31, 2014, of which $0.3 million is recorded as other long-term liabilities, are primarily related to future minimum lease payments on vacated facilities.

As plans to close facilities are developed and executed, assets that can be used at other facilities are transferred and assets to be abandoned or sold are written down to their net realizable value, including any long-lived assets. In situations where multiple facilities serve the same market we may temporarily close, or idle, facilities with plans to reopen these facilities once demand returns to the market. At December 31, 2014, we had four idled facilities; two in Florida and two in South Carolina. In these situations, finite lived assets continue to be depreciated and assessed for impairment. Should conditions in our markets worsen, or recovery take significantly longer than forecasted, we may temporarily idle or permanently close additional facilities, at which time we may incur additional facility closure costs or asset impairment charges. Future non-cash impairment charges would have the effect of decreasing our earnings or increasing our losses in such period, but would not impact our current outstanding debt obligations or compliance with covenants contained in the related debt agreements. We continuously monitor economic conditions in all our markets, and while at the present time there are no plans to close or idle additional facilities, changes in market conditions may warrant future closings or idling of facilities.

12. Income Taxes

The components of income tax expense (benefit) included in continuing operations were as follows for the years ended December 31:

	2014	2013	2012
	(In thousands)		
Current:			
Federal	$—	$(594)	$—
State	587	446	119
	587	(148)	119
Deferred:			
Federal	457	827	378
State	67	90	80
	524	917	458
Income tax expense	$1,111	$769	$577

Temporary differences, which give rise to deferred tax assets and liabilities, were as follows as of December 31:

	2014	2013
	(In thousands)	
Deferred tax assets related to:		
Accrued expenses	$1,764	$1,897
Insurance reserves	4,461	3,596
Facility closure reserves	1,128	1,486
Stock-based compensation expense	8,066	7,943
Accounts receivable	658	921
Inventories	6,394	5,117
Operating loss and credit carryforwards	106,593	116,926
Goodwill and other intangible assets	1,999	2,593
Property, plant and equipment	5,931	6,307
Other	512	435
	137,506	147,221
Valuation allowance	(133,183)	(143,682)
Total deferred tax assets	4,323	3,539
Deferred tax liabilities related to:		
Prepaid expenses	(2,223)	(1,383)
Goodwill and other intangible assets	(8,281)	(7,812)
Total deferred tax liabilities	(10,504)	(9,195)
Net deferred tax liability	$(6,181)	$(5,656)

A reconciliation of the statutory federal income tax rate to our effective rate for continuing operations is provided below for the years ended December 31:

	2014	2013	2012

Statutory federal income tax rate	35.0 %	35.0 %	35.0 %
State income taxes, net of federal income tax	5.2	0.1	3.5
Valuation allowance	(36.5)	(36.9)	(36.3)
Permanent differences	1.9	(1.3)	(3.3)
Other	–	1.2	–
	5.6 %	(1.9)%	(1.1)%

We have $434.4 million of state operating loss carry-forwards, which includes $2.6 million of state tax credit carry-forwards expiring at various dates through 2032. We also have $254.5 million of federal net operating loss carry-forwards that will expire at various dates through 2033. The federal and state operating loss carry-forwards exclude approximately $6.7 million of gross windfall tax benefits from stock option exercises that have not been recorded as of December 31, 2014. These deferred tax assets will be recorded as an increase to additional paid in capital when the related tax benefits are realized. To the extent we generate sufficient taxable income in the future to fully utilize the tax benefits of the net deferred tax assets on which a valuation allowance was recorded, our effective tax rate may decrease as the valuation allowance is reversed.

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

We evaluate our deferred tax assets on a quarterly basis to determine whether a valuation allowance is required. In accordance with the Income Taxes topic of the Codification we assess whether it is more likely than not that some or all of our deferred tax assets will not be realized. Significant judgment is required in estimating valuation allowances for deferred tax assets. The realization of a deferred tax asset ultimately depends on the existence of sufficient taxable income in the applicable carryback or carryforward periods. We consider nature, frequency, and severity of current and cumulative losses, among other matters, the reversal of existing deferred tax liabilities, historical and forecasted taxable income, and tax planning strategies in our assessment. Changes in our estimates of future taxable income and tax planning strategies will affect our estimate of the realization of the tax benefits of these tax carryforwards.

Poor housing market conditions have contributed to our cumulative loss position for the past several years. While we generated income in 2014, we still have a cumulative loss for the three year period ending December 31, 2014. We believe this, as well as uncertainty around the extent and timing of the housing market recovery, represents significant negative evidence in considering whether our deferred tax assets are realizable. Further, we do not believe that relying on projections of future taxable income to support the recovery of deferred tax assets is sufficient. Based on an evaluation of positive and negative evidence, we concluded that the negative evidence regarding our ability to realize our deferred tax assets outweighed the positive evidence as of December 31, 2014.

In 2014, we reduced our valuation allowance by $7.2 million due to the utilization of net operating losses against federal and state taxable income. In 2013, we recorded a valuation allowance of approximately $15.3 million related to our continuing operations, which is exclusive of $0.6 million related primarily to reversals of uncertain tax positions due to statute expirations that affected our net operating loss carryforward and valuation allowance. In 2012, we recorded a valuation allowance of approximately $19.6 million related to our continuing operations.

