

HUTTIG BUILDING PRODUCTS INC

Form 10-Q

November 05, 2008

**Table of Contents**

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

**Form 10-Q**

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

**For the quarterly period ended September 30, 2008  
Commission file number 1-14982**

**HUTTIG BUILDING PRODUCTS, INC.  
(Exact name of registrant as specified in its charter)**

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

**43-0334550  
(I.R.S. Employer  
Identification No.)**

**555 Maryville University Drive  
Suite 400  
St. Louis, Missouri  
(Address of principal executive offices)**

**63141  
(Zip code)**

**(314) 216-2600  
(Registrant's telephone number, including area code)**

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

Indicate by check mark whether the registrant 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  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

The number of shares of Common Stock outstanding on September 30, 2008 was 21,561,630 shares.

**PART I. FINANCIAL INFORMATION**

Item 1.	Financial Statements	
	<u>Consolidated Statements of Operations for the three and nine months ended September 30, 2008 and 2007 (unaudited)</u>	3
	<u>Consolidated Balance Sheets as of September 30, 2008 (unaudited), December 31, 2007 and September 30, 2007 (unaudited)</u>	4
	<u>Consolidated Statement of Shareholders' Equity for the nine months ended September 30, 2008 (unaudited)</u>	6
	<u>Consolidated Statements of Cash Flows for the three and nine months ended September 30, 2008 and 2007 (unaudited)</u>	7
	<u>Notes to Consolidated Financial Statements (unaudited)</u>	8
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	11
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	17
Item 4.	<u>Controls and Procedures</u>	17

**PART II. OTHER INFORMATION**

Item 1.	<u>Legal Proceedings</u>	18
Item 1A	<u>Risk Factors</u>	18
Item 6.	<u>Exhibits</u>	18
	<u>Signatures</u>	19
	<u>Exhibit Index</u>	20
	<u>EX-31.1</u>	
	<u>EX-31.2</u>	
	<u>EX-32.1</u>	

**Table of Contents**

**HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**UNAUDITED**

(In Millions, Except Share and Per Share Data)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net sales	\$ 182.8	\$ 233.0	\$ 545.0	\$ 694.9
Cost of sales	149.8	189.7	443.2	564.0
Gross margin	33.0	43.3	101.8	130.9
Operating expenses	39.2	42.3	117.2	132.3
Goodwill impairment	0.1		7.1	
Gain on disposal of capital assets	(0.1)		(0.2)	(1.5)
Operating income (loss)	(6.2)	1.0	(22.3)	0.1
Interest expense, net	0.6	1.1	2.0	3.4
Loss from continuing operations before income taxes	(6.8)	(0.1)	(24.3)	(3.3)
Provision (benefit) for income taxes	0.9		(4.4)	(1.1)
Loss from continuing operations	(7.7)	(0.1)	(19.9)	(2.2)
Loss from discontinued operations, net of taxes			(0.1)	(0.2)
Net loss	\$ (7.7)	\$ (0.1)	\$ (20.0)	\$ (2.4)
Net loss from continuing operations per share basic and diluted	\$ (0.37)	\$	\$ (0.95)	\$ (0.11)
Net loss from discontinued operations per share basic and diluted			(0.01)	(0.01)
Net loss per share basic and diluted	\$ (0.37)	\$	\$ (0.96)	\$ (0.12)
Basic and diluted shares outstanding	20,980,795	20,632,439	20,902,929	20,515,563

*See notes to unaudited consolidated financial statements*

**Table of Contents**

**HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(In Millions, Except Share and Per Share Data)

	September 30, 2008 (unaudited)	December 31, 2007	September 30, 2007 (unaudited)
<b>ASSETS</b>			
<b>CURRENT ASSETS:</b>			
Cash and equivalents	\$ 7.1	\$ 1.8	\$ 12.0
Trade accounts receivable, net	64.8	56.1	84.0
Inventories, net	70.8	88.7	98.1
Other current assets	5.0	13.6	9.5
<b>Total current assets</b>	<b>147.7</b>	<b>160.2</b>	<b>203.6</b>
<b>PROPERTY, PLANT AND EQUIPMENT</b>			
Land	5.6	5.6	5.7
Building and improvements	30.4	30.2	31.0
Machinery and equipment	29.6	30.0	30.1
<b>Gross property, plant and equipment</b>	<b>65.6</b>	<b>65.8</b>	<b>66.8</b>
Less accumulated depreciation	40.8	39.2	39.3
<b>Property, plant and equipment, net</b>	<b>24.8</b>	<b>26.6</b>	<b>27.5</b>
<b>OTHER ASSETS:</b>			
Goodwill, net	11.2	18.3	18.9
Other	3.9	5.1	5.5
Deferred income taxes	6.8	2.5	2.5
<b>Total other assets</b>	<b>21.9</b>	<b>25.9</b>	<b>26.9</b>
<b>TOTAL ASSETS</b>	<b>\$ 194.4</b>	<b>\$ 212.7</b>	<b>\$ 258.0</b>

