

NCI BUILDING SYSTEMS INC

Form 10-Q

June 08, 2011

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended May 1, 2011

or

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

For the transition period from _____ to _____

**Commission file number: 1-14315
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 No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

(Do not check if a smaller
reporting company)

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

APPLICABLE ONLY TO CORPORATE ISSUERS

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

Common Stock, \$.01 par value 19,772,612 shares as of June 3, 2011

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NCI BUILDING SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	May 1, 2011 (Unaudited)	October 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 57,409	\$ 77,419
Restricted cash	2,842	2,839
Accounts receivable, net	70,395	81,896
Inventories, net	107,562	81,386
Deferred income taxes	15,055	15,101
Income tax receivable	278	15,919
Investments in debt and equity securities, at market	4,190	3,738
Prepaid expenses and other	16,250	13,923
Assets held for sale	6,133	6,114
 Total current assets	 280,114	 298,335
Property, plant and equipment, net	208,857	214,453
Goodwill	5,200	5,200
Intangible assets, net	25,283	26,312
Other assets	13,874	16,224
 Total assets	 \$ 533,328	 \$ 560,524
 LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Note payable	\$ 1,167	\$ 289
Accounts payable	74,496	70,589
Accrued compensation and benefits	33,200	31,731
Accrued interest	1,458	1,546
Other accrued expenses	49,130	46,723
 Total current liabilities	 159,451	 150,878
Long-term debt	132,557	136,305
Deferred income taxes	3,505	10,947
Other long-term liabilities	4,807	4,820
 Total long-term liabilities	 140,869	 152,072
Series B cumulative convertible participating preferred stock	258,321	256,870
Redeemable common stock	1,821	3,418
Stockholders deficit:		

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Common stock, \$.01 par value, 100,000,000 shares authorized; 19,773,813 and 19,259,423 shares issued and outstanding at May 1, 2011 and October 31, 2010, respectively	924	921
Additional paid-in capital	246,784	255,248
Accumulated deficit	(272,900)	(256,946)
Accumulated other comprehensive loss	(1,942)	(1,937)
Total stockholders' deficit	(27,134)	(2,714)
Total liabilities and stockholders' deficit	\$ 533,328	\$ 560,524

See accompanying notes to consolidated financial statements.

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NCI BUILDING SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	Fiscal Three Months		Fiscal Six Months	
	Ended		Ended	
	May 1, 2011	May 2, 2010	May 1, 2011	May 2, 2010
Sales	\$ 225,565	\$ 201,573	\$ 415,651	\$ 383,780
Cost of sales, excluding asset impairments (recovery)	174,752	161,026	331,293	309,766
Asset impairments (recovery)		(116)		913
Gross profit	50,813	40,663	84,358	73,101
Engineering, selling, general and administrative expenses	52,657	48,991	100,338	93,637
Restructuring charges		829		1,353
Loss from operations	(1,844)	(9,157)	(15,980)	(21,889)
Interest income	30	12	77	37
Interest expense	(3,900)	(4,682)	(8,124)	(9,214)
Refinancing costs				(174)
Other income, net	699	635	1,278	1,783
Loss before income taxes	(5,015)	(13,192)	(22,749)	(29,457)
Benefit from income taxes	(1,786)	(5,536)	(6,795)	(11,315)
Net loss	\$ (3,229)	\$ (7,656)	\$ (15,954)	\$ (18,142)
Convertible preferred stock dividends and accretion	6,260	8,407	12,490	16,541
Convertible preferred stock beneficial conversion feature	(240)	241,282	1,546	241,469
Net loss applicable to common shares	\$ (9,249)	\$ (257,345)	\$ (29,990)	\$ (276,152)
Loss per common share:				
Basic	\$ (0.51)	\$ (14.15)	\$ (1.65)	\$ (15.22)
Diluted	\$ (0.51)	\$ (14.15)	\$ (1.65)	\$ (15.22)
Weighted average number of common shares outstanding:				
Basic	18,275	18,184	18,215	18,138
Diluted	18,275	18,184	18,215	18,138

See accompanying notes to consolidated financial statements.

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NCI BUILDING SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Fiscal Six Months Ended	
	May 1, 2011	May 2, 2010
Cash flows from operating activities:		
Net loss	\$ (15,954)	\$ (18,142)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	16,850	17,360
Share-based compensation expense	3,357	2,204
Refinancing costs		174
Gain on embedded derivative	(13)	(923)
Loss on sale of property, plant and equipment	11	112
Provision for doubtful accounts	690	(267)
Benefit from deferred income taxes	(6,978)	(668)
Asset impairments, net		913
Changes in operating assets and liabilities, net of effect of acquisitions:		
Accounts receivable	10,811	9,990
Inventories	(26,176)	(29,031)
Income tax receivable	15,702	(9,653)
Prepaid expenses and other	(1,133)	(885)
Accounts payable	3,907	(3,358)
Accrued expenses	3,863	(12,144)
Other, net	69	567
Net cash provided by (used in) operating activities	5,006	(43,751)
Cash flows from investing activities:		
Capital expenditures	(8,070)	(3,868)
Proceeds from sale of property, plant and equipment	143	65
Net cash used in investing activities	(7,927)	(3,803)
Cash flows from financing activities:		
Decrease (increase) of restricted cash	(3)	10,143
Proceeds from ABL Facility	5	235
Payments on ABL Facility	(3)	(44)
Payment on term loan	(3,750)	(375)
Payment of convertible notes		(59)
Payments on other long-term debt		(190)
Payments on note payable	(667)	(855)
Payment of financing costs	(75)	(50)
Payment of cash dividends on Convertible Preferred Stock	(11,039)	
Purchase of treasury stock	(1,477)	(381)

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Net cash (used in) provided by financing activities	(17,009)	8,424
Effect of exchange rate changes on cash and cash equivalents	(80)	(16)
Net decrease in cash and cash equivalents	(20,010)	(39,146)
Cash and cash equivalents at beginning of period	77,419	90,419
Cash and cash equivalents at end of period	\$ 57,409	\$ 51,273

See accompanying notes to consolidated financial statements.

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NCI BUILDING SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 1, 2011
(Unaudited)

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements for NCI Building Systems, Inc. and its subsidiaries (the Company, we, us, and our) 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, the unaudited consolidated financial statements included herein contain all adjustments necessary to fairly present our financial position, results of operations and cash flows for the periods indicated. Such adjustments, other than nonrecurring adjustments that have been separately disclosed, are of a normal, recurring nature. Operating results for the fiscal three and six month periods ended May 1, 2011 are not necessarily indicative of the results that may be expected for the fiscal year ending October 30, 2011. Our sales and earnings are subject to both seasonal and cyclical trends and are influenced by general economic conditions, interest rates, the price of steel relative to other building materials, the level of nonresidential construction activity, roof repair and retrofit demand and the availability and cost of financing for construction projects.

We use a four-four-five week calendar each quarter with our year end on the Sunday closest to October 31. The year end for fiscal 2011 is October 30, 2011.

Certain reclassifications have been made to prior period amounts in our consolidated balance sheets and consolidated statements of operations to conform to the current presentation. These reclassifications include the reclassification of shares of our common stock, par value \$0.01 (the Common Stock), to redeemable common stock. See Note 11 Redeemable Common Stock. The net effect of these reclassifications was not material to our consolidated financial statements.

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 31, 2010 filed with the Securities and Exchange Commission (the SEC) on December 22, 2010.

NOTE 2 RECENT ACCOUNTING PRONOUNCEMENT

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820) (ASU 2011-04). The amendments to this update provide a uniform framework for applying the principles of fair value measurement and include (i) amendments that clarify the Board's intent about the application of existing fair value measurement and disclosure requirements and (ii) amendments that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. These amendments do not require additional fair value measurements. We will adopt ASU 2011-04 in our second fiscal quarter ended April 29, 2012. We do not believe the adoption of ASU 2011-04 will have a material impact on our consolidated financial statements.

NOTE 3 PLANT RESTRUCTURING AND ASSET IMPAIRMENTS

As a result of the market downturn which began in fiscal 2008, we implemented a phased process to resize and realign our manufacturing operations. The purpose of these activities was to close some of our least efficient facilities and to retool certain of these facilities to allow us to better utilize our assets and expand into new markets or better provide products to our customers, such as insulated panel systems.