Without continued improvement in housing activity, we could be required to establish additional valuation allowances. However, we had positive earnings before taxes in 2014. To the extent we continue to generate sufficient taxable income in the same jurisdictions in the future to utilize the tax benefits of the related net deferred tax assets, we may reverse some or all of the valuation allowance. We currently estimate that we will likely transition into a three year cumulative income position on a rolling three year period at some time during the year ending December 2015. However, there continues to be uncertainty around housing market projections. Simply coming out of a cumulative loss is not viewed as a bright line and may not be considered sufficient positive evidence to reverse some or all of the valuation allowance if there are other offsetting negative factors. In upcoming quarters, we will closely monitor the positive and negative evidence surrounding our ability to realize our deferred tax assets.

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

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

The following table shows the changes in our valuation allowance:

	2014	2013	2012
	(In thousands)		
Balance at January 1,	$143,682	$127,700	$112,392
Additions charged to expense:			
Continuing operations	—	15,878	19,559
Discontinued operations	131	178	905
Reductions credited to expense:			
Continuing operations	(7,178)	—	—
Discontinued operations	—	—	—
Deductions	(3,452)	(74)	(5,156)
Balance at December 31,	$133,183	$143,682	$127,700

We accrue interest and penalties on our uncertain tax positions as a component of our provision for income taxes. We accrued no significant interest and penalties in 2014, 2013 or 2012. We had a total of $0.3 million and $0.2 million accrued for interest and penalties for our uncertain tax positions as of December 31, 2014 and 2013, respectively.

The following table shows the changes in the amount of our uncertain tax positions (exclusive of the effect of interest and penalties):

	2014	2013	2012
	(In thousands)		
Balance at January 1,	$950	$2,080	$2,257
Tax positions taken in prior periods:			
Gross increases	2	—	22
Gross decreases	—	—	(64)
Tax positions taken in current period:			
Gross increases	13	11	7
Settlements with taxing authorities	—	—	(142)
Lapse of applicable statute of limitations	(587)	(1,141)	—
Balance at December 31,	$378	$950	$2,080

The balance for uncertain tax positions was $0.4 million as of December 31, 2014 excluding penalties and interest. If this balance were recognized, the tax provision would decrease by $0.2 million excluding the impact to the valuation allowance.

We are subject to U.S. federal income tax as well as income tax of multiple state jurisdictions. Based on completed examinations and the expiration of statutes of limitations, we have concluded all U.S. federal income tax matters for years through 2004. We report in 17 states with various years open to examination.

13. Employee Benefit Plans

We maintain one active defined contribution 401(k) plan. Our employees are eligible after completing six months of employment to participate in the Builders FirstSource, Inc. 401(k) Plan. Participants can contribute up to 15% of their annual compensation, subject to federally mandated maximums. Participants are immediately vested in their own contributions. We match a certain percentage of the contributions made by participating employees, subject to IRS limitations. Our matching contributions are subject to a pro-rata five-year vesting schedule. We recognized expense of $0.4 million, $0.4 million and $0.3 million in 2014, 2013 and 2012, respectively, for contributions to the plan.

14. Commitments and Contingencies

We lease certain land, buildings and equipment used in operations. These leases are generally accounted for as operating leases with initial terms ranging from one to 20 years and they generally contain renewal options. Certain operating leases are subject to contingent rentals based on various measures, primarily consumer price index increases. Total rent expense under operating leases was approximately $25.4 million, $20.5 million and $19.0 million for the years ended December 31, 2014, 2013, and 2012, respectively.

In addition, we have residual value guarantees on certain equipment leases. Under these leases we have the option of (a) purchasing the equipment at the end of the lease term, (b) arranging for the sale of the equipment to a third party, or (c) returning the equipment to the lessor to sell the equipment. If the sales proceeds in any case are less than the residual value, we are required to reimburse the lessor for the deficiency up to a specified level as stated in each lease agreement. If the sales proceeds exceed the residual value, we are entitled to all of such excess amounts. The guarantees under these leases for the residual values of equipment at the end of the respective operating lease periods approximated $2.8 million as of December 31, 2014. Based upon the expectation that none of these leased assets will have a residual value at the end of the lease term that is materially less than the value specified in the related operating lease agreement or that we will purchase the equipment at the end of the lease term, we do not believe it is probable that we will be required to fund any amounts under the terms of these guarantee arrangements. Accordingly, no accruals have been recognized for these guarantees.

Future minimum commitments for noncancelable operating leases with initial or remaining lease terms in excess of one year are as follows:

	Related Party	Total*
	(In thousands)	
Year ending December 31,		
2015	$636	$24,554
2016	333	21,756
2017	285	18,071
2018	242	15,979
2019	227	9,257
Thereafter	1,078	16,618
	$2,801	$106,235

*Includes related party future minimum commitments for noncancelable operating leases.
As of December 31, 2014, we had outstanding letters of credit totaling $15.6 million under our 2013 Facility that principally support our self insurance programs.