*See notes to unaudited consolidated financial statements*

**Table of Contents**

**HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(In Millions, Except Share and Per Share Data)

	September 30, 2008 (unaudited)	December 31, 2007	September 30, 2007 (unaudited)
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>			
<b>CURRENT LIABILITIES:</b>			
Current maturities of long-term debt	\$ 0.4	\$ 1.2	\$ 0.9
Trade accounts payable	49.2	50.1	70.6
Deferred income taxes	5.3	5.3	5.1
Accrued compensation	5.1	6.3	6.2
Other accrued liabilities	13.7	15.9	15.3
Total current liabilities	73.7	78.8	98.1
<b>NON-CURRENT LIABILITIES:</b>			
Long-term debt, less current maturities	32.3	25.4	45.7
Other non-current liabilities	2.9	4.2	4.4
Total non-current liabilities	35.2	29.6	50.1
<b>SHAREHOLDERS EQUITY</b>			
Preferred shares; \$.01 par (5,000,000 shares authorized)			
Common shares; \$.01 par (50,000,000 shares authorized: 21,561,630, 20,968,445 and 20,968,445 shares issued at September 30, 2008, December 31, 2007 and September 30, 2007, respectively)	0.2	0.2	0.2
Additional paid-in capital	37.1	36.1	35.6
Retained earnings	48.2	68.2	74.0
Less: Treasury shares, at cost (0, 32,219 and 9,386 shares at September 30, 2008, December 31, 2007 and September 30, 2007, respectively)		(0.2)	
Total shareholders equity	85.5	104.3	109.8
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>	<b>\$ 194.4</b>	<b>\$ 212.7</b>	<b>\$ 258.0</b>

*See notes to unaudited consolidated financial statements*

**Table of Contents**

**HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**  
**UNAUDITED**  
(In Millions)

	<b>Common Shares Outstanding, at Par Value</b>	<b>Additional Paid-In Capital</b>	<b>Retained Earnings</b>	<b>Treasury Shares, at Cost</b>	<b>Total Shareholders' Equity</b>
Balance at January 1, 2008	\$ 0.2	\$ 36.1	\$ 68.2	\$ (0.2)	\$ 104.3
Net loss			(20.0)		(20.0)
Comprehensive loss					(20.0)
Restricted stock issued, net of forfeitures		(0.2)		0.2	
Stock options exercised, net		0.1			0.1
Stock compensation		1.1			1.1
Balance at September 30, 2008	\$ 0.2	\$ 37.1	\$ 48.2	\$	\$ 85.5

*See notes to unaudited consolidated financial statements*

**Table of Contents**

**HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**UNAUDITED**  
(In Millions)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Cash Flows From Operating Activities:</b>				
Net loss	\$ (7.7)	\$ (0.1)	\$ (20.0)	\$ (2.4)
Adjustments to reconcile net loss to net cash provided by operating activities:				
Net loss from discontinued operations			0.1	0.2
Depreciation and amortization	1.2	1.1	3.4	3.8
Stock compensation	0.4	0.4	1.2	1.3
Impairment of long-lived assets	0.3		7.3	0.5
Other adjustments	0.9	0.5	(4.7)	(0.9)
Changes in operating assets and liabilities:				
Trade accounts receivable	5.5	5.5	(8.7)	(9.9)
Inventories	7.0	4.0	17.9	(0.8)
Trade accounts payable	(5.4)	(10.0)	(0.9)	8.5
Other	0.4	2.6	3.8	3.3
<b>Total net cash provided by (used in) operating activities</b>	<b>2.6</b>	<b>4.0</b>	<b>(0.6)</b>	<b>3.6</b>
<b>Cash Flows From Investing Activities:</b>				
Capital expenditures	(0.9)	(0.6)	(1.7)	(2.6)
Proceeds from disposition of capital assets	0.1	0.1	0.6	3.0
<b>Total cash provided by (used in) investing activities</b>	<b>(0.8)</b>	<b>(0.5)</b>	<b>(1.1)</b>	<b>0.4</b>
<b>Cash Flows From Financing Activities:</b>				
Borrowings and payments of debt, net	(1.0)	1.3	6.1	0.9
Exercise of stock options	0.1	0.1	0.9	1.0
<b>Total cash provided by (used in) financing activities</b>	<b>(0.9)</b>	<b>1.4</b>	<b>7.0</b>	<b>1.9</b>
Net increase in cash and equivalents	0.9	4.9	5.3	5.9
Cash and equivalents, beginning of period	6.2	7.1	1.8	6.1
<b>Cash and equivalents, end of period</b>	<b>\$ 7.1</b>	<b>\$ 12.0</b>	<b>\$ 7.1</b>	<b>\$ 12.0</b>
<b>Supplemental Disclosure of Cash Flow Information:</b>				
Interest paid	\$ 0.6	\$ 1.0	\$ 1.8	\$ 3.3
Income taxes refunded			5.2	4.0
Cash received from exercise of stock options			0.4	0.8

*See notes to unaudited consolidated financial statements*





**Table of Contents**

**HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**1. BASIS OF PRESENTATION**

The unaudited interim consolidated financial statements of Huttig Building Products, Inc. (the Company or Huttig) were prepared in accordance with U.S. generally accepted accounting principles and reflect all adjustments (including normal recurring accruals) which, in the opinion of management, are considered necessary for the fair presentation of the results for the periods presented. These statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