As a result of actions taken in our restructuring, certain facilities in our engineered building systems and metal components segments are being actively marketed for sale and have been classified as held for sale in the Consolidated Balance Sheets. During the first quarter of fiscal 2010, we recorded an additional \$1.0 million impairment for one of our facilities in the engineered building systems segment related to facilities classified as held for sale as a result of deteriorating market conditions. In determining the impairment, the fair value of assets was determined based on prices of similar assets in similar condition, adjusted for their remaining useful life. We plan to sell these facilities within the next 12 months. In addition, during the three and six month periods ended May 2, 2010, we incurred \$0.8 million and \$1.4 million, respectively, in restructuring costs primarily related to idle facility costs. We did not incur significant similar costs related to our restructuring in the three or six month periods ended May 1,

2011 and do not expect to incur significant similar costs resulting from the restructuring plan in the future.

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On May 21, 2009, we entered into a cash collateral agreement with our agent bank to obtain letters of credit secured by cash collateral. The restricted cash is invested in a cash bank account securing our agent bank. As of May 1, 2011 and October 31, 2010, we had restricted cash in the amount of \$2.8 million as collateral related to our \$2.7 million of letters of credit. Restricted cash is classified as a current asset as the underlying letters of credit expire by October 2011. The letters of credit have either automatically renewed or will be renewed upon expiration.

NOTE 5 INVENTORIES

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

	May 1, 2011	October 31, 2010
Raw materials	\$ 81,460	\$ 56,834
Work in process and finished goods	26,102	24,552
	\$ 107,562	\$ 81,386

NOTE 6 SHARE-BASED COMPENSATION

Our 2003 Long-Term Stock Incentive Plan (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 May 1, 2011 and May 2, 2010, and for all periods presented, our share-based awards under this plan have consisted of restricted stock grants and stock option grants, none of which can be settled through cash payments. Both our stock options and restricted stock awards are subject only to vesting requirements based on continued employment at the end of a specified time period and typically vest over four years. However, from time to time certain individuals have received special one-time restricted stock awards that vest at retirement, upon a change of control or on termination without cause or for good reason, as defined by the agreements governing such awards.

The fair value of each option award is estimated as of the date of grant or the remeasurement date using a Black-Scholes-Merton option pricing formula. Expected volatility is based on normalized historical volatility of our stock over a preceding period commensurate with the expected term of the option and adjusted to exclude the increased volatility associated with the refinancing the Company experienced in fiscal 2009 because this volatility is not relevant to the expected future volatility of the stock. The risk-free rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Expected dividend yield was not considered in the option pricing formula since we do not currently pay dividends on our Common Stock and have no current plans to do so in the future. We have estimated a forfeiture rate of 10% for our non-officers and 0% for our officers in our calculation of share-based compensation expense for the three and six month periods ended May 1, 2011 and May 2, 2010. These estimates are based on historical forfeiture behavior exhibited by our employees.

The weighted average assumptions for the equity awards granted on December 14, 2010 and December 11, 2009 are noted in the following table:

	December 14, 2010	December 11, 2009
Expected volatility	51.53%	46.05%
Expected term (in years)	5.75	5.75
Risk-free interest rate	1.21%	2.44%

Prior to March 5, 2010, the Company did not have sufficient common shares available to settle the restricted stock and stock option awards, and thus, we classified a portion of the awards as liability awards in accordance with ASC Subtopic 718-10, Compensation-Stock Compensation (ASC 718-10). ASC 718-10 requires that liability awards be remeasured at fair value at each reporting date with changes in fair value recognized in earnings. On March 5, 2010, the Company effected a reverse stock split at an exchange ratio of 1-for-5 (the Reverse Stock Split) which caused the

shares to become available and resulted in all restricted stock and stock option awards being classified as equity awards. As such, on March 5, 2010, all liability awards were reclassified to equity awards and remeasured using a valuation date of March 5, 2010.

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The weighted average assumptions for the liability awards at the December 11, 2009 grant date and the subsequent reclassification to equity awards remeasured on March 5, 2010 are noted in the following table:

	March 5, 2010	December 11, 2009
Expected volatility	47.01%	46.05%
Expected term (in years)	5.52	5.75
Risk-free interest rate	2.49%	2.44%

During the six month period ended May 1, 2011 and May 2, 2010, we granted 121,669 and 1,781,729 stock options, respectively, and the weighted average grant-date fair value of options granted was \$5.78 and \$4.29, respectively. The fair value of restricted stock awards classified as equity awards is based on the Company's stock price as of the date of grant. During the six months ended May 1, 2011 and May 2, 2010, we granted restricted stock awards with a fair value of \$6.2 million or 515,053 shares and \$13.7 million or 1,498,718 shares, respectively. The total recurring pre-tax share-based compensation cost that has been recognized in results of operations was \$1.7 million and \$1.4 million for the three months ended May 1, 2011 and May 2, 2010, respectively, and \$3.4 million and \$2.2 million for the six months ended May 1, 2011 and May 2, 2010, respectively. Of these amounts, \$1.6 million and \$1.3 million for the three months ended May 1, 2011 and May 2, 2010, respectively, and \$3.2 million and \$2.1 million for the six months ended May 1, 2011 and May 2, 2010, respectively, were included in engineering, selling, general and administrative expense, with the remaining costs in each period in cost of goods sold. As of both May 1, 2011 and May 2, 2010, 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 \$0.6 million and \$0.5 million for the three months ended May 1, 2011 and May 2, 2010, respectively, and \$1.3 million and \$0.8 million for the six months ended May 1, 2011 and May 2, 2010, respectively. As of May 1, 2011 and May 2, 2010, there was approximately \$21.7 million and \$21.0 million, respectively, of total unrecognized compensation cost related to share-based compensation arrangements and this cost is expected to be recognized over a weighted-average remaining period of 3.2 years and 4.0 years, respectively.

There were no options exercised during the first six months of each of fiscal 2011 and fiscal 2010.

NOTE 7 LOSS PER COMMON SHARE

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

	Fiscal Three Months Ended		Fiscal Six Months Ended	
	May 1, 2011	May 2, 2010	May 1, 2011	May 2, 2010
Numerator for Basic and Diluted Loss Per Common Share				
Net loss allocated to common shares (1)	\$ (9,249)	\$ (257,345)	\$ (29,990)	\$ (276,152)
Denominator for Basic and Diluted Loss Per Common Share				
Weighted average common shares outstanding for basic and diluted loss per share	18,275	18,184	18,215	18,138
Basic and Diluted loss per common share	\$ (0.51)	\$ (14.15)	\$ (1.65)	\$ (15.22)

(1)

Participating securities consist of the holders of the Convertible Preferred Stock, as defined below, and the unvested restricted Common Stock related to our Incentive Plan. Participating securities do not have a contractual obligation to share in losses; therefore, no losses were allocated in both periods presented above. These participating securities will be allocated earnings when applicable.

We calculate earnings per share using the two-class method, whereby unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and, therefore, these participating securities are treated as a separate class in computing earnings per share. The calculation of earnings per share for Common Stock presented here excludes the income, if any, attributable to the unvested restricted stock awards and our Series B Cumulative Convertible Participating Preferred Stock (Convertible Preferred Stock, and shares thereof, Preferred Shares) from the numerator and excludes the dilutive impact of those shares from the denominator. There was no income amount attributable to unvested restricted stock or Preferred Shares for the three and six month periods ended May 1, 2011 and May 2, 2010 as the restricted stock and Preferred Shares do not

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share in the net losses. However, in periods of net income, a portion of this income will be allocable to the restricted stock and Preferred Shares. As of both May 1, 2011 and October 31, 2010, the Preferred Shares were convertible into 44.3 million shares of Common Stock.

For both the three and six month periods ended May 1, 2011 and May 2, 2010, all options and unvested restricted shares were anti-dilutive and, therefore, not included in the diluted loss per share calculation.

NOTE 8 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(TM), 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(TM) 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 deferred warranty revenue over the warranty coverage period in a manner that matches our estimated expenses relating to the warranty. Additionally, we maintain an accrued warranty at Robertson-Ceco II Corporation (RCC) in which the balance was \$3.1 million at both May 1, 2011 and October 31, 2010, respectively. RCC's accrued warranty programs have similar terms and characteristics to our other warranty programs.