We received $0.6 million from litigation settlements in 2012. These settlements were recorded as a reduction of selling, general and administrative expenses in the accompanying consolidated statement of operations and comprehensive income (loss) in 2012.

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

15. Segment and Product Information

We offer an integrated solution to our customers providing manufacturing, supply, and installation of a full range of structural and related building products. We provide a wide variety of building products and services directly to homebuilder customers. We manufacture floor trusses, roof trusses, wall panels, stairs, millwork, windows, and doors. We also provide a full range of construction services. We group our building products and services into five product categories: prefabricated components, windows & doors, lumber & lumber sheet goods, millwork, and other building products & services. We have one operating segment with centralized financial and operational oversight.

Sales by product category were as follows for the years ended December 31:

	2014	2013	2012
	(In thousands)		
Prefabricated components	$330,852	$294,008	$203,687
Windows & doors	356,897	308,607	233,111
Lumber & lumber sheet goods	522,655	526,633	348,132
Millwork	160,242	136,883	104,165
Other building products & services	233,450	223,761	181,581
Total sales	$1,604,096	$1,489,892	$1,070,676

16. Related Party Transactions

An affiliate of JLL Partners, Inc. was a principal beneficial owner of PGT, Inc. until late 2013. Floyd F. Sherman, our chief executive officer, serves on the board of directors for PGT, Inc. We purchased windows from PGT, Inc. totaling $6.3 million, $5.0 million and $4.4 million in 2014, 2013 and 2012, respectively. We had accounts payable to PGT, Inc. in the amounts of $0.8 million and $0.5 million as of December 31, 2014 and 2013, respectively.

In 2014, 2013 and 2012, we paid approximately $0.9 million, $0.8 million and $1.2 million, respectively, in rental expense to employees or our non-affiliate stockholders for leases of land and buildings.

17. Concentrations

We maintain cash at financial institutions in excess of federally insured limits. Accounts receivable potentially expose us to concentrations of credit risk. We provide credit in the normal course of business to customers in the residential construction industry. We perform ongoing credit evaluations of our customers and maintain allowances for potential credit losses. Because customers are dispersed among our various markets, our credit risk to any one customer or state economy is not significant.

Our customer mix is a balance of large national homebuilders, regional homebuilders and local homebuilders. For the year ended December 31, 2014, our top 10 customers accounted for approximately 25.1% of our sales, and no single customer accounted for more than 8% of sales.

We source products from a large number of suppliers. No materials purchased from any single supplier represented more than 10% of our total materials purchased in 2014.

18. Supplemental Cash Flow Information

Supplemental cash flow information was as follows for the years ended December 31:

	2014	2013	2012
	(In thousands)		
Cash payments for interest	$28,338	$78,232	$37,846
Cash payments (refunds) for income taxes	456	407	281

19. Unaudited Quarterly Financial Data

The following tables summarize the consolidated quarterly results of operations for 2014 and 2013 (in thousands, except per share amounts):

	2014			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net sales	$345,909	$ 426,543	$ 434,907	$ 396,737
Gross margin	74,915	93,799	97,647	90,636
Income (loss) from continuing operations	(3,312)(1)	10,620 (2)	8,739 (3)	2,511 (4)
Loss from discontinued operations, net of tax	(72)	(11)	(235)	(90)
Net income (loss)	(3,384)	10,609	8,504	2,421
Basic net income (loss) per share				
Income (loss) from continuing operations	$(0.03)(1)	$ 0.11 (2)	$ 0.09 (3)	$ 0.02 (4)
Loss from discontinued operations	(0.00)	(0.00)	(0.00)	(0.00)
Net income (loss)	$(0.03)	$ 0.11	$ 0.09	$ 0.02
Diluted net income (loss) per share				
Income (loss) from continuing operations	$(0.03)(1)	$ 0.09 (2)	$ 0.07 (3)	$ 0.02 (4)
Loss from discontinued operations	(0.00)	(0.00)	(0.00)	(0.00)
Net income (loss)	$(0.03)	$ 0.09	$ 0.07	$ 0.02

	2013			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net sales	$319,702	$ 398,148	$ 402,931	$ 369,111
Gross margin	62,347	82,232	92,494	82,847
Income (loss) from continuing operations	(11,605)(5)	(48,289)(6)	12,952 (7)	4,577 (8)
Income (loss) from discontinued operations, net of tax	(203)	83	(158)	(48)
Net income (loss)	(11,808)	(48,206)	12,794	4529
Basic and diluted net income (loss) per share				
Income (loss) from continuing operations	$(0.12)(5)	$ (0.50)(6)	$ 0.13 (7)	$ 0.05 (8)
Income (loss) from discontinued operations	(0.00)	(0.00)	(0.00)	(0.00)
Net income (loss)	$(0.12)	$ (0.50)	$ 0.13	$ 0.05