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

**2. STOCK-BASED EMPLOYEE COMPENSATION**

The Company recognized \$1.2 million and \$1.3 million in non-cash stock-based compensation in the nine months ended September 30, 2008 and 2007, respectively. During the first nine months of 2008, the Company granted an aggregate of 452,750 shares of restricted stock at a combined weighted average fair market value of \$3.95 per share under its 2005 Executive Incentive Compensation Plan. The restricted shares vest in three equal installments on the first, second and third anniversaries of the respective grant dates. During the first nine months of 2008, the Company granted 27,648 restricted stock units at a weighted average fair market value of \$2.39 per share under its 2005 Non-Employee Directors Restricted Stock Plan. The restricted stock units vest on the first anniversary of the grant date. The unearned compensation expense is being amortized into expense on a straight-line basis over the requisite service period for the entire award. As of September 30, 2008, the total compensation expense not yet recognized related to all outstanding restricted stock/unit awards and non-vested options was approximately \$2.2 million and less than \$0.1 million, respectively.

**3. DEBT**

Debt consisted of the following (in millions):

	September 30, 2008	December 31, 2007	September 30, 2007
Revolving credit facility	\$ 32.0	\$ 24.8	\$ 45.0
Other obligations	0.7	1.8	1.6
Total debt	32.7	26.6	46.6
Less current portion	0.4	1.2	0.9
Long-term debt	\$ 32.3	\$ 25.4	\$ 45.7

**Credit Agreement** The Company has a five-year \$160.0 million asset based senior secured revolving credit facility (credit facility). Borrowing availability under the credit facility is based on eligible accounts receivable, inventory and real estate. The Company added the real estate component to the borrowing base in July 2008. The inclusion of the real estate component initially provided approximately \$25 million of additional borrowing capacity under the credit facility. The real estate component of the borrowing base amortizes monthly over ten years on a straight-line basis. Additionally, the credit facility includes an option to request an increase in the size of the facility by up to an additional \$40.0 million, subject to certain conditions and approvals. The Company must also pay a fee in the range of 0.25% to 0.32% per annum on the average daily-unused amount of the revolving credit commitment. The entire unpaid balance under the credit facility is due and payable on October 20, 2011, the maturity date of the credit facility.



**Table of Contents**

At September 30, 2008, under the credit facility the Company had revolving credit borrowings of \$32.0 million outstanding at a weighted average interest rate of 3.76%, letters of credit outstanding totaling \$5.2 million, primarily for health and workers' compensation insurance, and \$76.4 million of additional borrowing capacity. In addition, the Company had \$0.7 million of other obligations outstanding at September 30, 2008.

The borrowings under the credit facility are collateralized by substantially all of the Company's assets and are subject to certain operating limitations commonly applicable to a loan of this type, which, among other things, place limitations on indebtedness, liens, investments, mergers and acquisitions, dispositions of assets, cash dividends, stock repurchases and transactions with affiliates. The financial covenant in the credit facility is limited to a fixed charge coverage ratio to be tested only when excess borrowing availability, as defined in the credit facility, is less than \$25.0 million, on a pro forma basis prior to consummation of certain significant business transactions outside the ordinary course of business, and prior to increasing the size of the facility.

**4. CONTINGENCIES**

The Company is involved in a number of legal proceedings incidental to the conduct of its business, relating to such matters as product liability, environmental liability and vehicular accidents. The Company carries insurance policies on insurable risks with coverage and other terms that it believes to be appropriate. The Company generally has self-insured retention limits and has obtained fully insured layers of coverage above such self-insured retention limits. Accruals for self-insurance losses are made based on claims experience. Liabilities for existing and unreported claims are accrued when it is probable that future costs will be incurred and such future costs can be reasonably estimated. The Company is subject to federal, state and local environmental protection laws and regulations. The Company's management believes the Company is in compliance, or is taking action aimed at assuring compliance, with applicable environmental protection laws and regulations. However, there can be no assurance that future environmental liabilities will not have a material adverse effect on the Company's consolidated financial condition or results of operations.

Huttig has been identified as a potentially responsible party in connection with the clean up of contamination at a formerly owned property in Montana that was used for the manufacture of wood windows and at a currently-owned facility in Prineville, Oregon, in connection with the clean up of petroleum hydrocarbons and PCP discovered in soil and groundwater at the facility. As of September 30, 2008, the Company had accrued approximately \$0.8 million for future costs of remediating these sites. However, until a final remedy is selected by the respective state departments of environmental quality, management cannot estimate the top of the range of loss or cost to Huttig of the final remediation order.

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

The Company accrues expenses for contingencies when it is probable that an asset has been impaired or a liability has been incurred and management can reasonably estimate the expense. Contingencies for which the Company has recorded accruals include environmental, product liability and other legal matters. Based on management's assessment of the most recent information available, management currently does not expect any of these contingencies to have a material adverse effect on the Company's financial position or cash flow. It is possible, however, that future results of operations for any particular quarter or annual period and our financial condition could be materially affected by changes in assumptions or other circumstances related to these matters.

