

HUTTIG BUILDING PRODUCTS INC

Form 10-Q

October 27, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016

Commission file number 1-14982

HUTTIG BUILDING PRODUCTS, INC.

(Exact name of registrant as specified in its charter)

Delaware	43-0334550
(State or other jurisdiction of	(I.R.S. Employer
incorporation or organization)	Identification No.)

555 Maryville University Drive Suite 400

St. Louis, Missouri	63141
(Address of principal executive offices)	(Zip code)

(314) 216-2600

(Registrant's telephone number, including area code)

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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 definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if smaller reporting company) Smaller reporting company

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

The number of shares of Common Stock outstanding on September 30, 2016 was 25,466,252 shares.

	Page No.
<u>PART I. FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements</u>	3
<u>Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2016 and 2015 (unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets as of September 30, 2016, December 31, 2015 and September 30, 2015 (unaudited)</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the three and nine months ended September 30, 2016 and 2015 (unaudited)</u>	6
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	7
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	12
Item 4. <u>Controls and Procedures</u>	17
<u>PART II. OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	17
Item 6. <u>Exhibits</u>	18
<u>Signatures</u>	19
<u>Exhibit Index</u>	20

PART 1 FINANCIAL INFORMATION

ITEM 1 — FINANCIAL STATEMENTS

HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

(In Millions, Except Per Share Data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net sales	\$192.8	\$181.7	\$549.5	\$504.2
Cost of sales	151.4	144.5	433.9	402.9
Gross margin	41.4	37.2	115.6	101.3
Operating expenses	33.6	30.8	94.7	88.7
Gain on disposal of assets	—	—	—	(0.4)
Operating income	7.8	6.4	20.9	13.0
Interest expense, net	0.5	0.6	1.6	1.7
Income from continuing operations before income taxes	7.3	5.8	19.3	11.3
Income tax expense (benefit)	2.5	(17.4)	7.1	(17.4)
Income from continuing operations	4.8	23.2	12.2	28.7
(Loss) income from discontinued operations, net of taxes	(0.1)	(2.7)	4.3	(3.1)
Net income	\$4.7	\$20.5	\$16.5	\$25.6
Income from continuing operations per share - basic and diluted	\$0.19	\$0.92	\$0.48	\$1.14
Income (loss) from discontinued operations per share - basic and diluted	\$—	\$(0.11)	\$0.17	\$(0.13)
Net income per share - basic and diluted	\$0.19	\$0.82	\$0.65	\$1.02
Weighted average shares outstanding:				
Basic and diluted shares outstanding	24.6	24.1	24.5	24.1

See notes to condensed consolidated financial statements

HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

(In Millions)

	September 30, 2016	December 31, 2015	September 30, 2015
ASSETS			
CURRENT ASSETS:			
Cash and equivalents	\$ 1.1	\$ 0.3	\$ 2.8
Trade accounts receivable, net	78.7	56.3	74.1
Net inventories	84.4	64.3	71.0
Other current assets	7.2	7.3	6.2
Total current assets	171.4	128.2	154.1
PROPERTY, PLANT AND EQUIPMENT:			
Land	5.0	4.3	4.3
Buildings and improvements	29.5	26.5	26.4
Machinery and equipment	41.5	37.3	37.2
Gross property, plant and equipment	76.0	68.1	67.9
Less accumulated depreciation	52.6	50.9	50.2
Property, plant and equipment, net	23.4	17.2	17.7
OTHER ASSETS:			
Goodwill	9.5	6.3	6.3
Other	7.8	1.7	1.8
Deferred income taxes	14.8	24.0	24.5
Total other assets	32.1	32.0	32.6
TOTAL ASSETS	\$ 226.9	\$ 177.4	\$ 204.4

See notes to condensed consolidated financial statements

HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

(In Millions, Except Share Data)