(1) Includes fair value adjustments for the warrants of $1.2 million as discussed in Note 9 and a valuation allowance of $1.0 million as discussed in Note 12.
(2) Includes fair value adjustments for the warrants of $(1.2) million as discussed in Note 9, and a valuation allowance of $(4.1) million as discussed in Note 12.
(3) Includes fair value adjustments for the warrants of $(1.3) million as discussed in Note 9, facility closure costs of $0.1 million as discussed in Note 11, and a valuation allowance of $(3.3) million as discussed in Note 12.
(4) Includes fair value adjustments for the warrants of $0.9 million as discussed in Note 9, facility closure costs of $0.2 million as discussed in Note 11, and a valuation allowance of $(0.9) million as discussed in Note 12.
(5) Includes fair value adjustments for the warrants of $0.4 million as discussed in Note 9 and a valuation allowance of $4.4 million as discussed in Note 12.
(6)

Includes a pre-payment premium on the term loan of $39.5 million as discussed in Note 9, debt discount write-off of $6.8 million as discussed in Note 9, debt issuance cost write-off of $2.1 million as discussed in Note 9, fair value adjustments for the warrants of $0.3 million as discussed in Note 9, and a valuation allowance of $17.0 million as discussed in Note 12.

(7) Includes fair value adjustments for the warrants of $(0.2) million as discussed in Note 9, facility closure costs of $(0.2) million as discussed in Note 11, and a valuation allowance of $(3.4) million as discussed in Note 12.

(8) Includes fair value adjustments for the warrants of $0.9 million as discussed in Note 9, facility closure costs of $0.1 million as discussed in Note 11, and a valuation allowance of $(2.6) million as discussed in Note 12.

Earnings per share is computed independently for each of the quarters presented; therefore, the sum of the quarterly earnings per share may not equal the annual earnings per share.

20. Subsequent Event

On February 6, 2015 the Company acquired certain assets and the operations of Timber Tech Texas, Inc. (“Timber Tech”) for $5.8 million in cash (including certain adjustments). Timber Tech is based in Cibolo, Texas, which is approximately 25 miles northeast of downtown San Antonio. Timber Tech is a manufacturer of roof trusses, floor trusses, wall panels and sub-components, as well as a supplier of glue laminated timber and veneer lumber beams.

This transaction will be accounted for by the acquisition method, and accordingly the results of operations will be included in the Company’s consolidated financial statements from the acquisition date. The purchase price will be allocated to the assets acquired based on estimated fair values at the acquisition date, with the excess of purchase price over the estimated fair value of the net assets acquired recorded as goodwill. The accounting for this acquisition has not been completed at the date of this filing given the proximity to the acquisition date.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

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

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

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

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

Conclusions regarding Disclosure Controls. Based on the required evaluation of our disclosure controls and procedures, our CEO and CFO have concluded that, as of December 31, 2014, we maintained disclosure controls and procedures that were effective in providing reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Management's Report on Internal Control Over Financial Reporting. Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act. Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework set forth in Internal Control — Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework set forth in Internal Control — Integrated Framework, our management concluded that our internal control over financial reporting was effective as of December 31, 2014.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2014, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Changes in Internal Control over Financial Reporting. During the quarter ended December 31, 2014, there were no changes in our internal control over financial reporting identified in connection with the evaluation described above that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

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

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

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

The disclosure below relates solely to activities conducted by EIG and SAMIH and their non-U.S. affiliates that may be deemed to be under common "control" with us. The disclosure does not relate to any activities conducted by us or by WP and does not involve our or WP's management. Neither we nor WP has had any involvement in or control over the disclosed activities of SAMIH or EIG. Neither we nor WP has independently verified or participated in the preparation of the disclosure. Neither we nor WP is representing as to the accuracy or completeness of the disclosure, nor do we or WP undertake any obligation to correct or update it.

As to EIG:

We understand that EIG's affiliates intend to disclose in their next annual or quarterly SEC report that: "on July 2, 2013, the billing information for a subscriber account, or the Subscriber Account was updated to include Seyed Mahmoud Mohaddes, or Mohaddes. On September 16, 2013, the Office of Foreign Assets Control, or OFAC, designated Mohaddes as a Specially Designated National, or SDN, pursuant to 31 C.F.R. Part 560.304. On or around September 26, 2014, during a routine compliance scan of new and existing subscriber accounts, EIG discovered that Mohaddes, a SDN, was named as an account contact for the Subscriber Account. EIG promptly suspended the Subscriber Account, locked the domain name IOCUKLTD.COM, which was registered to the Subscriber Account, and reported the domain name to OFAC as potentially the property of a SDN subject to blocking pursuant to Executive Order 13599. Since September 16, 2013, when Mohaddes was added to the SDN list, charges in the total amount of $120.35 were made to the Subscriber Account for web hosting and domain privacy services. EIG has ceased billing for the Subscriber Account. To date, EIG has not received any correspondence from OFAC regarding this matter."

