NCI BUILDING SYSTEMS INC
Form 10-Q
September 08, 2011

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 31, 2011

or

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

For the transition period from __________to__________

Commission file number: 1-14315
NCI BUILDING SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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). þ Yes o 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 o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes þ 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-19,899,212 shares as of September 6, 2011

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PART I FINANCIAL INFORMATION

Item 1. Unaudited Consolidated Financial Statements.

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

	July 31, 2011 (Unaudited)	October 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 49,675	$ 77,419
Restricted cash	2,843	2,839
Accounts receivable, net	91,884	81,896
Inventories, net	116,324	81,386
Deferred income taxes	20,908	15,101
Income tax receivable	1,445	15,919
Investments in debt and equity securities, at market	4,070	3,738
Prepaid expenses and other	15,555	13,923
Assets held for sale	5,804	6,114
Total current assets	308,508	298,335
Property, plant and equipment, net	208,783	214,453
Goodwill	5,200	5,200
Intangible assets, net	24,768	26,312
Other assets	12,686	16,224
Total assets	$ 559,945	$ 560,524
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Note payable	$ 730	$ 289
Accounts payable	91,839	70,589
Accrued compensation and benefits	32,514	31,731
Accrued interest	1,416	1,546
Other accrued expenses	49,961	46,723
Total current liabilities	176,460	150,878
Long-term debt	131,056	136,305
Deferred income taxes	10,275	10,947
Other long-term liabilities	4,801	4,820
Total long-term liabilities	146,132	152,072
Series B cumulative convertible participating preferred stock	267,497	256,870
Redeemable common stock	1,063	3,418
Stockholders deficit:		

Common stock, $.01 par value, 100,000,000 shares authorized; 19,900,413 and 19,564,287 shares issued and outstanding at July 31, 2011 and October 31, 2010, respectively	924	921
Additional paid-in capital	240,141	255,248
Accumulated deficit	(270,307)	(256,946)
Accumulated other comprehensive loss	(1,965)	(1,937)
Total stockholders deficit	(31,207)	(2,714)
Total liabilities and stockholders deficit	$ 559,945	$ 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 Ended		Fiscal Nine Months Ended	
	July 31, 2011	August 1, 2010	July 31, 2011	August 1, 2010
Sales	$ 262,138	$ 245,292	$ 677,789	$ 629,072
Cost of sales, excluding asset impairments (recovery)	205,348	194,999	536,641	504,765
Asset impairments (recovery)	(93)	(64)	(93)	849
Gross profit	56,883	50,357	141,241	123,458
Engineering, selling, general and administrative expenses	50,889	48,730	151,227	142,367
Restructuring charges (recovery)	(575)	551	(575)	1,904
Income (loss) from operations	6,569	1,076	(9,411)	(20,813)
Interest income	26	32	103	69
Interest expense	(3,890)	(4,424)	(12,014)	(13,638)
Refinancing costs				(174)
Other income (expense), net	(112)	(204)	1,166	1,579
Income (loss) before income taxes	2,593	(3,520)	(20,156)	(32,977)
Benefit from income taxes		(221)	(6,795)	(11,536)
Net income (loss)	$ 2,593	$ (3,299)	$ (13,361)	$ (21,441)
Convertible preferred stock dividends and accretion	9,176	8,637	21,666	25,178
Convertible preferred stock beneficial conversion feature	6,494	4,583	8,040	246,052
Net loss applicable to common shares	$ (13,077)	$ (16,519)	$ (43,067)	$ (292,671)
Loss per common share:				
Basic	$ (0.71)	$ (0.90)	$ (2.35)	$ (16.10)
Diluted	$ (0.71)	$ (0.90)	$ (2.35)	$ (16.10)
Weighted average number of common shares outstanding:				
Basic	18,467	18,274	18,292	18,184
Diluted	18,467	18,274	18,292	18,184

See accompanying notes to consolidated financial statements.

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

	Fiscal Nine Months Ended	
	July 31, 2011	**August 1, 2010**
Cash flows from operating activities:		
Net loss	$ (13,361)	$ (21,441)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	25,249	26,017
Share-based compensation expense	5,132	3,578
Refinancing costs		174
Gain on embedded derivative	(19)	(930)
Loss on sale of property, plant and equipment	41	166
Provision for doubtful accounts	1,452	131
Benefit from deferred income taxes	(6,227)	(580)
Asset impairments, net	(93)	849
Changes in operating assets and liabilities, net of effect of acquisitions:		
Accounts receivable	(11,440)	924
Inventories	(34,938)	(33,774)
Income tax receivable	14,209	15,016
Prepaid expenses and other	(57)	1,424
Accounts payable	21,250	649
Accrued expenses	3,966	(13,868)
Other, net	283	920
Net cash provided by (used in) operating activities	5,447	(20,745)
Cash flows from investing activities:		
Capital expenditures	(14,735)	(11,258)
Proceeds from sale of property, plant and equipment	582	760
Net cash used in investing activities	(14,153)	(10,498)
Cash flows from financing activities:		
Decrease (increase) of restricted cash	(4)	10,141
Proceeds from ABL Facility	43	241
Payments on ABL Facility	(43)	(246)
Payments on term loan	(5,250)	(13,695)
Payment of convertible notes		(59)
Payments on other long-term debt		(190)
Payments on note payable	(1,105)	(1,289)
Payment of financing costs	(100)	(50)
Payment of cash dividends on Convertible Preferred Stock	(11,039)	
Purchase of treasury stock	(1,477)	(381)

Net cash (used in) financing activities	(18,975)	(5,528)
Effect of exchange rate changes on cash and cash equivalents	(63)	(5)
Net decrease in cash and cash equivalents	(27,744)	(36,776)
Cash and cash equivalents at beginning of period	77,419	90,419
Cash and cash equivalents at end of period	$ 49,675	$ 53,643

See accompanying notes to consolidated financial statements.