**5. BASIC AND DILUTED SHARES**

For the three and nine months ended September 30, 2008 and 2007, all outstanding stock options and all non-vested restricted shares/units were anti-dilutive and, therefore, were not included in the computations of diluted income per share amounts. At September 30, 2008, the Company had 512,500 stock options and an aggregate of 680,609 shares of restricted stock and restricted stock units outstanding.

**Table of Contents****6. BRANCH CLOSURES AND OTHER SEVERANCE**

In the first nine months of 2008, the Company recorded \$1.1 million in net inventory losses in Cost of sales and \$2.1 million of expense in Operating expenses related to branch closures. In the first nine months of 2007, the Company recorded \$1.0 million in net inventory losses in Cost of sales and \$2.7 million of expense in Operating expenses related to branch closures.

At September 30, 2008, the Company had \$1.5 million in accruals related to severance and the remaining building lease rentals for closed branches that will be paid out over the terms of the various leases through 2015.

Branch Closure Reserve and Other Accrued Severance (in millions):

	<b>Inventory</b>	<b>Operating Expenses</b>	<b>Total</b>
Balance December 31, 2007	\$	\$ 1.8	\$ 1.8
Branch closures and other severance	1.1	2.1	3.2
Amount paid/utilized	(1.1)	(2.4)	(3.5)
Balance September 30, 2008	\$	\$ 1.5	\$ 1.5

**7. GOODWILL IMPAIRMENT**

During the first nine months of 2008, the Company determined that, based on a further decline in actual and forecasted operating results at certain of its reporting units, an interim test for goodwill impairment was necessary for the impacted units. In determining if there was impairment, the Company first compared the fair value of the reporting unit (calculated by discounting projected cash flows and earnings multiples) to the carrying value. Because the carrying value of certain reporting units exceeded the fair value, the Company allocated the fair value to the assets and liabilities of the units and determined that the fair value of the implied goodwill was lower than what was recorded. Accordingly, goodwill impairment charges of \$7.1 million were recorded for these reporting units in the Consolidated Statements of Operations. At September 30, 2008, the Company had \$11.2 million remaining in goodwill. A prolonged continuation of the current downturn and any future unanticipated downturns in the markets the Company serves could result in further goodwill impairment charges in future periods.

**8. INCOME TAXES**

In accordance with the Financial Accounting Standards Board's Statement of Financial Accounting Standards (SFAS) 109, Accounting for Income Taxes, the Company evaluates its deferred tax assets quarterly to determine if valuation allowances are required to offset the carrying value of future tax benefits. Due to the Company's third quarter branch closures and further deterioration of the housing market in the third quarter 2008, we have determined that an additional valuation allowance should be established with regard to a portion of the deferred tax assets related to federal tax loss carryforwards. After recording these valuation allowances, the Company has net deferred tax assets of \$6.8 million as of September 30, 2008. Management believes that it is more likely than not that, based upon its projections of future taxable income, including available tax planning strategies, the Company will generate sufficient future taxable income to realize the benefits of the \$6.8 million net deferred tax assets existing at September 30, 2008. However, it is likely that additional valuation allowances will need to be established against deferred tax assets generated in conjunction with losses incurred in future periods.

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

Huttig is a distributor of building materials used principally in new residential construction and in home improvement, remodeling and repair work. We distribute our products through 31 distribution centers serving 44 states and sell primarily to building materials dealers, national buying groups, home centers and industrial users, including makers of manufactured homes.

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Millwork(1)	43%	48%	45%	49%
General Building Products(2)	45%	39%	43%	37%
Wood Products(3)	12%	13%	12%	14%
Total Net Product Sales	100%	100%	100%	100%

(1) Millwork includes exterior and interior doors, pre-hung door units, windows, patio doors, mouldings, frames, stair parts and columns.

(2) General building products include composite decking, connectors, fasteners, housewrap, roofing products, insulation and other miscellaneous building products.

(3)

Wood products include engineered wood products and other wood products, such as lumber and panels.

### **Industry Conditions**

Various factors historically have caused our results of operations to fluctuate from period to period. These factors include levels of construction, home improvement and remodeling activity, weather, prices of commodity wood, steel and petroleum-based products, fuel costs, interest rates, competitive pressures, availability of credit and other local, regional and national economic conditions. Many of these factors are cyclical or seasonal in nature. During the past two years, our results of operations have been adversely affected by the severe downturn in new housing activity in the United States. We expect the severe downturn in new housing activity to continue to adversely affect our operating results for at least the next twelve months. We anticipate that further fluctuations in operating results from period to period will continue in the future. Our first quarter and fourth quarter are generally adversely affected by winter weather patterns in the Midwest and Northeast, which typically result in seasonal decreases in levels of construction activity in these areas. Because much of our overhead and expenses remain relatively fixed throughout the year, our operating profits tend to be lower during the first and fourth quarters.

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

### **Critical Accounting Policies**

We prepare our consolidated financial statements in accordance with U.S. generally accepted accounting principles, which require management to make estimates and assumptions. Management bases these estimates and assumptions on historical results and known trends as well as management forecasts. Actual results could differ from these estimates and assumptions. See our Annual Report on Form 10-K for the year ended December 31, 2007 in Part II, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations-Critical Accounting Policies.