	September 30, 2016	December 31, 2015	September 30, 2015
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Current maturities of long-term debt	\$ 0.8	\$ 1.2	\$ 0.7
Trade accounts payable	57.2	43.6	52.0
Deferred income taxes	5.0	4.9	5.2
Accrued compensation	5.2	5.5	6.0
Other accrued liabilities	13.0	13.8	13.0
Total current liabilities	81.2	69.0	76.9
NON-CURRENT LIABILITIES:			
Long-term debt, less current maturities	68.1	47.4	67.2
Other non-current liabilities	7.3	8.1	8.2
Total non-current liabilities	75.4	55.5	75.4
SHAREHOLDERS' EQUITY:			
Preferred shares: \$.01 par (5,000,000 shares authorized)	—	—	—
Common shares: \$.01 par (50,000,000 shares authorized: 25,466,252; 24,977,208; and 24,879,750 shares issued at September 30, 2016, December 31, 2015 and September 30, 2015, respectively)	0.3	0.2	0.2
Additional paid-in capital	42.4	41.6	41.2
Retained earnings	27.6	11.1	10.7
Total shareholders' equity	70.3	52.9	52.1
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 226.9	\$ 177.4	\$ 204.4

See notes to condensed consolidated financial statements

HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(In Millions)

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Cash Flows From Operating Activities:				
Net income	\$4.7	\$20.5	\$16.5	\$25.6
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Loss (income) from discontinued operations	0.1	2.7	(4.3)	3.1
Depreciation and amortization	1.0	0.7	2.8	2.2
Non-cash interest expense	0.1	0.1	0.3	0.3
Stock-based compensation	0.4	0.5	1.2	1.3
Deferred taxes	2.4	(19.3)	9.3	(19.3)
Gain on disposal of assets	—	—	—	(0.4)
Changes in operating assets and liabilities:				
Trade accounts receivable	4.1	(2.1)	(20.9)	(25.6)
Net inventories	(6.0)	5.2	(18.0)	(5.2)
Trade accounts payable	1.0	(1.7)	12.7	12.6
Other	2.5	4.0	(1.1)	3.2
Cash provided by (used in) continuing operating activities	10.3	10.6	(1.5)	(2.2)
Cash provided by (used in) discontinued operating activities	(0.8)	1.7	3.6	1.3
Total cash provided by (used in) operating activities	9.5	12.3	2.1	(0.9)
Cash Flows From Investing Activities:				
Capital expenditures	(1.5)	(1.7)	(2.7)	(2.6)
Acquisition	—	—	(17.3)	—
Proceeds from disposition of capital assets	—	0.1	—	2.5
Total cash used in investing activities	(1.5)	(1.6)	(20.0)	(0.1)
Cash Flows From Financing Activities:				
Borrowings of debt, net	(7.7)	(10.4)	19.1	3.9
Repurchase shares of common stock	—	—	(0.4)	(0.6)
Total cash (used in) provided by financing activities	(7.7)	(10.4)	18.7	3.3
Net increase in cash and equivalents	0.3	0.3	0.8	2.3
Cash and equivalents, beginning of period	0.8	2.5	0.3	0.5
Cash and equivalents, end of period	\$1.1	\$2.8	\$1.1	\$2.8

Supplemental Disclosure of Cash Flow Information:

Interest paid	\$0.5	\$0.4	\$1.4	\$1.3
Income taxes paid	—	—	0.4	0.1

See notes to condensed consolidated financial statements

HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. BASIS OF PRESENTATION

The unaudited interim condensed consolidated financial statements of Huttig Building Products, Inc. and its subsidiary (the "Company" or "Huttig") were prepared in accordance with U.S. generally accepted accounting principles ("GAAP") and reflect all adjustments (including normal recurring accruals) which, in the opinion of management, are considered necessary for the fair presentation of the results for the periods presented. These statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

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

2. NEW ACCOUNTING STANDARDS

In March 2016, the Financial Accounting Standards Board ("FASB") issued accounting guidance, "Improvements to Employee Share-Based Payment Accounting", which will simplify the income tax consequences, accounting for forfeitures and classification on the Statements of Consolidated Cash Flows. This standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016, with early adoption permitted. Huttig is required to adopt the standard in the first quarter of 2017. The Company is currently evaluating the impact this guidance will have on the consolidated financial statements and related disclosures.