"On July 10, 2014, OFAC designated each of Stars Group Holding, or Stars, and Teleserve Plus SAL, or Teleserve, as SDNs under Executive Order 13224, and their property became subject to blocking pursuant to the Global Terrorism Sanctions Regulations, 31 C.F.R. Part 594. On July 15, 2014, as part of EIG's compliance review processes, EIG discovered that the domain names associated with each of Stars, STARSCOM.NET, and Teleserve, TELESERVEPLUS.COM, or collectively, the Stars/Teleserve Domain Names, were registered through EIG's platform. EIG immediately took steps to suspend and lock the Stars/Teleserve Domain Names to prevent them from being transferred or resolving to a website, and EIG promptly reported the Domain Names as potentially blocked property to OFAC. EIG did not generate any revenue from the Stars/Teleserve Domain Names between when they were added to the SDN list on July 10, 2014 and when EIG discovered that they were registered through EIG's platform on July 15, 2014. To date, EIG has not received any correspondence from OFAC regarding the matter."

"On July 15, 2014 during a compliance scan of all domain names on one of our platforms, EIG identified the domain name KAHANETZADAK.COM, or the Domain Name, which was listed as an 'also known as,' or AKA, of the entity Kahane Chai which operates as the American Friends of the United Yeshiva. Kahane Chai was designated as a SDN on November 2, 2001 pursuant to Executive Order 13224. Because the Domain Name was transferred into a customer account of one of EIG's resellers, there was no direct financial transaction between EIG and the registered owner of the Domain Name. The Domain Name was suspended upon EIG's discovering it on EIG's platform, and EIG reported the Domain Name to OFAC as potentially the property of a SDN. To date, EIG have not received any correspondence from OFAC regarding the matter."

As to SAMIH:

We understand that SAMIH's affiliates intend to disclose in their next annual or quarterly SEC report that "Santander UK holds frozen savings and current accounts for three customers resident in the U.K. who are currently designated by the U.S. for terrorism. The accounts held by each customer were blocked after the customer's designation and remained blocked and dormant throughout 2014. No revenue has been generated by Santander UK on these accounts. The bank account held for one of these customers was closed in the fourth quarter of 2014."

“An Iranian national, resident in the U.K., who is currently designated by the U.S. under the Iranian Financial Sanctions Regulations and the Weapons of Mass Destruction Proliferators Sanctions Regulations (“NPWMD sanctions program”), holds a mortgage with Santander UK that was issued prior to any such designation. No further drawdown has been made (or would be permitted) under this mortgage although Santander UK continues to receive repayment installments. In 2014, total revenue in connection with the mortgage was approximately £2,580 and net profits were negligible relative to the overall profits of Santander UK. The same Iranian national also holds two investment accounts with Santander Asset Management UK Limited. The accounts have remained frozen during 2014. The investment returns are being automatically reinvested, and no disbursements have been made to the customer. Total revenue for the Santander Group in connection with the investment accounts was £250 and net profits in 2014 were negligible relative to the overall profits of Banco Santander, S.A.”

“In addition, during the third quarter 2014, Santander UK identified two additional customers: a UK national designated by the U.S. under the NPWMD sanctions program held a business account. No transactions were made and the account was closed in the fourth quarter of 2014. No revenue or profit has been generated. A second UK national designated by the US for reasons of terrorism held a personal current account and a personal credit card account, both of which were closed in the third quarter of 2014. Although transactions took place on the current account during the third quarter of 2014, revenue and profits generated were negligible. No transactions took place on the credit card.”

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item appears in our definitive proxy statement for our annual meeting of stockholders to be held May 27, 2015 under the captions “Proposal 1 — Election of Directors,” “Continuing Directors,” “Information Regarding the Board and Its Committees,” “Corporate Governance,” “Section 16(a) Beneficial Ownership Reporting Compliance,” and “Executive Officers of the Registrant,” which information is incorporated herein by reference.

Code of Business Conduct and Ethics

Builders FirstSource, Inc. and its subsidiaries endeavor to do business according to the highest ethical and legal standards, complying with both the letter and spirit of the law. Our board of directors approved a Code of Business Conduct and Ethics that applies to our directors, officers (including our principal executive officer, principal financial officer and controller) and employees. Our Code of Business Conduct and Ethics is administered by a compliance committee made up of representatives from our legal, human resources, finance and internal audit departments.

Our employees are encouraged to report any suspected violations of laws, regulations and the Code of Business Conduct and Ethics, and all unethical business practices. We provide continuously monitored hotlines for anonymous reporting by employees.

Our board of directors has also approved a Supplemental Code of Ethics for the Chief Executive Officer, President, and Senior Financial Officers of Builders FirstSource, Inc., which is administered by our general counsel.

Both of these policies are listed as exhibits to this annual report on Form 10-K and can be found in the “investors” section of our corporate Web site at: www.bldr.com.

Stockholders may request a free copy of these policies by contacting the Corporate Secretary, Builders FirstSource, Inc., 2001 Bryan Street, Suite 1600, Dallas, Texas 75201, United States of America.

In addition, within four business days of:

- Any amendment to a provision of our Code of Business Conduct and Ethics or our Supplemental Code of Ethics for Chief Executive Officer, President and Senior Financial Officers of Builders FirstSource, Inc. that applies to our chief executive officer, our chief financial officer or controller; or
- The grant of any waiver, including an implicit waiver, from a provision of one of these policies to one of these officers that relates to one or more of the items set forth in Item 406(b) of Regulation S-K.