### **Results of Operations**

#### **Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007**

Net sales from continuing operations for the third quarter of 2008 were \$182.8 million, which were \$50.2 million, or approximately 22%, lower than the third quarter of 2007. Third quarter 2008 results were impacted by a 32% drop in housing starts to an average annualized rate of approximately .88 million, compared to approximately 1.30 million in the third quarter

**Table of Contents**

of 2007. We continue to anticipate decreased housing starts for the balance of 2008 versus 2007 based on the current level of housing activity and industry forecasts. As a result, we are continuing to examine our cost structure, looking for opportunities to reduce expenses and increase efficiencies.

Sales decreased in all product categories. General building products sales decreased 8% to \$83.0 million. Millwork sales decreased 30% to \$78.8 million. Other wood products, mostly commodity products, decreased 27% to \$15.7 million and engineered wood sales were down 41% to \$5.3 million.

Gross margin decreased 24% to \$33.0 million, or 18.1% of sales, as compared to \$43.3 million, or 18.6% of sales, in the prior year period. Third quarter 2008 results reflect the liquidation and net write down of inventory at closed branches of \$0.8 million. These items negatively impacted 2008 gross margin percentage by approximately 0.4%. In addition, third quarter 2008 was negatively impacted by a less favorable mix of millwork sales partially offset by higher margins on building products, a more favorable mix of higher margin non-direct sales and lower customer rebates earned.

Operating expenses decreased 7% to \$39.2 million, or 21.4% of sales, in the 2008 third quarter, compared to \$42.3 million, or 18.2% of sales, in the 2007 third quarter. Third quarter 2008 results included \$1.1 million in charges related to the cost reduction actions. Excluding these 2008 third quarter charges, operating expenses decreased by \$4.2 million primarily due to lower employee headcount and lower infrastructure levels as a result of the prior restructuring actions, partially offset by higher fuel and contract hauling costs.

Net interest expense decreased to \$0.6 million in the 2008 third quarter from \$1.1 million in the prior year third quarter due to lower interest rates and decreased borrowing levels.

We recognized income tax expense of \$0.9 in the third quarter of 2008 as we decreased our projections of the full year 2008 income tax benefit to 18% of income before taxes at September 30, 2008, from 31% at June 30, 2008. The decrease primarily related to our third quarter branch closures and additional deterioration of the housing market in the third quarter 2008, resulting in the Company recording a valuation allowance against a portion of its federal tax loss carryforward benefit. We had long-term deferred tax assets, net of valuation allowances, of \$6.8 million at September 30, 2008. We believe it is more likely than not that, considering our projections of future taxable income, including available tax planning strategies, we will generate sufficient future taxable income to realize the benefits of the net deferred tax assets existing at September 30, 2008. However, we believe it is likely that a valuation allowance will need to be established for any additional deferred tax assets generated in conjunction with losses incurred in future periods.

As a result of the foregoing factors, operating loss from continuing operations was \$6.2 million in the 2008 third quarter, as compared to \$1.0 million of operating income from continuing operations in the 2007 third quarter. Net loss from continuing operations was \$7.7 million, or \$0.37 per diluted share, in the 2008 third quarter, as compared to a net loss from continuing operations of \$0.1 million, or breakeven per diluted share, in the 2007 third quarter.

**Nine Months Ended September 30, 2008 Compared to Nine Months Ended September 30, 2007**

Net sales from continuing operations for the nine months ended September 30, 2008 were \$545.0 million, which were \$149.9 million, or approximately 22%, lower than in the first nine months of 2007. The results for the nine months ended September 30, 2008 were impacted by a 30% drop in housing starts to an average annualized rate of approximately .99 million, compared to approximately 1.40 million in the first nine months of 2007. We continue to anticipate decreased housing starts for the balance of 2008 versus 2007 based on the current level of housing activity and industry forecasts.

Sales decreased in all product categories. Millwork sales decreased 29% to \$244.8 million. General building products sales decreased 7% to \$237.3 million. Other wood products, mostly commodity products, decreased 30% to \$46.2 million and engineered wood sales were down 41% to \$16.7 million.

Gross margin decreased 22% to \$101.8 million, or 18.7% of sales, as compared to \$130.9 million, or 18.8% of sales, in the prior year period. The results for first nine months of 2008 and 2007 reflect the liquidation and net write down of inventory at closed branches of \$1.1 and \$1.0 million, respectively. These items negatively impacted 2008 and 2007 gross margin percentages by approximately 0.2% and 0.1%, respectively. In addition, the gross margin percentage in the first nine months of 2008 was negatively impacted by a less favorable mix of millwork sales, which was substantially offset by higher margins on building products and more favorable inventory variances.





## **Table of Contents**

Operating expenses decreased 11% to \$117.2 million, or 21.5% of sales, in the first nine months of 2008, compared to \$132.3 million, or 19.0% of sales, in the first nine months of 2007. Results for the first nine months of 2008 and 2007 included \$2.1 and \$2.7 million in charges related to the cost reduction actions, respectively. Excluding these charges, operating expenses in the first nine months of 2008 decreased by \$14.5 million primarily due to lower employee headcount and lower infrastructure levels as a result of the prior restructuring actions, partially offset by higher fuel and contract hauling costs and increased bad debt expense.