In February 2016, the FASB issued accounting guidance, "Leases", which will supersede the existing lease guidance and will require all leases with a term greater than 12 months to be recognized in the statements of financial position and eliminate current real estate-specific lease guidance, while maintaining substantially similar classification criteria for distinguishing between finance leases and operating leases. This standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. This standard will be adopted on a modified retrospective basis. Huttig is required to adopt the standard in the first quarter of 2019. The Company is currently evaluating the impact this guidance will have on the consolidated financial statements and related disclosures.

In November 2015, the FASB issued accounting guidance, "Balance Sheet Classification of Deferred Taxes", which removes the requirement to separate deferred tax liabilities and assets into current and noncurrent amounts and instead requires all such amounts be classified as noncurrent on the Statement of Financial Position. This standard is effective

for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016, with early adoption permitted, including adoption in an interim period, for financial periods not yet reported. The standard may be adopted on a prospective or retrospective basis. Huttig is required to adopt the standard in the first quarter of 2017. The Company is currently evaluating the impact this guidance will have on the consolidated financial statements and related disclosures.

In May 2014, the FASB issued accounting guidance, "Revenue from Contracts with Customers" which has been further clarified and amended. The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard also will result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and clarify guidance for multiple-element arrangements. Entities have the option to apply the new guidance under a retrospective approach to each prior reporting period presented or a modified retrospective approach with the cumulative effect of initially applying the new guidance recognized at the date of initial application within the Statement of Consolidated Financial Position. In August 2015, the FASB amended the guidance to allow for the deferral of the effective date of this standard. The standard is effective for fiscal years, and interim periods within those years, beginning after Dec. 15, 2017. Accordingly, Huttig is required to adopt this standard in the first quarter of fiscal year 2018. One-year early adoption is permitted. The Company is currently evaluating the impact this guidance will have on the consolidated financial statements and related disclosures.

3. COMPREHENSIVE INCOME

Comprehensive income refers to net income adjusted by gains and losses that in conformity with GAAP are excluded from net income. Other comprehensive items are amounts that are included in shareholders' equity in the condensed consolidated balance sheets. The Company has no comprehensive income items and therefore the comprehensive net income is equal to net income for all periods presented.

4. DEBT

Debt consisted of the following (in millions):

	September 30, 2016	December 31, 2015	September 30, 2015
Revolving credit facility	\$ 66.2	\$ 46.1	\$ 65.8
Other obligations	2.7	2.5	2.1
Total debt	68.9	48.6	67.9
Less current portion	0.8	1.2	0.7
Long-term debt	\$ 68.1	\$ 47.4	\$ 67.2

Credit Agreement — The Company has a \$160.0 million asset-based senior secured revolving credit facility (“credit facility”). Borrowing availability under the credit facility is based on eligible accounts receivable, inventory and real estate. The real estate component of the borrowing base amortizes monthly over 12.5 years on a straight-line basis. Borrowings under the credit facility are collateralized by substantially all of the Company’s assets, and the Company is subject to certain operating limitations applicable to a loan of this type, which, among other things, place limitations on indebtedness, liens, investments, mergers and acquisitions, dispositions of assets, cash dividends and transactions with affiliates. The entire unpaid balance under the credit facility is due and payable on May 28, 2019.

At September 30, 2016, under the credit facility, the Company had revolving credit borrowings of \$66.2 million outstanding at a weighted average interest rate of 2.2% per annum, letters of credit outstanding totaling \$3.0 million, primarily for health and workers’ compensation insurance and \$83.2 million of excess committed borrowing capacity. The Company pays an unused commitment fee of 0.25% per annum. In addition, the Company had \$2.7 million of capital lease and other obligations outstanding at September 30, 2016.