We will provide information regarding any such amendment or waiver (including the nature of any waiver, the name of the person to whom the waiver was granted and the date of the waiver) on our Web site at the Internet address above, and such information will be available on our Web site for at least a 12-month period. In addition, we will disclose any amendments and waivers to our Code of Business Conduct and Ethics or our Supplemental Code of Ethics for Chief Executive Officer, President and Senior Financial Officers of Builders FirstSource, Inc. as required by the listing standards of the NASDAQ Stock Market LLC.

Item 11. Executive Compensation

The information required by this item appears in our definitive proxy statement for our annual meeting of stockholders to be held May 27, 2015 under the captions “Executive Compensation and Other Information,” “Information Regarding the Board and its Committees — Compensation of Directors,” and “Compensation Committee Interlocks and Insider Participation,” which information is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item appears in our definitive proxy statement for our annual meeting of stockholders to be held on May 27, 2015 under the caption “Ownership of Securities” and “Equity Compensation Plan Information,” which information is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item appears in our definitive proxy statement for our annual meeting of stockholders to be held May 27, 2015 under the caption “Election of Directors and Management Information,” “Information Regarding the Board and its Committees,” and “Certain Relationships and Related Party Transactions,” which information is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information required by this item appears in our definitive proxy statement for our annual meeting of stockholders to be held May 27, 2015 under the caption “Proposal 2 — Ratification of Selection of Independent Registered Public Accounting Firm — Fees Paid to PricewaterhouseCoopers LLP,” which information is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) (1) See the index to consolidated financial statements provided in Item 8 for a list of the financial statements filed as part of this report.

(2) Financial statement schedules are omitted because they are either not applicable or not material.

(3) The following documents are filed, furnished or incorporated by reference as exhibits to this report as required by Item 601 of Regulation S-K.

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation of Builders FirstSource, Inc. (incorporated by reference to Exhibit 3.1 to Amendment No. 4 to the Registration Statement of the Company on Form S-1, filed with the Securities and Exchange Commission on June 6, 2005, File Number 333-122788)
3.2	Amended and Restated By-Laws of Builders FirstSource, Inc. (incorporated by reference to Exhibit 3.2 to the Company’s Current Report on Form 8-K, filed with the Securities and Exchange Commission on March 5, 2007, File Number 0-51357)
4.1	Registration Rights Agreement, dated as of January 21, 2010, among Builders FirstSource, Inc., JLL Partners Fund V, L.P., and Warburg Pincus Private Equity IX, L.P. (incorporated by reference to Exhibit 10.2 to the Company’s Current Report on Form 8-K, filed with the Securities and Exchange Commission on January 22, 2010, File Number 0-51357)
4.2	Indenture, dated as of May 29, 2013, among Builders FirstSource, Inc., the guarantors party thereto, and Wilmington Trust Company, as trustee (form of Note included therein) (incorporated by reference to Exhibit 4.1 to the Company’s Current Report on Form 8-K, filed with the Securities Exchange Commission on June 3, 2013, File Number 0-51357)
10.1	Credit Agreement, dated as of May 29, 2013, among Builders FirstSource, Inc., as borrower, the additional borrowers party thereto, the lenders party thereto, and SunTrust Bank, as administrative agent, swing line lender, and letter of credit issuer (incorporated by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K, filed with the Securities Exchange Commission on June 3, 2013, File Number 0-51357)
10.2	

	ABL/Bond Intercreditor Agreement, dated as of May 29, 2013, among Builders FirstSource, Inc. and certain of its subsidiaries, as grantors, SunTrust Bank, as ABL agent, and Wilmington Trust, National Association, as notes collateral agent (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K, filed with the Securities Exchange Commission on June 3, 2013, File Number 0-51357)
10.3	Notes Collateral Agreement, dated as of May 29, 2013, by and among Builders FirstSource, Inc. and certain of its subsidiaries, as grantors, and Wilmington Trust, National Association, as collateral agent (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K, filed with the Securities Exchange Commission on June 3, 2013, File Number 0-51357)
10.4	Security Agreement, dated as of May 29, 2013, by and among Builders FirstSource, Inc. and certain of its subsidiaries, as grantors, and SunTrust Bank, as administrative agent and collateral agent (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K, filed with the Securities Exchange Commission on June 3, 2013, File Number 0-51357)
10.5	Guaranty, dated as of May 29, 2013, among Builders FirstSource, Inc., the other guarantors party thereto from time to time, and SunTrust Bank, as administrative agent and collateral agent (incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K, filed with the Securities Exchange Commission on June 3, 2013, File Number 0-51357)
10.6	Warrant Issuance Agreement, dated as of December 2, 2011, by and among Builders FirstSource, Inc., Highbridge Principal Strategies – Senior Loan Fund II, L.P., Highbridge Onshore Senior Investments, LLC, and Highbridge Senior Loan Sector A Investment Fund, L.P. (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on December 8, 2011, File Number 0-51357)
10.7	Form of Warrant issued pursuant to the Warrant Issuance Agreement dated December 2, 2011 (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on December 8, 2011, File Number 0-51357)
10.8+	Builders FirstSource, Inc. 1998 Stock Incentive Plan, as amended, effective March 1, 2004 (incorporated by reference to Exhibit 10.4 to Amendment No. 1 to the Registration Statement of the Company on Form S-1, filed with the Securities and Exchange Commission on April 27, 2005, File Number 333-122788)