During the first nine months of 2008, we determined that, based on a further decline in actual and forecasted operating results at certain of our reporting units, an interim test for goodwill impairment was necessary for the impacted units. In determining if there was impairment, we first compared the fair value of the reporting unit (calculated by discounting projected cash flows and earnings multiples) to the carrying value. Because the carrying value of certain reporting units exceeded the fair value, we allocated the fair value to the assets and liabilities of the units and determined that the fair value of the implied goodwill was lower than what was recorded. Accordingly, we recorded goodwill impairment charges of \$7.1 million for these reporting units in the Consolidated Statements of Operations. At September 30, 2008, we had \$11.2 million remaining in goodwill. A prolonged continuation of the current downturn and any future unanticipated downturns in the markets we serve could result in further goodwill impairment charges in future periods.

In the nine months ended September 30, 2007, we recognized gains of \$0.5 million on the sale of our Grand Rapids, MI facility and \$1.0 million on the sale of our Spokane, WA facility.

Net interest expense decreased to \$2.0 million in the nine months ended September 30, 2008 from \$3.4 million in the prior year first nine months due to lower interest rates and decreased borrowing levels.

Income taxes as a percentage of pre-tax loss for the nine months ended September 30, 2008 and 2007 were approximately 18% and 33%, respectively. We believe that the 18% rate will approximate the full year rate for 2008, and includes the impact of a valuation allowance established to offset a portion of our federal tax loss carryforward benefit. We had long-term net deferred tax assets of \$6.8 million at September 30, 2008. We believe it is more likely than not that, considering our projections of future taxable income, including available tax planning strategies, we will generate sufficient future taxable income to realize the benefits of the net deferred tax assets existing at September 30, 2008. However, we believe it is likely that a valuation allowance will need to be established for any additional deferred tax assets generated in conjunction with losses incurred in future periods.

As a result of the foregoing factors, operating loss from continuing operations was \$22.3 million in the first nine months of 2008, as compared to an operating profit of \$0.1 million from continuing operations in the first nine months of 2007. Net loss from continuing operations was \$19.9 million, or \$0.95 per diluted share, in the first nine months of 2008, as compared to a net loss from continuing operations of \$2.2 million, or \$0.11 per diluted share, in the first nine months of 2007.

### **Discontinued Operations**

We recorded a \$0.1 million and \$0.2 million after-tax loss from discontinued operations for environmental and litigation expenses associated with previously reported discontinued operations in the nine months ended September 30, 2008 and 2007, respectively.

### **Liquidity and Capital Resources**

We depend on cash flow from operations and funds available under our revolving credit facility to finance seasonal working capital needs, capital expenditures and any acquisitions that we may undertake. Our working capital requirements are generally greatest in the second and third quarters, which reflect the seasonal nature of our business. The second and third quarters are also typically our strongest operating quarters, largely due to increased construction activities from more favorable weather throughout many of our markets compared to the first and fourth quarters. Absent unusual market conditions, we typically generate cash from working capital reductions in the fourth quarter of the year and build working capital during the first quarter in preparation for our second and third quarters. We also maintain significant inventories to meet rapid delivery requirements of our customers and to enable us to obtain favorable pricing, delivery and service terms with our suppliers. At September 30, 2008, December 31, 2007 and September 30, 2007, inventories constituted approximately 36%, 42% and 38% of our total assets, respectively. We also closely monitor operating expenses and



**Table of Contents**

inventory levels during seasonally affected periods and, to the extent possible, manage variable operating costs to minimize seasonal effects on our profitability.

**Operations.** Cash used in operating activities totaled \$0.6 million for the nine months ended September 30, 2008 as compared to cash provided by operating activities of \$3.6 million for the first nine months of 2007. Accounts receivable increased by \$8.7 million in the first nine months of 2008, compared to an increase of \$9.9 million in the first nine months of 2007. Days sales outstanding decreased to 32.3 days at September 30, 2008, compared to 32.9 days at September 30, 2007, based on annualized sales for the respective immediately preceding quarter. Inventory decreased by \$17.9 million in the 2008 first nine months, compared to an increase of \$0.8 million in the 2007 first nine months. Annualized inventory turns, calculated as the ratio of annualized cost of goods sold for each three-month period ended September 30 divided by the average of the beginning and ending inventory balances for each such three-month period, were 8.1 turns at September 30, 2008 compared to 7.6 at September 30, 2007. Accounts payable decreased by \$0.9 million in the nine months ended September 30, 2008 as compared to an increase of \$8.5 million in the nine months ended September 30, 2007.

**Investing.** In the nine-month period ended September 30, 2008, net cash used in investing activities was \$1.1 million, as compared to \$0.4 million of net cash provided by investing activities in the nine-month period ended September 30, 2007. We made capital expenditures of \$1.7 million in the first nine months of 2008 primarily to purchase machinery and equipment at multiple branches. In the first nine months of 2007, we made capital expenditures of \$2.6 million related primarily to the purchase of computer software necessary to upgrade our enterprise resource planning system and to purchase machinery and equipment at multiple branch locations. In the 2007 first nine months, we received proceeds of \$2.9 million and recorded gains on disposal of capital assets of \$1.5 million as a result of our sales of the Grand Rapids, MI and Spokane, WA facilities.