The sole financial covenant in the credit facility is the fixed charge coverage ratio of 1.05:1.00, which must be tested by the Company if the excess committed borrowing availability falls below an amount in a range between \$12.5 million to \$20.0 million, which amounts depend on the Company’s borrowing base, and must also be tested on a pro forma basis prior to consummation of certain significant transactions outside the ordinary course of the Company’s business, as defined in the credit agreement.

5. CONTINGENCIES

The Company carries insurance policies on insurable risks with coverage and other terms that it believes to be appropriate. The Company generally has self-insured retention limits and has obtained fully insured layers of coverage above such self-insured retention limits. Accruals for self-insurance losses are made based on claims experience. Liabilities for existing and unreported claims are accrued for when it is probable that future costs will be incurred and can be reasonably estimated.

As described in Note 7 — “Commitments and Contingencies” to the Company’s audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015, the Company was previously identified as a potentially responsible party in connection with the cleanup of contamination at a formerly owned property in Montana. On February 18, 2015, the Montana Department of Environmental Quality (the “DEQ”) issued an amendment to the unilateral administrative order of the DEQ outlining the final remediation of the property in its Record of Decision (the “ROD”). Under the ROD, the DEQ estimated the remediation costs of the property to be \$8.3 million.

The Company submitted a comprehensive final remedial action work plan (the “RAWP”) in September 2015 that was approved by the DEQ. The Company is currently implementing the RAWP and has commenced field work at the Montana site subject to DEQ oversight and approval. As of September 30, 2016, the Company estimates the total remaining cost to implement the RAWP to be \$7.3 million, as compared to \$8.0 million at December 31, 2015.

As of September 30, 2016, the Company believes the accrual represents a reasonable best estimate of the total remaining remediation costs, based on facts, circumstances, and information currently available to Huttig. However, there are currently unknown variables relating to the actual levels of contaminants and amounts of soil that will ultimately require treatment or removal and as part of the remediation process, additional soil and groundwater sampling, and bench and pilot testing that is required to ensure the remediation will achieve the projected outcome required by the DEQ. The ultimate final amount of remediation costs and expenditures are difficult to estimate with certainty and as a result, the amount of actual costs and expenses ultimately incurred by Huttig with respect to this property could be lower than, or exceed the amount accrued as of September 30, 2016 by a material amount and could have a material adverse effect on our liquidity, financial condition or operating results of any fiscal quarter or year in which estimated costs or additional expenses are, or are not incurred.

On June 29, 2015, certain private plaintiffs owning properties adjacent to the Montana site sued the Company, Crane Co., and other defendants in the Montana Fourth Judicial District Court seeking remediation of the property in excess of what is contemplated by the ROD and other damages. In October 2015, the lawsuit was amended to include additional plaintiffs and the Company was formally served. Crane Co. asserted its right of indemnification under the Distribution Agreement between the Company and Crane Co. dated December 6, 1999. On September 30, 2016, the Company conducted a mediation with the plaintiffs at which the litigation was not resolved. The Company continues to defend the lawsuit vigorously. Due to the uncertain nature of this litigation at this time, the Company cannot currently make an estimate of the potential loss or range of potential loss. Should additional information be made available to the Company to reasonably estimate the potential loss, or range of potential loss, associated with this case in future periods, the Company will disclose such estimated potential loss.

In December 2014, the Company filed a declaratory action in the United States District Court for the Eastern District of Missouri against certain liability insurers seeking, inter alia, defense and indemnification for the costs of implementing the final remediation activities associated with the Montana property and defense and indemnification costs associated with the related lawsuit described above. The Company entered into settlement agreements with certain of the insurers as well as with Crane Co. and all claims against the insurers were dismissed as of July 2016, and Huttig agreed to release Crane Co. of any of Huttig's claims related to the Distribution Agreement, including its rights under Crane Co.'s insurance policies.