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NCI BUILDING SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JULY 31, 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 fo 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 nine month periods ended July 31, 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 PRONOUNCEMENTS

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.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220) (ASU 2011-05) which amends its guidance on the presentation of comprehensive income to increase the prominence of items reported in other comprehensive income. The new guidance requires that all components of comprehensive income in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This amendment is to be applied retrospectively. We will adopt ASU 2011-05 in our first quarter of fiscal 2013 and its adoption will not have any 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

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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 nine month periods ended August 1, 2010, we incurred $0.6 million and $1.9 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 nine month periods ended July 31, 2011 and do not expect to incur significant similar costs resulting from this restructuring plan in the future. However, we did record a $0.6 million recovery in the three and nine month periods ended July 31, 2011 as a result of a legal settlement for a closed facility.

NOTE 4 RESTRICTED CASH

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 July 31, 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):

	July 31, 2011	October 31, 2010
Raw materials	$ 86,422	$ 56,834
Work in process and finished goods	29,902	24,552
	$ 116,324	$ 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 July 31, 2011 and August 1, 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 or earlier upon death, disability or a change of control. However, our annual restricted stock awards also vest upon retirement and, only in the case of certain special one-time restricted stock awards, a portion vest 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 nine month periods ended July 31, 2011 and August 1, 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.

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 nine month period ended July 31, 2011 and August 1, 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 nine months ended July 31, 2011 and August 1, 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 July 31, 2011 and August 1, 2010, respectively, and $5.1 million and $3.6 million for the nine months ended July 31, 2011 and August 1, 2010, respectively. Of these amounts, $1.7 million and $1.4 million for the three months ended July 31, 2011 and August 1, 2010, respectively, and $4.9 million and $3.5 million for the nine months ended July 31, 2011 and August 1, 2010, respectively, were included in engineering, selling, general and administrative expenses, with the remaining costs in each period in cost of sales. As of both July 31, 2011 and August 1, 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 $0.7 million and $0.5 million for the three months ended July 31, 2011 and August 1, 2010, respectively, and $2.0 million and $1.4 million for the nine months ended July 31, 2011 and August 1, 2010, respectively. As of July 31, 2011 and August 1, 2010, there was approximately $19.9 million and $19.6 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 3.0 years and 3.8 years, respectively.

There were no options exercised during the first nine 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 Nine Months Ended**	
	July 31, 2011	**August 1, 2010**	**July 31, 2011**	**August 1, 2010**
Numerator for Basic and Diluted Loss Per Common Share				
Net loss allocated to common shares (1)	$ (13,077)	$ (16,519)	$ (43,067)	$ (292,671)
Denominator for Basic and Diluted Loss Per Common Share				
Weighted average common shares outstanding for basic and diluted loss per	18,467	18,274	18,292	18,184

share								
Basic and Diluted loss per common share	$	(0.71)	$	(0.90)	$	(2.35)	$	(16.10)

(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 any 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 nine month periods ended July 31, 2011 and August 1, 2010 as the restricted stock and Preferred Shares do not 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 July 31, 2011 and October 31, 2010, the Preferred Shares were convertible into 45.7 million and 44.3 million shares of Common Stock, respectively.

For both the three and nine month periods ended July 31, 2011 and August 1, 2010, all options and unvested restricted shares were anti-dilutive and, therefore, not included in the diluted loss per common 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 , 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 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 July 31, 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 nine months ended (in thousands):

	Fiscal Nine Months Ended	
	July 31, 2011	August 1, 2010
Beginning balance	$ 16,977	$ 16,116
Warranties sold	2,081	2,028
Revenue recognized	(1,205)	(1,024)
Costs incurred		(313)
Other	(309)	(119)
Ending balance	$ 17,544	$ 16,688

NOTE 9 LONG-TERM DEBT AND NOTE PAYABLE

Debt is comprised of the following (in thousands):

	July 31, 2011	October 31, 2010

Amended Credit Agreement (due April 2014, interest at 8.0%)	$	131,056	$	136,305
Asset-Based Lending Facility (due April 2014, interest at 4.75%)				
		131,056		136,305
Current portion of long-term debt				
Total long-term debt, less current portion	$	131,056	$	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 June 2011, March 2011 and December 2010, we made optional prepayments in the amount of $1.5 million, $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, although we intend to continue to make voluntary prepayments.

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 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 July 31, 2011, including the mandatory prepayment in connection with our tax refund, the leverage ratio covenant has been effectively deferred until the first quarter of fiscal 2013. At July 31, 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 limits 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 July 31, 2011.

The term loan under the Amended Credit Agreement bears interest, at our option, at either LIBOR or Base Rate plus an applicable margin. To date, we have selected LIBOR interest rates. 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 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 July 31, 2011 and October 31, 2010, our excess availability under the ABL Facility was $104.5 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 July 31, 2011 and October 31, 2010. In addition, at July 31, 2011 and October 31, 2010, standby letters of credit totaling approximately $6.4 million and $8.1 million, respectively, 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