The following table represents the rollforward of our acquired accrued warranty obligation and deferred warranty revenue activity for each of the fiscal six months ended (in thousands):

	Fiscal Six Months Ended	
	May 1, 2011	May 2, 2010
Beginning balance	\$ 16,977	\$ 16,116
Warranties sold	1,411	1,248
Revenue recognized	(769)	(671)
Costs incurred		(309)
Other	(302)	(62)
Ending balance	\$ 17,317	\$ 16,322

NOTE 9 LONG-TERM DEBT AND NOTE PAYABLE

Debt is comprised of the following (in thousands):

	May 1, 2011	October 31, 2010
Amended Credit Agreement (due April 2014, interest at 8.0%)	\$ 132,555	\$ 136,305
Asset-Based Lending Facility (due April 2014, interest at 4.75%)	2	
	132,557	136,305
Current portion of long-term debt		
Total long-term debt, less current portion	\$ 132,557	\$ 136,305

Amended Credit Agreement

On October 20, 2009, we entered into the Amended Credit Agreement (the "Amended Credit Agreement"), pursuant to which we repaid \$143.3 million of the \$293.3 million in principal amount of term loans outstanding under such credit agreement and modified the terms and maturity of the remaining \$150.0 million balance. The terms of the term loan require quarterly principal payments in an amount equal to 0.25% of the principal amount of the term loan then outstanding as of the last day of each calendar quarter and a final payment of approximately \$136.3 million at maturity on April 20, 2014. We made a mandatory prepayment on the Amended Credit Agreement in May 2010 in connection with our tax refund resulting from the carry back of the 2009 net operating loss. In March 2011 and December 2010, we made optional prepayments in the amount of \$1.0 million and \$2.8 million, respectively. These prepayments are allowed to be applied against the remaining required quarterly principal payments, and as a result, we are not required to make any additional quarterly principal payments for the remaining term of the term loan. The Company's obligations under the Amended Credit Agreement and any interest rate protection agreements or other permitted hedging agreement entered into with any lender under the Amended Credit Agreement are irrevocably and unconditionally guaranteed

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on a joint and several basis by each direct and indirect domestic subsidiary of the Company (other than any domestic subsidiary that is a foreign subsidiary holding company or a subsidiary of a foreign subsidiary).

The obligations under the Amended Credit Agreement and under any permitted hedging agreement and the guarantees thereof are secured by (i) all of the capital stock and other equity interests of all direct domestic subsidiaries owned by the Company and the guarantors, (ii) up to 65% of the capital stock of certain direct foreign subsidiaries of the Company or any guarantor (it being understood that a foreign subsidiary holding company or a domestic subsidiary of a foreign subsidiary is considered a foreign subsidiary for these purposes) and (iii) substantially all other tangible and intangible assets owned by the Company and each guarantor, including liens on material real property, in each case to the extent permitted by applicable law and subject to certain enumerated exceptions. The liens securing the obligations under the Amended Credit Agreement, the permitted hedging agreements and the guarantees thereof are first in priority (as between the Amended Credit Agreement and the Asset-Based Lending Facility (the ABL Facility)) with respect to stock, material real property and assets other than accounts receivable, inventory, certain deposit accounts, associated intangibles and certain other specified assets of the Company and the guarantors. Such liens are second in priority (as between the Amended Credit Agreement and the ABL Facility) with respect to accounts receivable, inventory, associated intangibles and certain other specified assets of the Company and the guarantors.

The Amended Credit Agreement contains a number of covenants that, among other things, limit or restrict our ability to dispose of assets, incur additional indebtedness, incur guarantee obligations, prepay other indebtedness, make dividends and other restricted payments, create liens, make investments, make acquisitions, engage in mergers, change the nature of our business and engage in certain transactions with affiliates.

The Amended Credit Agreement has no financial covenants until October 30, 2011 (subject to prepayment deferrals as noted below), at which time our consolidated leverage ratio of net indebtedness to EBITDA must be no more than 5 to 1. Net indebtedness is defined as consolidated debt less the lesser of unrestricted cash or \$50 million. This ratio steps down by 0.25 each quarter until October 28, 2012 at which time the maximum ratio is 4 to 1. The ratio continues to step down by 0.125 each quarter until November 3, 2013 to a ratio of 3.5 to 1, which remains the maximum ratio for each fiscal quarter thereafter. We will, however, not be subject to this financial covenant with respect to a specified period if certain prepayments or repurchases of the term loans under the Amended Credit Agreement are made prior to the specified period. Based on our prepayments made through May 1, 2011, including the mandatory prepayment in connection with our tax refund, the leverage ratio covenant has been effectively deferred until the third quarter of fiscal 2012. We intend to continue to make voluntary prepayments totaling approximately \$1.0 million sufficient to defer the leverage ratio until at least the fourth quarter of fiscal 2012. At May 1, 2011 and October 31, 2010, our Amended Credit Agreement did not require any financial covenant compliance.

Term loans under the Amended Credit Agreement may be repaid at any time, without premium or penalty but subject to customary LIBOR breakage costs. We also have the ability to repurchase a portion of the term loans under the Amended Credit Agreement, subject to certain terms and conditions set forth in the Amended Credit Agreement. In addition, the Amended Credit Agreement requires mandatory prepayment and reduction in an amount equal to:

the net cash proceeds of (1) certain asset sales, (2) certain debt offerings and (3) certain insurance recovery and condemnation events; and

50% of annual excess cash flow (as defined in the Amended Credit Agreement) for any fiscal year ending on or after October 31, 2010, unless a specified leverage ratio target is met.

The Amended Credit Agreement limited our ability to pay cash dividends on or prior to October 31, 2010 after which time we are permitted to pay dividends in an amount not to exceed the available amount (as defined in the Amended Credit Agreement). The available amount is defined as the sum of 50% of the cumulative consolidated net income from August 2, 2009 to the end of the most recent fiscal quarter, plus net proceeds of property or assets received as capital contributions, less the sum of all dividends, payments or other distributions of such available amounts, in each case subject to certain adjustments and exceptions as specified in the Amended Credit Agreement. In the absence of accumulated earnings, cash dividends and other cash restricted payments are limited to \$14.5 million in the aggregate during the term of the loan of which we used \$11.0 million as of May 1, 2011.

The term loan under the Amended Credit Agreement bears interest, at our option, at either LIBOR or Base Rate plus an applicable margin. We have selected LIBOR interest rates during which the applicable margin is 6%. Overdue amounts will bear interest at a rate that is 2% higher than the rate otherwise applicable. Base Rate is defined as the highest of (i) the Wells Fargo Bank, National Association prime rate, (ii) the overnight Federal Funds rate plus 0.5%, and (iii) 3%. LIBOR is defined as the applicable London

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interbank offered rate (not to be less than 2%) adjusted for reserves. The applicable margin until October 30, 2011 will be 5.00% on Base Rate loans and 6.00% on LIBOR loans under the Amended Credit Agreement.

ABL Facility

On October 20, 2009, the subsidiaries of the Company, NCI Group, Inc. and RCC and the Company entered into the ABL Facility pursuant to a loan and security agreement that provided for a \$125.0 million asset-based loan facility. The ABL Facility allows us an aggregate maximum borrowing of up to \$125.0 million. Borrowing availability under the ABL Facility is determined by a monthly borrowing base collateral calculation that is based on specified percentages of the value of qualified cash, eligible inventory and eligible accounts receivable, less certain reserves and subject to certain other adjustments. At May 1, 2011 and October 31, 2010, our excess availability under the ABL Facility was \$83.0 million and \$73.8 million, respectively. The ABL Facility has a maturity of April 20, 2014 and includes borrowing capacity of up to \$25 million for letters of credit and up to \$10 million for swingline borrowings. Under the ABL Facility, there were no amounts of borrowings outstanding at both May 1, 2011 and October 31, 2010. In addition, at both May 1, 2011 and October 31, 2010, standby letters of credit totaling approximately \$8.1 million were issued under the ABL Facility.

On December 3, 2010, we finalized an amendment of our ABL Facility that reduces the unused commitment fee from 1% or 0.75% based on the average daily balance of loans and letters of credit obligations outstanding to an annual rate of 0.5%. The calculation is determined on the amount by which the maximum credit exceeds the average daily principal balance of outstanding loans and letter of credit obligations. Additional customary fees in connection with the ABL Facility also apply. In addition, the amendment reduced the effective interest rate on borrowings, if any, by nearly 40% or 175 basis points. It also relaxes the prohibitions against making restricted payments or paying cash dividends, including on the Convertible Preferred Stock, to allow, in the aggregate, up to \$6.5 million of restricted payments or cash dividends each calendar quarter, provided certain excess availability conditions or certain other excess availability conditions and a fixed charge coverage ratio under the ABL Facility are satisfied.