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

The Company accrues expenses for contingencies when it is probable that an asset has been impaired or a liability has been incurred and management can reasonably estimate the expense. Contingencies for which the Company has made accruals include environmental, product liability and other legal matters. It is possible, however, that actual expenses could, or could not exceed our accrual by a material amount which could have a material adverse effect on the Company's future liquidity, financial condition or operating results in the period in which any such additional expenses are incurred or recognized.

6. EARNINGS PER SHARE

The Company calculates its basic income per share by dividing net income allocated to common shares outstanding by the weighted average number of common shares outstanding. Although the Company does not currently pay dividends, holders of unvested shares of restricted stock have a right to participate in dividends on the same basis as common shares. As a result, these share-based awards meet the definition of participating securities and the Company applies the two-class method to compute earnings per share. The two-class method is an earnings allocation formula that treats participating securities as having rights to earnings that would otherwise have been available to common stockholders. In periods in which the Company has net losses, the losses are not allocated to participating securities because the participating security holders are not obligated to share in such losses. The following table presents the number of participating securities and earnings allocated to those securities (in millions).

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Earnings allocated to participating shareholders	\$0.2	\$0.9	\$0.6	\$1.2
Number of participating securities	1.0	1.0	1.0	1.0

The diluted earnings per share calculations include the effect of the assumed exercise using the treasury stock method for both stock options and unvested restricted stock units, except when the effect would be anti-dilutive. The following table presents the number of common shares used in the calculation of net income per share from continuing operations (in millions).

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Weighted-average number of common shares-basic	24.6	24.1	24.5	24.1
Dilutive potential common shares	—	—	—	—
Weighted-average number of common shares-dilutive	24.6	24.1	24.5	24.1

7. INCOME TAXES

The Company's effective tax rate for continuing operations was 36.8% for the nine month period ended September 30, 2016. In the third quarter of 2015, the Company released a significant portion of our valuation allowance on our net deferred tax assets, resulting in a \$21.7 million benefit in our provision for income taxes. Prior to September 30, 2015, the Company recognized no income tax expense or benefit as it had 100% valuation allowance on all of its net deferred tax assets. As of September 30, 2016, the Company has \$7.2 million valuation allowance primarily relating to certain state net operating loss carryforwards that are not likely to be realized in future periods.

8. STOCK-BASED EMPLOYEE COMPENSATION

The Company recognized \$1.2 million and \$1.3 million in non-cash stock-based compensation expense in the nine-month periods ended September 30, 2016 and September 30, 2015, respectively. During the first nine months of 2016, the Company granted an aggregate of 583,882 shares of restricted stock at a fair market value of \$3.518 per share under its 2005 Executive Incentive Compensation Plan, as amended and restated. The restricted shares vest in three equal installments on the first, second and third anniversaries of the grant date. During the first nine months of 2016, the Company granted 53,274 shares of restricted stock under its Non-Employee Directors' Restricted Stock Plan, as amended, at an average fair market value of \$4.505 per share. The directors' restricted shares vest on the date of the 2017 Annual Meeting. The unearned compensation expense is being amortized into expense on a straight-line basis over the requisite service period for the entire award. As of September 30, 2016 and 2015, the total compensation expense not yet recognized related to all outstanding restricted stock/unit awards was \$2.6 million and \$2.1 million,

respectively.

9. RIGHTS AGREEMENT

On May 18, 2016, the Board of Directors (the “Board”) of the Company entered into a rights agreement (the “Rights Agreement”) with Computershare Trust Company, N.A. and declared a dividend of one preferred share purchase right (a “Right”) for each outstanding share of common stock, \$0.01 par value per share, of the Company. The dividend was payable upon the close of business on May 31, 2016 to the stockholders of record upon the close of business on that date. The Board adopted the Rights Agreement to protect stockholder value by attempting to reduce the risk that the Company’s ability to use its net operating losses to reduce potential future federal income tax obligations may become substantially limited.