Exhibit Number	Description
10.9+	Amendment No. 7 to Builders FirstSource, Inc. 1998 Stock Incentive Plan (incorporated by reference to Exhibit 10.6 to the Company's Annual Report on Form 10-K for the year ended December 31, 2006, filed with the Securities and Exchange Commission on March 12, 2007, File Number 0-51357)
10.10+	2004 Form of Builders FirstSource, Inc. 1998 Stock Incentive Plan Nonqualified Stock Option Agreement (incorporated by reference to Exhibit 10.5 to Amendment No. 1 to the Registration Statement of the Company on Form S-1, filed with the Securities and Exchange Commission on April 27, 2005, File Number 333-122788)
10.11+	Builders FirstSource, Inc. 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.14 to Amendment No. 4 to the Registration Statement of the Company on Form S-1, filed with the Securities and Exchange Commission on June 6, 2005, File Number 333-122788)
10.12+	2007 Form of Builders FirstSource, Inc. 2005 Equity Incentive Plan Nonqualified Stock Option Agreement for Employee Directors (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on March 5, 2007, File Number 0-51357)
10.13+	2012 Form of Builders FirstSource, Inc. 2005 Equity Incentive Plan Director Restricted Stock Agreement (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, filed with the Securities and Exchange Commission on August 1, 2012, File Number 0-51357)
10.14+	Builders FirstSource, Inc. 2007 Incentive Plan (incorporated by reference to Annex D of the Company's definitive Proxy Statement on Schedule 14A, filed with the Securities and Exchange Commission on December 15, 2009, File Number 0-51357)
10.15+	2008 Form of Builders FirstSource, Inc. 2007 Incentive Plan Nonqualified Stock Option Agreement (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008, filed with the Securities and Exchange Commission on May 1, 2008, File Number 0-51357)
10.16+	2008 Form of Builders FirstSource, Inc. 2007 Incentive Plan Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008, filed with the Securities and Exchange Commission on May 1, 2008, File Number 0-51357)
10.17+	

	2010 Form of Builders FirstSource, Inc. 2007 Incentive Plan Nonqualified Stock Option Agreement for Employee Directors (incorporated by reference to Exhibit 10.21 to the Company's Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Securities and Exchange Commission on March 4, 2010, File Number 0-51357)
10.18+	2014 Form of Builders FirstSource, Inc. 2007 Incentive Plan Restricted Stock Unit Award Certificate (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, filed with the Securities and Exchange Commission on August 1, 2014, File Number 0-51357)
10.19+	2014 Form of Builders FirstSource, Inc. 2007 Incentive Plan Director Restricted Stock Unit Award Certificate (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, filed with the Securities and Exchange Commission on November 5, 2014, File Number 0-51357)
10.20+	Builders FirstSource, Inc. 2014 Incentive Plan (incorporated herein by reference to Appendix A of the Company's Definitive Proxy Statement on Schedule 14A filed with the Securities and Exchange Commission on April 11, 2014, File Number 0-51357)
10.21+	2014 Form of Builders FirstSource, Inc. 2014 Incentive Plan Restricted Stock Unit Award Certificate (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, filed with the Securities and Exchange Commission on August 1, 2014, File Number 0-51357)
10.22*+	2015 Form of Builders FirstSource, Inc. 2014 Incentive Plan Non-Statutory Stock Option Award Certificate
10.23+	Builders FirstSource, Inc. Amended and Restated Director Compensation Policy (incorporated by reference to Exhibit 10.18 to the Company's Annual Report on Form 10-K for the year ended December 31, 2013, filed with the Securities and Exchange Commission on February 28, 2014, File Number 0-51357)
10.24+	Builders FirstSource, Inc. Form of Director Indemnification Agreement (incorporated by reference to Exhibit 10.13 to Amendment No. 3 to the Registration Statement of the Company on Form S-1, filed with the Securities and Exchange Commission on May 26, 2005, File Number 333-122788)