The obligations of the borrowers under the ABL Facility are guaranteed by us and each direct and indirect domestic subsidiary of the Company (other than any domestic subsidiary that is a foreign subsidiary holding company or a subsidiary of a foreign subsidiary) that is not a borrower under the ABL Facility. Our obligations under certain specified bank products agreements are guaranteed by each borrower and each other direct and indirect domestic subsidiary of the Company and the other guarantors. These guarantees are made pursuant to a guarantee agreement, dated as of October 20, 2009, entered into by the Company and each other guarantor with Wells Fargo Foothill, LLC, as administrative agent.

The obligations under the ABL Facility and the guarantees thereof are secured by a first priority lien on our accounts receivable, inventory, certain deposit accounts, associated intangibles and certain other specified assets of the Company and a second priority lien on the assets securing the term loans under the Amended Credit Agreement on a first-lien basis, in each case subject to certain exceptions.

The ABL Facility contains a number of covenants that, among other things, limit or restrict our ability to dispose of assets, incur additional indebtedness, incur guarantee obligations, engage in sale and leaseback transactions, prepay other indebtedness, modify organizational documents and certain other agreements, create restrictions affecting subsidiaries, make dividends and other restricted payments, create liens, make investments, make acquisitions, engage in mergers, change the nature of our business and engage in certain transactions with affiliates.

Under the ABL Facility, a *Dominion Event* occurs if either an event of default is continuing or excess availability falls below certain levels, during which period, and for certain periods thereafter, the administrative agent may apply all amounts in the Company's, the borrowers' and the other guarantors' concentration accounts to the repayment of the loans outstanding under the ABL Facility, subject to the Intercreditor Agreement. In addition, during such *Dominion Event*, we are required to make mandatory payments on our ABL Facility upon the occurrence of certain events, including the sale of assets and the issuance of debt, in each case subject to certain limitations and conditions set forth in the ABL Facility.

The ABL Facility includes a minimum fixed charge coverage ratio of one to one, which will apply if we fail to maintain at least \$15 million of minimum borrowing capacity.

Loans under the ABL Facility bear interest, at our option, as follows:

(1) Base Rate loans at the Base Rate plus a margin. The margin ranges from 1.50% to 2.00% depending on the quarterly average excess availability under such facility, and

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(2) LIBOR loans at LIBOR plus a margin. The margin ranges from 2.50% to 3.00% depending on the quarterly average excess availability under such facility.

During an event of default, loans under the ABL Facility will bear interest at a rate that is 2% higher than the rate otherwise applicable. Base Rate is defined as the higher of the Wells Fargo Bank, N.A. prime rate and the overnight Federal Funds rate plus 0.5% and LIBOR is defined as the applicable London interbank offered rate adjusted for reserves.

Deferred Financing Costs

At May 1, 2011 and October 31, 2010, the unamortized balance in deferred financing costs was \$13.9 million and \$16.2 million, respectively.

Insurance Note Payable

The note payable is related to financed insurance premiums. As of May 1, 2011 and October 31, 2010, we had outstanding a note payable in the amount of \$1.2 million and \$0.3 million, respectively. Insurance premium financings are generally secured by the unearned premiums under such policies.

NOTE 10 SERIES B CUMULATIVE CONVERTIBLE PARTICIPATING PREFERRED STOCK**The CD&R Equity Investment**

On August 14, 2009, the Company entered into an Investment Agreement (as amended, the Investment Agreement), by and between the Company and Clayton, Dubilier & Rice Fund VIII, L.P. (CD&R Fund VIII), pursuant to which the Company agreed to issue and sell to CD&R Fund VIII, and CD&R Fund VIII agreed to purchase from the Company, for an aggregate purchase price of \$250 million (less reimbursement to CD&R Fund VIII or direct payment to its service providers of up to \$14.5 million in the aggregate of transaction expenses and a deal fee, paid to Clayton, Dubilier & Rice, Inc., the manager of CD&R Fund VIII, of \$8.25 million), 250,000 shares of Convertible Preferred Stock. Pursuant to the Investment Agreement, on October 20, 2009 (the Closing Date), the Company issued and sold to CD&R Fund VIII and CD&R Friends & Family Fund VIII, L.P. (the CD&R Funds), and the CD&R Funds purchased from the Company, an aggregate of 250,000 Preferred Shares, representing approximately 39.2 million shares of Common Stock or 68.4% of the voting power and Common Stock of the Company on an as-converted basis as of the Closing Date (such purchase and sale, the CD&R Equity Investment). At May 1, 2011, the CD&R Funds own 69.0% of the voting power and Common Stock of the Company on an as-converted basis.

Certain Terms of the Convertible Preferred Stock

In connection with the consummation of the CD&R Equity Investment, on October 19, 2009 we filed the Certificate of Designations of the Convertible Preferred Stock (the Certificate of Designations), setting forth the terms, rights, powers, and preferences, and the qualifications, limitations and restrictions thereof, of the Convertible Preferred Stock.

Liquidation Value. Each Preferred Share has an initial liquidation preference of \$1,000.

Rank. The Convertible Preferred Stock ranks senior as to dividend rights, redemption payments and rights upon liquidation to the Common Stock and each other class or series of our equity securities, whether currently issued or to be issued in the future, that by its terms ranks junior to the Convertible Preferred Stock, and junior to each class or series of equity securities of the Company, whether currently issued or issued in the future, that by its terms ranks senior to the Convertible Preferred Stock. We have no outstanding securities ranking senior to the Convertible Preferred Stock. Pursuant to the Certificate of Designations, the issuance of any senior securities of the Company requires the approval of the holders of the Convertible Preferred Stock.

Dividends. Dividends on the Convertible Preferred Stock are payable, on a cumulative daily basis, as and if declared by the board of directors, at a rate per annum of 12% of the sum of the liquidation preference of \$1,000 per Preferred Share plus accrued and unpaid dividends thereon or at a rate per annum of 8% of the sum of the liquidation preference of \$1,000 per Preferred Share plus any accrued and unpaid dividends thereon if paid in cash on the dividend payment date on which such dividends would otherwise compound. If dividends are not paid on the dividend payment date, either in cash or in kind, such dividends compound on the dividend payment date. Members of the board of directors who are not affiliated with the CD&R Funds have the right to choose whether such dividends are paid in cash or in-kind, subject to the conditions of the Amended Credit Agreement and ABL Facility which restricts the Company's ability to pay cash dividends until the first quarter of fiscal 2011 under the Amended Credit Agreement and until

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20, 2010 under the ABL Facility. In addition, the Company's Amended Credit Agreement currently restricts the payment of cash dividends to 50% of cumulative earnings beginning with the fourth quarter of 2009, and in the absence of accumulated earnings, cash dividends and other cash restricted payments are limited to \$14.5 million in the aggregate during the term of the loan of which we used \$11.0 million as of May 1, 2011. The Company's ABL Facility, among other potentially available baskets, permits the Company to pay cash dividends, including on the Convertible Preferred Stock, up to \$6.5 million each calendar quarter, provided certain excess availability conditions or certain other excess availability conditions and a fixed charge coverage ratio under the ABL Facility are satisfied. If, at any time after the 30-month anniversary of the Closing Date of October 20, 2009, the trading price of the Common Stock exceeds 200% of the initial conversion price of the Convertible Preferred Stock (\$6.3740, as adjusted for any stock dividends, splits, combinations or similar events) for each of 20 consecutive trading days (the Dividend Rate Reduction Event), the dividend rate (excluding any applicable adjustments as a result of a default) will become 0.00%. However, this does not preclude the payment of default dividends after the 30-month anniversary of the Closing Date. As a result of certain restrictions on dividend payments in the Company's Amended Credit Agreement and ABL Facility, the dividends for each quarter of fiscal 2010 were paid in-kind, at a pro rata rate of 12% per annum. See Note 9 Long-term Debt for more information on our Amended Credit Agreement and ABL Facility.

At any time prior to the Dividend Rate Reduction Event, if dividends are not declared in cash on the applicable dividend declaration date, the rate at which such dividends are payable will be at least 12% per annum. Prior to the vote of the Dividend Payment Committee, the Company is obligated to the 12% dividend rate. Therefore, the Company accrues dividends daily based on the 12% rate and if and when the Company determines the dividends will be paid in cash on the applicable dividend declaration date, the Company will record a subsequent benefit of the excess 4% accrual upon the board's declaration of such cash dividend and reverse the beneficial conversion feature charge associated with such accrual.