Each Right entitles the registered holder to purchase from the Company one one-hundredth of a share of Series A Junior Participating Preferred Stock, par value \$0.01 per share (“Preferred Shares”), of the Company at a price of \$13.86 per one one-hundredth of a Preferred Share, subject to adjustment. As a result of the Rights Agreement, any person or group that acquires beneficial ownership of 4.99% or more of the Company’s common stock without the approval of the Board would be subject to significant dilution in the ownership interest of that person or group.

In connection with the entry into the Rights Agreement, on May 18, 2016, the Company filed with the Secretary of State of the State of Delaware an Amended and Restated Certificate of Designation of Series A Junior Participating Preferred Stock to create the Preferred Shares.

10. ACQUISITION

During the second quarter of 2016 the Company purchased the assets of a distributor and door fabricator in the Mid-Atlantic region. All transaction costs incurred as part of this acquisition were expensed. The Company preliminarily recorded goodwill of \$3.2 million and other intangible assets of \$6.7 million related to this acquisition.

11. DISCONTINUED OPERATIONS

The Company recorded \$4.3 million in after-tax income from discontinued operations for the nine month period ended September 30, 2016 primarily as a result of payments received from settlement agreements with insurers, as well as with Crane Co., in connection with the declaratory action filed in the United States District court for the Eastern District of Missouri. The Company recorded a loss of \$3.1 million for the nine month period ended September 30, 2015 due to environmental and related legal expenses.

ITEM 2 — MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Huttig is a distributor of a broad array of building material products used principally in new residential construction, home improvement, and remodeling and repair projects. We distribute our products through 27 distribution centers serving 41 states and sell primarily to building materials dealers, national buying groups, home centers and industrial users, including makers of manufactured homes.

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

	Three Months Ended September 30, 2016		2015		Nine Months Ended September 30, 2016		2015	
Millwork(1)	51 %	49 %	50 %	48 %				
Building Products(2)	40 %	42 %	40 %	41 %				
Wood Products(3)	9 %	9 %	10 %	11 %				
Total Net Product Sales	100 %	100 %	100 %	100 %				

- (1) Millwork generally includes exterior and interior doors, pre-hung door units, windows, mouldings, frames, stair parts and columns.
- (2) Building products generally include composite decking, connectors, fasteners, housewrap, siding, roofing products, insulation and other miscellaneous building products.
- (3) Wood products generally include engineered wood products and other wood products, such as lumber and panels.

Industry Conditions

New housing activity in the United States has shown modest improvement each year since 2009. However, 2016 activity is still below the historical average of 1.4 million total housing starts from 1959 to 2015 based on statistics tracked by the United States Census Bureau. Total housing starts were approximately 1.1 million in 2015. Through September 30, 2016, based on the most recent data provided by the United States Census Bureau, total new housing starts were approximately 4% above 2015 levels for the corresponding nine-month period.

Various factors historically have caused our results of operations to fluctuate from period to period. These factors include levels of residential construction, the mix of single family and multi-family starts as a percent of the total residential construction, home improvement and remodeling activity, weather, prices of commodity wood and steel products, interest rates, competitive pressures, availability of credit and other local, regional and national economic conditions. Many of these factors are cyclical or seasonal in nature. We anticipate that further fluctuations in operating results from period to period will continue in the future. Our results in the first and fourth quarter of each year are generally adversely affected by winter weather patterns in the Midwest, Northeast and Northwest, which typically result in seasonal decreases in levels of construction activity in these areas. As much of our overhead and expenses

remain relatively fixed throughout the year, our operating profits tend to be lower during the first and fourth quarters.