**Financing.** Cash provided by financing activities for the first nine months of 2008 primarily reflects a \$6.1 million increase in net borrowings and \$0.9 million from stock options. Cash provided from financing activities for the first nine months of 2007 primarily reflects \$1.0 million from stock options and a \$0.9 million increase in net borrowings.

**Credit Agreement.** We have a five-year \$160.0 million asset based senior secured revolving credit facility ( credit facility ). Borrowing availability under the credit facility is based on eligible accounts receivable, inventory and real estate. We added the real estate component to the borrowing base in July 2008. The inclusion of the real estate component initially provided approximately \$25 million of additional borrowing capacity under the credit facility. The real estate component of the borrowing base amortizes monthly over ten years on a straight-line basis. Additionally, the credit facility includes an option to request an increase in the size of the facility by up to an additional \$40.0 million, subject to certain conditions and approvals. We must also pay a fee in the range of 0.25% to 0.32% per annum on the average daily-unused amount of the revolving credit commitment. The entire unpaid balance under the credit facility is due and payable on October 20, 2011, the maturity date of the credit facility.

At September 30, 2008, under the credit facility we had revolving credit borrowings of \$32.0 million outstanding at a weighted average interest rate of 3.76%, letters of credit outstanding totaling \$5.2 million, primarily for health and workers compensation insurance, and \$76.4 million of additional borrowing capacity. In addition, we had \$0.7 million of other obligations outstanding at September 30, 2008. Given the Company's current LIBOR based borrowing rates, we expect the weighted average interest rate under the credit facility will increase as the outstanding advances at September 30, 2008 roll-over in the fourth quarter of 2008.

The borrowings under the credit facility are collateralized by substantially all of our assets and are subject to certain operating limitations commonly applicable to a loan of this type, which, among other things, place limitations on indebtedness, liens, investments, mergers and acquisitions dispositions of assets, cash dividends, stock repurchases and transactions with affiliates. The financial covenant in the credit facility is limited to a fixed charge coverage ratio to be tested only when excess borrowing availability, as defined, is less than \$25.0 million, on a pro forma basis prior to consummation of certain significant business transactions outside the ordinary course of business, and prior to increasing the size of the facility.

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

**Off-Balance Sheet Arrangements**

In addition to funds available from operating cash flows and our credit facility as described above, we use operating leases as a principal off-balance sheet financing technique. Operating leases are employed as an alternative to purchasing certain

**Table of Contents**

property, plant and equipment. See our Annual Report on Form 10-K for the year ended December 31, 2007 in Part II, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations-Commitments and Contingencies.

**Contingencies**

We are involved in a number of legal proceedings incidental to the conduct of our business, relating to such matters as product liability, environmental liability and vehicular accidents. We carry insurance policies on insurable risks with coverage and other terms that we believe to be appropriate. We generally have self-insured retention limits and have obtained fully insured layers of coverage above such self-insured retention limits. Accruals for self-insurance losses are made based on claims experience. Liabilities for existing and unreported claims are accrued when it is probable that future costs will be incurred and such future costs can be reasonably estimated.

We are subject to federal, state and local environmental protection laws and regulations. Our management believes we are in compliance, or are taking action aimed at assuring compliance, with applicable environmental protection laws and regulations. However, there can be no assurance that future environmental liabilities will not have a material adverse effect on our consolidated financial condition or results of operations.

We have been identified as a potentially responsible party in connection with the clean up of contamination at a formerly owned property in Montana that was used for the manufacture of wood windows and at a currently-owned facility in Prineville, Oregon, in connection with the clean up of petroleum hydrocarbons and PCP discovered in soil and groundwater at the facility. As of September 30, 2008, we have accrued approximately \$0.8 million for future costs of remediating these sites. However, until a final remedy is selected by the respective state departments of environmental quality, management cannot estimate the top of the range of loss or cost to us of the final remediation order.

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

We accrue expenses for contingencies when it is probable that an asset has been impaired or a liability has been incurred and management can reasonably estimate the expense. Contingencies for which we have made accruals include environmental, product liability and other legal matters. Based on management's assessment of the most recent information available, management currently does not expect any of these contingencies to have a material adverse effect on our financial position or cash flow. It is possible, however, that future results of operations for any particular quarter or annual period and our financial condition could be materially affected by changes in assumptions or other circumstances related to these matters.

**Cautionary Statement**

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

our expectation that known contingencies, including risks relating to environmental, product liability and other legal matters, will not have a material adverse effect on our financial position or cash flow;

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

our anticipation of decreased housing starts for the balance of 2008 as compared to 2007;

our belief that the weighted average interest rate under our credit facilities will increase as the outstanding advances roll over in the fourth quarter of 2008;

our belief that cash from operations and funds under our credit facility will be sufficient to meet our future liquidity and capital expenditure requirements;

our belief that it is more likely than not we will generate sufficient taxable income to realize the benefits of the net deferred tax assets existing at September 30, 2008;

**Table of Contents**

our belief that it is likely that a valuation allowance will need to be established for any additional deferred tax assets generated in conjunction with losses incurred in future periods;

our expectation that the severe downturn in new housing activity will continue to adversely affect our operating results for at least the next twelve months;

our estimate of the annualized effective tax rate for 2008;

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

our liquidity and exposure to market risk; and

cyclical and seasonal trends.