Exhibit Number	Description
10.25+	Employment Agreement, dated September 1, 2001, between Builders FirstSource, Inc. and Floyd F. Sherman (incorporated by reference to Exhibit 10.9 to Amendment No. 1 to the Registration Statement of the Company on Form S-1, filed with the Securities and Exchange Commission on April 27, 2005, File Number 333-122788)
10.26+	Amendment to Employment Agreement, dated June 1, 2005, between Builders FirstSource, Inc. and Floyd F. Sherman (incorporated by reference to Exhibit 10.15 to Amendment No. 4 to the Registration Statement of the Company on Form S-1, filed with the Securities and Exchange Commission on June 6, 2005, File Number 333-122788)
10.27+	Second Amendment to Employment Agreement, dated October 29, 2008, between Builders FirstSource, Inc. and Floyd F. Sherman (incorporated by reference to Exhibit 10.27 to the Company's Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Securities and Exchange Commission on March 2, 2009, File Number 0-51357)
10.28+	Employment Agreement, dated February 23, 2010, between Builders FirstSource, Inc. and M. Chad Crow (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on February 26, 2010, File Number 0-51357)
10.29+	Employment Agreement, dated January 15, 2004, between Builders FirstSource, Inc. and Morris E. Tolly (incorporated by reference to Exhibit 10.22 to the Company's Annual Report on Form 10-K for the year ended December 31, 2007, filed with the Securities and Exchange Commission on March 5, 2008, File Number 0-51357)
10.30+	Amendment to Employment Agreement, dated October 29, 2008, between Builders FirstSource, Inc. and Morris E. Tolly (incorporated by reference to Exhibit 10.31 to the Company's Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Securities and Exchange Commission on March 2, 2009, File Number 0-51357)
10.31+	Employment Agreement, dated January 15, 2004, between Builders FirstSource, Inc. and Donald F. McAleenan (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005, filed with the Securities Exchange Commission on November 2, 2005, File Number 0-51357)
10.32+	Amendment to Employment Agreement, dated October 29, 2008, between Builders FirstSource, Inc. and Donald F. McAleenan (incorporated by reference to Exhibit 10.33 to the Company's Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Securities and Exchange Commission on March 2, 2009, File Number 0-51357)

14.1	Builders FirstSource, Inc. Code of Business Conduct and Ethics (incorporated by reference to Exhibit 14.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed with the Securities and Exchange Commission on March 13, 2006, File Number 0-51357)
14.2	Builders FirstSource, Inc. Supplemental Code of Ethics (incorporated by reference to Exhibit 14.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed with the Securities and Exchange Commission on March 13, 2006, File Number 0-51357)
21.1	Subsidiaries of the Registrant (incorporated by reference to Exhibit 21.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Securities and Exchange Commission on March 4, 2010, File Number 0-51357)
23.1*	Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm
24.1*	Power of Attorney (included as part of signature page)
31.1*	Certification of Chief Executive Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, signed by Floyd F. Sherman as Chief Executive Officer
31.2*	Certification of Chief Financial Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, signed by M. Chad Crow as Chief Financial Officer
32.1**	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, signed by Floyd F. Sherman as Chief Executive Officer and M. Chad Crow as Chief Financial Officer

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Exhibit Number	Description
101*	The following financial information from Builders FirstSource, Inc.’s Form 10-K filed on March 3, 2015, formatted in eXtensible Business Reporting Language (“XBRL”): (i) Consolidated Statements of Operations and Comprehensive Income (Loss) for the years ended December 31, 2014, 2013 and 2012, (ii) Consolidated Balance Sheets at December 31, 2014 and 2013, (iii) Consolidated Statements of Cash Flows for the years ended December 31, 2014, 2013 and 2012, (iv) Consolidated Statements of Changes in Stockholders’ Equity for the years ended December 31, 2014, 2013 and 2012, and (v) the Notes to Consolidated Financial Statements.

* Filed herewith
** Builders FirstSource, Inc. is furnishing, but not filing, the written statement pursuant to Title 18 United States Code 1350, as added by Section 906 of the Sarbanes-Oxley Act of 2002, of Floyd F. Sherman, our Chief Executive Officer, and M. Chad Crow, our Chief Financial Officer.
+ Indicates a management contract or compensatory plan or arrangement

(b) A list of exhibits filed, furnished or incorporated by reference with this Form 10-K is provided above under Item 15(a)(3) of this report. Builders FirstSource, Inc. will furnish a copy of any exhibit listed above to any stockholder without charge upon written request to Donald F. McAleenan, Senior Vice President and General Counsel, 2001 Bryan Street, Suite 1600, Dallas, Texas 75201.

(c) Not applicable

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

March 3, 2015

BUILDERS FIRSTSOURCE, INC.

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

The undersigned hereby constitute and appoint Donald F. McAleenan and his substitutes our true and lawful attorneys-in-fact with full power to execute in our name and behalf in the capacities indicated below any and all amendments to this report and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, and hereby ratify and confirm all that such attorney-in-fact or his substitutes shall lawfully do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ FLOYD F. SHERMAN Floyd F. Sherman	Chief Executive Officer and Director (Principal Executive Officer)	March 3, 2015
/s/ M. CHAD CROW M. Chad Crow	President, Chief Operating Officer and Chief Financial Officer (Principal Financial and Accounting Officer)	March 3, 2015
/s/ PAUL S. LEVY Paul S. Levy	Chairman and Director	March 3, 2015
/s/ DAVID A. BARR David A. Barr	Director	March 3, 2015
/s/ CLEVELAND A. CHRISTOPHE Cleveland A. Christophe	Director	March 3, 2015
/s/ DANIEL AGROSKIN	Director	

Daniel Agroskin		March 3, 2015
/s/ MICHAEL GRAFF Michael Graff	Director	March 3, 2015
/s/ ROBERT C. GRIFFIN Robert C. Griffin	Director	March 3, 2015
/s/ KEVIN J. KRUSE Kevin J. Kruse	Director	March 3, 2015
/s/ BRETT N. MILGRIM Brett N. Milgrim	Director	March 3, 2015
/s/ CRAIG A. STEINKE Craig A. Steinke	Director	March 3, 2015

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