The dividend rate will increase by up to 6% per annum above the rates described in the preceding paragraph upon and during certain defaults specified in the Certificate of Designations involving the Company's failure to have a number of authorized and unissued shares of Common Stock reserved and available sufficient for the conversion of all outstanding Preferred Shares. The Company currently has sufficient authorized, unissued and reserved shares of Common Stock.

On the Dividend Payment Committee date, the Company has the right to choose whether dividends are paid in cash or in-kind. However, the first dividend payment which was scheduled to be paid on December 15, 2009 in the amount of \$4.6 million, was required to be paid in cash by the Certificate of Designations but could not be paid in cash based on the terms of our Amended Credit Agreement and ABL Facility which restricted the Company's ability to pay cash dividends until the first quarter of fiscal 2011 and until October 20, 2010, respectively. As a result, the dividend for the period up to the December 15, 2009 dividend payment date compounded at a rate of 12% per annum. We currently can not pay this dividend in cash because the Company's Amended Credit Agreement currently restricts the payment of cash dividends to 50% of cumulative earnings beginning with the fourth quarter of 2009, and in the absence of accumulated earnings, cash dividends and other cash restricted payments are limited to \$14.5 million in the aggregate during the term of the loan of which we used \$11.0 million as of May 1, 2011.

In addition to any dividends declared and paid as described in the preceding paragraphs, holders of the outstanding Preferred Shares also have the right to participate equally and ratably, on an as-converted basis, with the holders of shares of Common Stock in all cash dividends and distributions paid on the Common Stock.

On March 15, 2011, the Dividend Payment Committee of the board of directors declared and paid to the holders of Convertible Preferred Stock, the CD&R Funds, a \$5.5 million cash dividend at a pro rata rate of 8% per annum. As a result of paying an 8% cash dividend, we recorded a dividend accrual reversal of \$2.7 million in the second quarter of fiscal 2011 related to dividends accrued in excess of 8% between December 16, 2010 and March 15, 2011. In addition, we reversed the related beneficial conversion feature previously recorded of \$8.2 million in the second quarter of fiscal 2011 related to the paid-in-kind dividends accrued between December 16, 2010 and March 15, 2011. Similarly, on December 15, 2010, the Dividend Payment Committee of the board of directors declared and paid to the holders of Convertible Preferred Stock, the CD&R Funds, a \$5.55 million cash dividend at a pro rata rate of 8% per annum. As a result of paying an 8% cash dividend, we recorded a dividend accrual reversal of \$2.5 million in the first

quarter of fiscal 2011 related to dividends accrued in excess of 8% between September 16, 2010 and December 15, 2010. In addition, we reversed the related beneficial conversion feature previously recorded of \$5.1 million in the first quarter of fiscal 2011 related to the paid-in-kind dividends accrued between September 16, 2010 and December 15, 2010.

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Convertibility and Anti-Dilution Adjustments. To the extent that we have authorized but unissued shares of Common Stock, holders of Preferred Shares have the right, at any time and from time to time, at their option, to convert any or all of their Preferred Shares, in whole or in part, into fully paid and non-assessable shares of the Company's Common Stock at the conversion price set forth in the Certificate of Designations. The number of shares of Common Stock into which a Preferred Share is convertible is determined by dividing the sum of the liquidation preference of \$1,000 per Preferred Share and the accrued and unpaid dividends of such share as of the time of conversion by the conversion price in effect at the time of conversion.

The initial conversion price of the Convertible Preferred Stock was equal to \$6.3740 as of May 1, 2011, as adjusted for the Reverse Stock Split. The conversion price is subject to adjustment as set forth in the Certificate of Designations and is subject to customary anti-dilution adjustments, including stock dividends, splits, combinations or similar events and issuance of our Common Stock at a price below the then-current market price and, within the first three years after the Closing Date, issuances of our Common Stock below the then applicable conversion price.

Milestone Redemption Right. The Company has the right, at any time on or after the tenth anniversary of the Closing Date, to redeem in whole, but not in part, all then-issued and outstanding shares of Convertible Preferred Stock in accordance with the procedures set forth in the Certificate of Designations. Any holder of Convertible Preferred Stock has the right, at any time on or after the tenth anniversary of the Closing Date, to require that the Company redeem all, but not less than all, of its shares of Convertible Preferred Stock in accordance with the procedures set forth in the Certificate of Designations. In each case, such right (the Milestone Redemption Right), is exercisable at a redemption price for each Preferred Share equal to the sum of the liquidation preference of \$1,000 per Preferred Share and the accrued and unpaid dividends of such share as of the time of redemption.

Change of Control Redemption Right. Upon certain change of control events specified in the Certificate of Designations, including certain business combinations involving the Company and certain changes to the beneficial ownership of the voting power of the Company, so long as the CD&R Funds do not own 45% or more of the voting power of the Company and directors designated by the CD&R Funds are not entitled to cast a majority of the total number of votes that can be cast by the Company's board of directors or by the directors constituting the quorum approving or recommending such change of control event, holders of Preferred Shares are able to require redemption by the Company, in whole but not in part, of the Convertible Preferred Stock (1) if redeemed after the fourth anniversary of the Closing Date, at a purchase price equal to the sum of the liquidation value of such Preferred Shares and the accrued and unpaid dividends thereon as of the redemption date or (2) if redeemed prior to the fourth anniversary of the Closing Date, at a purchase price equal to the sum of (a) the liquidation value of such Preferred Shares plus the accrued and unpaid dividends thereon as of the redemption date and (b) a make-whole premium equal to the net present value of the sum of all dividends that would otherwise be payable on and after the redemption date, to and including such fourth anniversary date, assuming that such dividends are paid in cash. In addition, upon change of control events pursuant to the Amended Credit Agreement or the ABL Facility, holders of Preferred Shares are able to require redemption by the Company, in whole but not in part, of the Convertible Preferred Stock, at a purchase price equal to 101% of the sum of the liquidation value of such Preferred Shares and the accrued and unpaid dividends thereon as of the redemption date.

In the event of a merger or other business combination resulting in a change of control in which the holders of shares of our Common Stock receive cash or securities of an unaffiliated entity as consideration for such shares, if the holder of Preferred Shares does not exercise the change of control redemption right described in the paragraph above or is not entitled to the change of control redemption right in connection with such event, such holder will be entitled to receive, pursuant to such merger or business combination, the consideration such holder would have received for its Preferred Shares had it converted such shares immediately prior to the merger or business combination transaction. In the event of a merger or other business combination not resulting in a change of control in which the holders of shares of our Common Stock receive cash or securities of an unaffiliated entity as consideration for such shares, holders of Convertible Preferred Stock shall have the option to exchange their Preferred Shares for shares of the surviving entity's capital stock having terms, preferences, rights, privileges and powers no less favorable than the terms, preferences, rights, privileges and powers under the Certificate of Designations.

Vote. Holders of Preferred Shares generally are entitled to vote with the holders of the shares of our Common Stock on all matters submitted for a vote of holders of shares of the Company's Common Stock (voting together with the holders of shares of our Common Stock as one class) and are entitled to a number of votes equal to the number of shares of Common Stock issuable upon conversion of such holder's Preferred Shares (without any limitations based on our authorized but unissued shares of the Company's Common Stock) as of the applicable record date for the determination of stockholders entitled to vote on such matters.

Certain matters require the approval of the holders of a majority of the outstanding Preferred Shares, voting as a separate class, including (1) amendments or modifications to the Company's Certificate of Incorporation, by-laws or the Certificate of Designations,

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that would adversely affect the terms or the powers, preferences, rights or privileges of the Convertible Preferred Stock, (2) authorization, creation, increase in the authorized amount of, or issuance of any class or series of senior securities or any security convertible into, or exchangeable or exercisable for, shares of senior securities and (3) any increase or decrease in the authorized number of Preferred Shares or the issuance of additional Preferred Shares. In addition, in the event that the Company fails to fulfill its obligations to redeem the Convertible Preferred Stock in accordance with the terms of the Certificate of Designations following the exercise of the Milestone Redemption Right or change of control redemption rights described above, until such failure is remedied, certain additional actions of the Company shall require the approval of the holders of a majority of the outstanding Preferred Shares, voting as a separate class, including the adoption of an annual budget, the hiring and firing, or the changing of the compensation, of executive officers and the commitment, resolution or agreement to effect any business combination.