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

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

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

interest rates;

immigration patterns;

job and household formation;

household prices;

tax policy;

regional demographics;

employment levels;

availability of credit;

inventory levels of new and existing homes for sale;

prices of wood and steel-based products;

fuel costs; and

consumer confidence;

the level of competition in our industry;



our relationships with suppliers of the products we distribute;

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

the financial condition and credit worthiness of our customers;

**Table of Contents**

fluctuation in prices of wood and steel-based products;

cyclical and seasonal trends;

costs of complying with environmental laws and regulations,;

our exposure to product liability claims;

our ability to attract and retain key personnel;

risk of losses associated with accidents;

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

accuracy of our assumptions underlying our projections of future taxable income, including available tax planning strategies.

We disclaim any obligation to publicly update or revise any of these forward-looking statements.

**ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We have exposure to market risk as it relates to effects of changes in interest rates. We had debt outstanding at September 30, 2008 under our credit facility of \$32.0 million.

All of our debt under our revolving credit facility accrues interest at a floating rate basis. If market interest rates for LIBOR had been different by an average of 1% for the nine months ended September 30, 2008, our interest expense and income before taxes would have changed by \$0.3 million. These amounts are determined by considering the impact of the hypothetical interest rates on our borrowing cost. This analysis does not consider the effects of any change in the overall economic activity that could exist in such an environment. Further, in the event of a change of such magnitude, management may take actions to further mitigate its exposure to the change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, the sensitivity analysis assumes no changes in our financial structure.

We are subject to periodic fluctuations in the price of wood, steel commodities, petrochemical-based products and fuel. Profitability is influenced by these changes as prices change between the time we buy and sell the wood, steel or petrochemical-based products. Profitability also is influenced by changes in prices in fuel. In addition, to the extent changes in interest rates affect the housing and remodeling market, we would be affected by such changes.

**ITEM 4 CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures** The Company, under the supervision and with the participation of our Disclosure Committee and management, including our Chief Executive Officer and our Interim Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities and Exchange Act of 1934). Based upon that evaluation, our Chief Executive Officer and our Interim Chief Financial Officer concluded that our disclosure controls and procedures are effective as of September 30, 2008 in all material respects in (a) causing information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 to be recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (b) causing such information to be accumulated and communicated to our management, including our Chief Executive Officer and our Interim Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control of Financial Reporting** There have been no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2008, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****ITEM 1 LEGAL PROCEEDINGS**

See Note 4 Contingencies of the Notes to Consolidated Financial Statements in Item 1 for information on legal proceedings in which the Company is involved. See also Part I, Item 3- Legal Proceedings in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

**ITEM 1A RISK FACTORS**

The information contained in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2007, along with the matters addressed in the following discussion, represent those factors that we presently believe could materially adversely affect our business, financial condition and results in the future. Additional risks and uncertainties not now known to us or that we now believe to be immaterial also may materially adversely affect our business, financial condition and results of operations in the future.

**Our common stock could be delisted by the New York Stock Exchange if we do not comply with its continued listing standards.**

Our common stock is listed on the New York Stock Exchange. Under the NYSE's continued listing standards, if our average market capitalization over 30 consecutive trading days is less than \$25 million, our stock would be delisted automatically from the NYSE. As of November 5, 2008, our market capitalization has closed below \$25 million for 6 of the last 30 trading days and our average market capitalization for the period is approximately \$32.4 million. We cannot provide any assurance that our average market capitalization will continue to exceed \$25 million in the future or that we can continue to comply with other NYSE continued listing standards. If our common stock is delisted from the NYSE, it will likely be quoted on the over-the-counter market, or "pink sheets". Delisting of our common stock from the NYSE would likely reduce the liquidity of an investment in our common stock and could also make it more difficult for us to raise capital in the future. In addition, efforts to maintain our listing on the NYSE or to arrange for the listing or quotation of our common stock on another exchange or quotation system may result in the incurrence of costs that are material in any given period.

**ITEM 6 EXHIBITS****Exhibit**

<b>Number</b>	<b>Description</b>
3.1	Restated Certificate of Incorporation of the Company (Incorporated by reference to Exhibit 3.1 to the Form 10 filed with the Securities and Exchange Commission on September 21, 1999.)
3.2	Amended and Restated Bylaws of the Company (as of September 26, 2007) (Incorporated by reference to Exhibit 3.1 to the Form 8-K filed with the Securities and Exchange Commission on September 28, 2007.)
31.1	Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Interim Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by Chief Executive Officer and Interim Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.

**Table of Contents**

**SIGNATURES**

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

HUTTIG BUILDING PRODUCTS, INC.

Date: November 5, 2008

*/s/ Jon P. Vrabely*  
Jon P. Vrabely  
President, Chief Executive Officer  
(Principal Executive Officer)

Date: November 5, 2008

*/s/ Kenneth L. Young*  
Kenneth L. Young  
Interim Chief Financial Officer and  
Treasurer  
(Principal Financial and Accounting  
Officer)  
19

---

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
31.1	Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Interim Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by Chief Executive Officer and Interim Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.