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

Commission file number: 1-14315

NCI BUILDING SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of** **incorporation or organization)**	**76-0127701** **(I.R.S. Employer** **Identification No.)**
10943 N. Sam Houston Parkway W.	
Houston, TX **(Address of principal executive offices)**	**77064** **(Zip Code)**

(281) 897-7788

Registrant s telephone number, including area code

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

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 x No ¨

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

APPLICABLE ONLY TO CORPORATE ISSUERS

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

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

Table of Contents

TABLE OF CONTENTS

-i-

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

NCI BUILDING SYSTEMS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

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

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NCI BUILDING SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NCI BUILDING SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

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

See accompanying notes to condensed consolidated financial statements.

-3-

Table of Contents

NCI BUILDING SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NCI BUILDING SYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JULY 29, 2007

(Unaudited)

NOTE 1 BASIS OF PRESENTATION

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

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

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

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

NOTE 2 ACQUISITIONS

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

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

Table of Contents

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

Cash consideration	$ 371,014
Transaction costs	5,128
	$ 376,142

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

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

NOTE 3 INVENTORIES

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

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

NOTE 4 BUSINESS SEGMENTS

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

-6-

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

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

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

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

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

NOTE 5 SHARE-BASED COMPENSATION

Our 2003 Long-Term Stock Incentive Plan is an equity-based compensation plan that allows us to grant a variety of types of awards, including stock options, restricted stock, restricted stock units, stock appreciation rights, performance share awards, phantom stock awards and cash awards. As of July 29, 2007 and for all periods presented, our share-based awards under this plan have consisted of restricted stock grants and stock option grants, neither of which can be settled through cash payments. We account for these restricted stock grants and stock option grants in accordance with Statement of Financial Accounting Standards 123(Revised), *Share-Based Payment*.

Table of Contents

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

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

NOTE 6 EARNINGS PER SHARE

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

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

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

Table of Contents

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

NOTE 7 WARRANTY

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

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

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

NOTE 8 EMPLOYEE BENEFIT PLANS

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

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

Table of Contents

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

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

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

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

NOTE 9 LONG-TERM DEBT

Debt is comprised of the following (in thousands):

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

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

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

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

Table of Contents

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

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

NOTE 10 INTEREST RATE SWAP

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

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

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

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

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

Table of Contents

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

NOTE 11 COMPREHENSIVE INCOME

Comprehensive income consists of the following (in thousands):

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

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

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

NOTE 12 RECENT ACCOUNTING PRONOUNCEMENTS

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

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

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

Table of Contents

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

NOTE 13 CONTINGENCIES

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

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

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

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

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

Table of Contents

NCI BUILDING SYSTEMS, INC.

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

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

OVERVIEW

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

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

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

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

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

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

Business Strategy

In late 2003, we conducted a comprehensive review of our business and growth strategy, which resulted in a strategic plan that was approved by our board of directors in early 2004. Our primary goal under the strategic plan is to materially increase our market value by increasing our earnings per share over a five-year period beginning in fiscal 2004, utilizing a combination of accretive acquisitions, organic growth and information technology upgrades.

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

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

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

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

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

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

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

Industry Conditions

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

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

Table of Contents

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

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

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

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

RESULTS OF OPERATIONS

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

Products of all business segments use similar basic raw materials. The metal components segment products include metal roof and wall panels, doors, metal partitions, metal trim and other related accessories. The engineered building systems segment includes the manufacturing of main frames, Long Bay® Systems and value-added engineering and drafting, which are typically not part of metal components or metal coil coating products or services. The metal coil coating segment consists of cleaning, treating, painting and slitting continuous steel coils before the steel is fabricated. The reporting