Restriction on Dividends on Junior Securities. The Company is prohibited from (i) paying any dividend with respect to our Common Stock or other junior securities, except for ordinary cash dividends in which the Convertible Preferred Stock participates and which are declared, paid or set aside after the base dividend rate for the Convertible Preferred Stock has been reduced to 0.00% as described above and dividends payable solely in shares of our Common Stock or other junior securities, or (ii) repurchasing or redeeming any shares of our Common Stock or other junior securities, unless, in each case, we have sufficient access to lawful funds immediately following such action such that we would be legally permitted to redeem in full all Preferred Shares then outstanding.

Accounting for Convertible Preferred Stock

The Convertible Preferred Shares balance and changes in the carrying amount of the Convertible Preferred Stock are as follows (in thousands):

	Dividends and Accretion	Convertible Preferred Stock
Balance as of October 31, 2010		\$ 256,870
Accretion	680	
Accrued paid-in-kind dividends(1)	8,051	
Reversal of additional 4% accrued dividends(2)	(2,501)	
Subtotal		6,230
Payment of cash dividend(3)		(5,550)
Balance as of January 30, 2011		257,550
Accretion	680	
Accrued paid-in-kind dividends(1)	8,325	
Reversal of additional 4% accrued dividends(4)	(2,745)	
Subtotal		6,260
Payment of cash dividend(5)		(5,489)
Balance as of May 1, 2011		\$ 258,321

(1) Dividends are accrued at the 12% rate on a daily basis until the dividend declaration date.

(2) The reversal of the additional 4% accrued dividends relates to the period from September 16, 2010 to December 15, 2010.

(3)

The payment of the December 15, 2010 cash dividend relates to the period from September 16, 2010 to December 15, 2010.

- (4) The reversal of the additional 4% accrued dividends relates to the period from December 16, 2010 to March 15, 2011.
- (5) The payment of the March 15, 2011 cash dividend relates to the period from December 16, 2010 to March 15, 2011.

In accordance with ASC Topic 815, *Derivatives and Hedging*, and ASC Topic 480, *Distinguishing Liabilities from Equity*, we classified the Convertible Preferred Stock as mezzanine equity because the Convertible Preferred Stock (1) can be settled in cash or shares of our Common Stock, (2) contains change of control rights allowing for early redemption, and (3) contains Milestone Redemption Rights which allow the Convertible Preferred Stock to remain outstanding without a stated maturity date.

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In addition, the Certificate of Designations, which is the underlying contract of the Convertible Preferred Stock, includes features that are required to be bifurcated and recorded at fair value. We classified the Convertible Preferred Stock as an equity host contract because of (1) the voting rights, (2) the participating dividends on Common Stock and mandatory, cumulative preferred stock dividends, and (3) the Milestone Redemption Right which allows the Convertible Preferred Stock to remain outstanding without a stated maturity date. We then determined that the conditions resulting in the application of the default dividend rate are not clearly and closely related to this equity host contract and we bifurcated and separately recorded these features at fair value. See Note 12-Derivative Instruments and Hedging Strategy.

Because the dividends accrue and accumulate on a daily basis and the amount payable upon redemption of the Convertible Preferred Stock is the liquidation preference plus accrued and unpaid dividends, accrued dividends are recorded into Convertible Preferred Stock.

In accordance with ASC Subtopic 470-20, *Debt with Conversion and Other Options*, the Convertible Preferred Stock contains a beneficial conversion feature because it was issued with an initial conversion price of \$6.3740 (as adjusted for the Reverse Stock Split) and the closing stock price per share of Common Stock just prior to the execution of the CD&R Equity Investment was \$12.55 (as adjusted for the Reverse Stock Split). The intrinsic value of the beneficial conversion feature cannot exceed the issuance proceeds of the Convertible Preferred Stock less the cash paid for the deal fee paid to the CD&R Funds manager in connection with the CD&R Equity Investment, and thus was \$241.4 million as of October 20, 2009. At both May 1, 2011 and October 31, 2010, all of the potentially 44.3 million shares of Common Stock issuable upon conversion of the Preferred Shares, which includes paid-in-kind dividends, were authorized and unissued.

As of both May 1, 2011 and October 31, 2010, the Preferred Shares were convertible into 44.3 million shares of Common Stock at an initial conversion price of (\$6.3740 as adjusted for the Reverse Stock Split). On March 5, 2010, the Company effected the Reverse Stock Split in which every five shares of Common Stock, that were issued and outstanding were automatically combined into one issued and outstanding share of Common Stock. As a result of the Reverse Stock Split on March 5, 2010, we recorded a beneficial conversion feature charge in the amount of \$230.7 million in the second quarter of fiscal 2010 related to the availability of shares of Common Stock into which the CD&R Funds may convert their Preferred Shares. In addition, we recorded an \$8.0 million and \$10.6 million beneficial conversion feature charge, prior to any applicable reversal, in the three month periods ended May 1, 2011 and May 2, 2010, respectively, and \$14.9 million and \$10.8 million beneficial conversion feature charge, prior to any applicable reversal, in the six month periods ended May 1, 2011 and May 2, 2010, respectively, related to dividends that have accrued and are convertible into shares of Common Stock. In addition, we expect to recognize additional beneficial conversion feature charges on paid-in-kind dividends to the extent that the Preferred Shares are accrued. Our policy is to recognize beneficial conversion feature charges on paid-in-kind dividends based on a daily dividend recognition and the daily closing stock price of our Common Stock.

At any time prior to the Dividend Rate Reduction Event, if dividends are not paid in cash on the applicable dividend payment date, the rate at which such dividends are payable will be at least 12% per annum. Therefore, we accrue dividends daily based on the 12% rate and if and when we determine the dividends will be paid in cash on the applicable dividend payment date, we will record a subsequent benefit of the excess 4% accrual upon our board's declaration of such cash dividend and reverse the beneficial conversion feature charge associated with such accrual. However, we currently cannot pay dividends in cash because the Company's Amended Credit Agreement currently restricts the payment of cash dividends to 50% of cumulative earnings beginning with the fourth quarter of 2009, and in the absence of accumulated earnings, cash dividends and other cash restricted payments are limited to \$14.5 million in the aggregate during the term of the loan of which we used \$11.0 million as of May 1, 2011.

As a result of paying an 8% cash dividend on March 15, 2011, we recorded a dividend accrual reversal of \$2.7 million in the second quarter of fiscal 2011 related to dividends accrued in excess of 8% between December 16, 2010 and March 15, 2011. In addition, we reversed the related beneficial conversion feature previously recorded of \$8.2 million in the second quarter of fiscal 2011 related to the paid-in-kind dividends accrued between December 16, 2010 and March 15, 2011. As a result of paying an 8% cash dividend on December 15, 2010, we recorded a dividend accrual reversal of \$2.5 million in the first quarter of fiscal 2011 related to dividends accrued in excess of 8% between

September 16, 2010 and December 15, 2010. In addition, we reversed the related beneficial conversion feature previously recorded of \$5.1 million in the first quarter of fiscal 2011 related to the paid-in-kind dividends accrued between September 16, 2010 and December 15, 2010.

Our aggregate liquidation preference plus accrued dividends of the Convertible Preferred Stock at May 1, 2011 and October 31, 2010 are as follows (in thousands):

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	May 1, 2011	October 31, 2010
Liquidation preference	\$ 272,503	\$ 272,503
Accrued cash and Convertible Preferred Stock dividends	10,075	9,983
Total	\$ 282,578	\$ 282,486

At both May 1, 2011 and October 31, 2010, we had 272,503 Preferred Shares outstanding.

NOTE 11 REDEEMABLE COMMON STOCK

Under federal securities laws, shares of the Company's Common Stock purchased on behalf of participants in the Company's 401(k) Profit Sharing Plan (the Plan) are required to be registered with the SEC or sold in transactions that are exempt from registration under the Securities Act of 1933. On February 7, 2011, the Company discovered that it inadvertently issued more shares of the Company's Common Stock in connection with the Plan than had been registered with the SEC. As a result, certain participants in the Plan may bring claims against the Company for rescission or damages in respect of the unregistered shares for an amount equal to the purchase price for the shares (or if the shares have been disposed of, to receive damages with respect to any loss on such disposition) plus interest, less income, from the date of purchase, although the Company believes that such claims would be time barred. Moreover, even if such claims were allowed, the Company believes that the statute of limitations applicable to any such claims would be one year under the federal securities laws, and that the statute of limitations with respect to the inadvertent issuances that occurred prior to May 2, 2010 has expired. Accordingly, at May 1, 2011, approximately 0.2 million shares (\$1.8 million) of the Company's Common Stock were classified outside stockholders' equity as redeemable common stock because of the potential rescission rights. The potential damage claims with respect to unregistered Company Common Stock were related to purchases made under the Plan between May 2, 2010 and February 15, 2011. The redeemable common stock will be reclassified into permanent equity upon the expiration of the potential rescission rights associated with those common shares. We may also be subject to civil and other penalties by regulatory authorities as a result of the failure to register. We believe that the potential negative impact on our consolidated statement of operations will not be material.

NOTE 12 DERIVATIVE INSTRUMENTS AND HEDGING STRATEGY***Foreign Currency Risk***

We are exposed to foreign currency risk associated with fluctuations in the foreign currency exchange rates on certain purchase orders denominated in a foreign currency related to the purchase of certain equipment. On March 17, 2011, we entered into a three month forward contract to pay \$1.1 million and receive 0.8 million on June 15, 2011, and on March 18, 2011, we entered into a five month forward contract to pay \$1.5 million and receive 1.0 million on August 15, 2011 (Foreign Currency Contract). We designated the Foreign Currency Contract as a cash flow hedge. The fair value of the Foreign Currency Contract as of May 1, 2011 was an asset of \$0.1 million and is included in prepaid expenses and other in the Consolidated Balance Sheet. The fair value of the Foreign Currency Contract takes into consideration the current creditworthiness of us or the counterparty, as applicable. Accumulated other comprehensive income will amortize over the life of the equipment purchased.

Interest Rate Risk

We are exposed to interest rate risk associated with fluctuations in the interest rates on our variable interest rate debt. We previously managed this risk by entering into a forward interest rate swap agreement (Swap Agreement) hedging a portion of our then \$400 million Credit Agreement. The Swap Agreement expired on June 17, 2010 and, therefore, there was no remaining notional amount outstanding on May 1, 2011 and October 31, 2010. At inception, we designated the Swap Agreement as a cash flow hedge. The fair value of the Swap Agreement excludes accrued interest and takes into consideration current interest rates and current creditworthiness of us or the counterparty, as applicable.

During the fourth quarter of fiscal 2009, in connection with our refinancing and Amended Credit Agreement, we modified the terms of our credit agreement to include a 2% LIBOR minimum market interest rate. At that time, based

on the current expected LIBOR rates over the remaining term of the Swap Agreement, the forecasted market rate interest payments had effectively converted to fixed rate interest payments making the Swap Agreement both ineffective and the underlying hedged cash flow no longer probable. Therefore, all subsequent changes in fair market value were recorded directly to earnings. During the three and six month periods ended May 2, 2010, we reduced interest expense by \$0.8 million and \$1.8 million, respectively, as a result of the changes in fair value of the hedge.

Table of Contents***Embedded Derivative Bifurcated From Convertible Preferred Stock (See Note 10)***

The terms of the Convertible Preferred Stock include a default dividend rate of 3% per annum if we fail to (1) pay holders of Convertible Preferred Stock, in cash on an as-converted basis, dividends paid on shares of our Common Stock; (2) following the date that there are no Convertible Notes outstanding, as defined in the Certificate of Designations, pay, in cash or in kind, any dividend (other than dividends payable pursuant to the preceding clause (1)) payable to holders of Preferred Shares pursuant to the Certificate of Designations, on the applicable quarterly dividend payment date; (3) after June 30, 2010, reserve and keep available for issuance the number of shares of our Common Stock equal to 110% of the number of shares of Common Stock issuable upon conversion of all outstanding shares of Convertible Preferred Stock; (4) maintain the listing of our Common Stock on the New York Stock Exchange or another U.S. national securities exchange; (5) comply with our obligations to convert the Convertible Preferred Stock in accordance with our obligations under the Certificate of Designations; (6) redeem the Convertible Preferred Stock in compliance with the Certificate of Designations; or (7) comply with any dividend payment restrictions with respect to junior securities dividends. If, at a time when a 3% per annum default dividend rate is in effect after June 30, 2011, we fail to reserve and keep available authorized common shares pursuant to the terms of the Certificate of Designations the default dividend rate shall increase to 6% until such default is no longer continuing. The default dividend represents an embedded derivative which is bifurcated from the CD&R Equity Investment host contract (i.e., the Certificate of Designations). See Note 10-Series B Cumulative Convertible Participating Preferred Stock for further discussion of the Convertible Preferred Stock.

To determine the Level 3 fair value of the embedded derivative, we used a probability-weighted discounted cash flow model and assigned probabilities for each qualified default event. We originally recorded the fair value of the embedded derivative in the amount of \$1.0 million at November 1, 2009 in other accrued liabilities on the Consolidated Balance Sheet. The majority of the value of the derivative was derived from the default dividend rate. On December 14, 2009, the CD&R Funds, our majority equity holders expressed their intention to vote in favor of the proposed Reverse Stock Split, which became effective on March 5, 2010. Based upon these events we reevaluated the assigned probabilities used previously in the probability-weighted discounted cash flow model. As a result, we recorded a \$0.9 million decrease in fair value of the embedded derivative during the six months ended May 2, 2010 which was recorded in other income and expense during the six month period.

At May 1, 2011 and October 31, 2010, the fair value carrying amount of our derivative instrument was recorded as follows (in thousands):

	Asset Derivatives		
	Balance Sheet	May 1,	October 31,
	Location	2011	2010
		Fair Value	Fair Value
Derivative designated as hedging instrument under ASC 815:			
	Prepaid expenses and other	\$ 121	\$
Foreign currency contract			

At May 1, 2011 and October 31, 2010, the fair value carrying amount of our derivative instruments were recorded as follows (in thousands):

	Liability Derivatives		
	Balance Sheet	May 1,	October 31,
	Location	2011	2010
		Fair Value	Fair Value
Derivative not designated as hedging instruments under ASC 815:			
	Other long-term liabilities	\$ 91	\$ 104
Embedded derivative			

The effect of derivative instruments on the Consolidated Statement of Operations for the three and six months ended May 1, 2011 and May 2, 2010 was as follows (in thousands):

Derivative in ASC 815 Cash	Amount of Gain Recognized in OCI on Derivative (Effective Portion) Fiscal Three Months Ended		Amount of Gain Recognized in OCI on Derivative (Effective Portion) Fiscal Six Months Ended	
	May 1, 2011	May 2, 2010	May 1, 2011	May 2, 2010
	Flow Hedging Relationship			
Foreign currency contract	\$ 75	\$	\$ 75	\$

The effect of derivative instruments not designated as hedging instruments on the Consolidated Statement of Operations for the three and six month periods ended May 1, 2011 and May 2, 2010 was as follows (in thousands):

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Derivatives Not Designated as Hedging Instruments Under ASC 815	Amount of Income Recognized in Income (Loss) on Derivatives		Amount of Income Recognized in Income (Loss) on Derivatives		Location of Income Recognized in Income (Loss) on Derivatives Interest expense Other income, net
	Fiscal Three Months Ended		Fiscal Six Months Ended		
	May 1, 2011	May 2, 2010	May 1, 2011	May 2, 2010	
Interest rate contract	\$	\$ 836	\$	\$ 1,787	
Embedded derivative	\$ 6	\$ 4	\$ 13	\$ 923	

The maximum length of time over which we are hedging our exposure to the variability of future cash flows related to fluctuations in the foreign currency exchange rates on certain purchase orders denominated in a foreign currency is through August 2011. Over the next 12 months, we expect to reclassify an immaterial amount of deferred gains from accumulated other comprehensive income to depreciation expense. We will recognize depreciation expense over the depreciable life of the fixed asset to which the purchase orders relate.

NOTE 13 FAIR VALUE OF FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS***Fair Value of Financial Instruments***

The carrying amounts of cash and cash equivalents, trade accounts receivable and accounts payable approximate fair value as of May 1, 2011 and October 31, 2010 because of the relatively short maturity of these instruments. The fair values of the remaining financial instruments not currently recognized at fair value on our consolidated balance sheets at the respective fiscal period ends were (in thousands):

	May 1, 2011		October 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Amended Credit Agreement	\$ 132,555	\$ 132,555	\$ 136,305	\$ 132,046

The fair value of the Amended Credit Agreement was based on recent trading activities of comparable market instruments.

Fair Value Measurements

ASC Subtopic 820-10, *Fair Value Measurements and Disclosures*, requires us to use valuation techniques to measure fair value that maximize the use of observable inputs and minimize the use of unobservable inputs. These inputs are prioritized as follows:

Level 1: Observable inputs such as quoted prices for identical assets or liabilities in active markets.

Level 2: Other inputs that are observable directly or indirectly, such as quoted prices for similar assets or liabilities or market-corroborated inputs.

Level 3: Unobservable inputs for which there is little or no market data and which require us to develop our own assumptions about how market participants would price the assets or liabilities.

The following is a description of the valuation methodologies used for assets and liabilities measured at fair value. There have been no changes in the methodologies used at May 1, 2011 and October 31, 2010.

Money market: Money market funds have original maturities of three months or less. The original cost of these assets approximates fair value due to their short-term maturity.

Mutual funds: Mutual funds are valued at the closing price reported in the active market in which the mutual fund is traded.

Assets held for sale: Assets held for sale are valued based on current market conditions, prices of similar assets in similar condition and expected proceeds from the sale of the assets.

Foreign currency contract: The fair value of the foreign currency derivative is based on a market approach and takes into consideration current foreign currency exchange rates and current creditworthiness of us or the counterparty, as applicable.

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Deferred compensation plan liability: Deferred compensation plan liability comprises of phantom investments in the deferred compensation plan and is valued at the closing price reported in the active market in which the money market, mutual fund or NCI stock phantom investments are traded.

Embedded derivative: The embedded derivative value is based on an income approach in which we used a probability-weighted discounted cash flow model and assigned probabilities for each qualified default event. The following table summarizes information regarding our financial assets and liabilities that are measured at fair value as of May 1, 2011 (in thousands):

	Level 1	Level 2	Level 3	Total
Assets:				
Short-term investments in deferred compensation plan(1):				
Money market	\$ 189	\$	\$	\$ 189
Mutual funds Growth	738			738
Mutual funds Blend	1,871			1,871
Mutual funds Foreign blend	819			819
Mutual funds Fixed income	573			573
Total short-term investments in deferred compensation plan	\$ 4,190	\$	\$	\$ 4,190
Foreign currency contract		121		121
Assets held for sale		6,133		6,133
Total assets	\$ 4,190	\$ 6,254	\$	\$ 10,444
Liabilities:				
Deferred compensation plan liability	\$ (4,478)	\$	\$	\$ (4,478)
Embedded derivative			(91)	(91)
Total liabilities	\$ (4,478)	\$	\$ (91)	\$ (4,569)

(1) Unrealized holding gains for both the three months ended May 1, 2011 and May 2, 2010 were \$0.2 million.

Unrealized holding gains for both the six months ended May 1, 2011 and May 2, 2010 were \$0.3 million. These unrealized holding gains are primarily offset by changes in the deferred compensation plan liability.

The following table summarizes the activity in Level 3 financial instruments during the six months ended May 1, 2011 and May 2, 2010 (in thousands):

	May 1, 2011	May 2, 2010
Beginning balance	\$ (104)	\$ (1,041)
Unrealized gains (1)	13	923
Ending balance	\$ (91)	\$ (118)

(1) Unrealized gains on the embedded derivative are recorded in other income, net in the Consolidated Statement of Operations during the six months ended May 1, 2011 and May 2, 2010.

NOTE 14 INCOME TAXES

The reconciliation of income tax computed at the statutory tax rate to the effective income tax rate is as follows:

	Fiscal Three Months Ended		Fiscal Six Months Ended	
	May 1, 2011	May 2, 2010	May 1, 2011	May 2, 2010
Statutory federal income tax rate	35.0%	35.0%	35.0%	35.0%
State income taxes	(1.9)%	3.4%	(1.9)%	3.4%
Canada valuation allowance	(0.5)%		(0.9)%	
Non-deductible expenses	(2.9)%	(2.5)%	(2.9)%	(2.5)%
Recognition of tax benefit previously deemed to be uncertain		7.8%		3.5%
Other	5.9%	(1.7)%	0.6%	(1.0)%
Effective tax rate	35.6%	42.0%	29.9%	38.4%

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The increase in our effective tax rate for the six months ended May 1, 2011 as compared to the prior year period was primarily due to a 5.3% decrease in the benefit related to state income taxes.

In assessing the realizability of deferred tax assets, we must consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. We consider all available evidence in determining whether a valuation allowance is required. Such evidence includes the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment, and judgment is required in considering the relative weight of negative and positive evidence. As of May 1, 2011, we expect to fully utilize the net U.S. deferred tax assets of \$13.1 million against future operating income. However, in the event our expectations of future operating results change, a valuation allowance may be required on our existing unreserved net U.S. deferred tax assets.

The total amount of unrecognized tax benefit at May 1, 2011 and October 31, 2010 was \$0.5 million and \$0.7 million, respectively, all of which would impact our effective tax rate if recognized. We do not anticipate any material change in the total amount of unrecognized tax benefits to occur within the next twelve months.

NOTE 15 COMPREHENSIVE LOSS

Comprehensive loss consists of the following (in thousands):

	Fiscal Three Months Ended		Fiscal Six Months Ended	
	May 1, 2011	May 2, 2010	May 1, 2011	May 2, 2010
Net loss	\$ (3,229)	\$ (7,656)	\$ (15,954)	\$ (18,142)
Foreign exchange translation gain (loss) and other, net of tax	5	(8)	(5)	189
Comprehensive loss	\$ (3,224)	\$ (7,664)	\$ (15,959)	\$ (17,953)

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

	May 1, 2011	May 2, 2010
Foreign exchange translation adjustments	\$ 507	\$ 580
Defined benefit pension plan actuarial losses	(2,524)	(9,250)
Foreign currency derivative	75	
Accumulated other comprehensive loss	\$ (1,942)	\$ (8,670)

A summary of the components of other comprehensive income (loss) and the related tax effects for each of the periods presented is as follows (in thousands):

	Fiscal Three Months Ended May 1, 2011			Fiscal Three Months Ended May 2, 2010		
	Before-Tax Amount	Tax (Expense) or Benefit	Net-of-Tax Amount	Before-Tax Amount	Tax (Expense) or Benefit	Net-of-Tax Amount
Foreign exchange translation loss and other	\$ (70)	\$	\$ (70)	\$ (12)	\$ 4	\$ (8)
Gain in fair value of foreign currency derivative	\$ 121	\$ (46)	\$ 75	\$	\$	\$

Other Comprehensive income (loss)	\$ 51	\$ (46)	\$ 5	\$ (12)	\$ 4	\$ (8)
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	Fiscal Six Months Ended May 1, 2011			Fiscal Six Months Ended May 2, 2010		
	Before-Tax Amount	Tax (Expense) or Benefit	Net-of-Tax Amount	Before-Tax Amount	Tax (Expense) or Benefit	Net-of-Tax Amount
Foreign exchange translation gain (loss) and other	\$ (80)	\$	\$ (80)	\$ 182	\$ 7	\$ 189
Gain in fair value of foreign currency derivative	\$ 121	\$ (46)	\$ 75	\$	\$	\$
Other Comprehensive income (loss)	\$ 41	\$ (46)	\$ (5)	\$ 182	\$ 7	\$ 189

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We have aggregated our operations into three reportable segments based upon similarities in product lines, manufacturing processes, marketing and management of our businesses: metal coil coating; metal components; and engineered building systems. All business segments operate primarily in the nonresidential construction market. Sales and earnings are influenced by general economic conditions, the level of nonresidential construction activity, metal roof repair and retrofit demand and the availability and terms of financing available for construction. Products of our business segments use similar basic raw materials. The metal coil coating segment consists of cleaning, treating, painting and slitting continuous steel coils before the steel is fabricated for use by construction and industrial users. The metal components segment products include metal roof and wall panels, doors, metal partitions, metal trim, insulated panels 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 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) 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; (ii) building components provided by the metal components segment to the engineered building systems segment; and (iii) structural framing provided by the engineered building systems segment to the metal components segment.

Corporate assets consist primarily of cash but also include deferred financing costs, deferred taxes 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. Unallocated expenses include interest income, interest expense and refinancing costs and other (expense) income.

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 Six Months Ended	
	May 1, 2011	May 2, 2010	May 1, 2011	May 2, 2010
Total sales:				
Metal coil coating	\$ 47,927	\$ 44,759	\$ 90,201	\$ 83,790
Metal components	103,375	95,069	193,680	181,875
Engineered building systems	129,790	113,403	231,202	215,341
Intersegment sales	(55,527)	(51,658)	(99,432)	(97,226)
Total sales	\$ 225,565	\$ 201,573	\$ 415,651	\$ 383,780