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

Critical Accounting Policies

We prepare our condensed consolidated financial statements in accordance with U.S. generally accepted accounting principles, which require management to make estimates and assumptions. Management bases these estimates and assumptions on historical results and known trends as well as management forecasts. Actual results could differ from these estimates and assumptions and these differences may be material. For a discussion of our significant accounting policies and estimates, see our Annual Report on Form 10-K for the year ended December 31, 2015 in Part II, Item 7 - “Management’s Discussion and Analysis of Financial Condition and Results of Operations-Critical Accounting Policies.” During the nine months ended September 30, 2016, there were no material changes to the critical accounting policies and estimates discussed in our Annual Report on Form 10-K for the year ended December 31, 2015.

Results of Operations

Three Months Ended September 30, 2016 Compared to Three Months Ended September 30, 2015

Net sales were \$192.8 million in 2016, which was \$11.1 million, or 6%, higher than in 2015. The increase was primarily due to higher levels of construction activity, the addition of a new product line and the acquisition that was completed during the second quarter of 2016.

Sales increased in all product categories in 2016 compared to 2015. Millwork sales increased 10% in 2016 to \$97.4 million, primarily due to increased construction activity and the acquisition. Building products sales increased 2% in 2016 to \$76.9 million. Wood product sales increased 8% in 2016 to \$18.5 million.

Gross margin increased 11% to \$41.4 million in 2016 compared to \$37.2 million in 2015. As a percentage of sales, gross margin increased to 21.5% in 2016 from 20.5% in 2015. The increase in gross margin percentage was primarily due to our operational initiatives as well as improved product mix as we continue to expand our value-add capabilities to serve the repair/remodel construction segment.

Operating expenses increased \$2.8 million to \$33.6 million in 2016, compared to \$30.8 million in 2015. The increase was primarily due to higher personnel costs as a result of hiring additional personnel and expenses attributable to higher variable costs associated with increased sales and profitability. As a percentage of sales, operating expenses were 17.4% in 2016 and 17.0% in 2015.

Net interest expense was \$0.5 million in 2016 and \$0.6 million in 2015. The decrease was primarily due to lower average debt and lower borrowing rates in 2016 compared to 2015.

Income tax expense of \$2.5 million was recognized for the quarter ended September 30, 2016. An income tax benefit of \$17.4 million was recognized in the third quarter of 2015 as the Company released a significant portion of its valuation allowance related to federal and certain state net operating loss carryforwards. See Note 7 – “Income Taxes” of the Notes to Condensed Consolidated Financial Statements (unaudited) in Item 1 for more information.

As a result of the foregoing factors, we reported income from continuing operations of \$4.8 million in the third quarter of 2016 compared to \$23.2 million in the third quarter of 2015.

Nine Months Ended September 30, 2016 Compared to Nine Months Ended September 30, 2015

Net sales were \$549.5 million in 2016, which was \$45.3 million, or 9%, higher than in 2015. The increase was primarily due to higher levels of construction activity, the addition of a new product line and the acquisition that was completed during the second quarter of 2016.

Sales increased in all product categories in 2016 compared to 2015. Millwork sales increased 13% in 2016 to \$273.5 million, primarily due to increased construction activity and the acquisition. Building products sales increased 6% in 2016 to \$219.4 million. Wood product sales increased 3% in 2016 to \$56.6 million.

Gross margin increased 14% to \$115.6 million in 2016 compared to \$101.3 million in 2015. As a percentage of sales, gross margin increased to 21.0% in 2016 from 20.1% in 2015. The increase in gross margin percentage was primarily due to our operational initiatives as well as improved product mix as we continue to expand our value-add capabilities to service the repair/remodel construction segment.

Operating expenses increased \$6.0 million to \$94.7 million in 2016, compared to \$88.7 million in 2015. The increase was primarily due to higher personnel costs as a result of hiring additional personnel and expenses attributable to higher variable costs associated with increased sales and profitability. The increase in personnel costs was partially offset by a decrease in fuel expense due to lower diesel costs. As a percentage of sales, operating expenses were 17.2% in 2016 and 17.6% in 2015.

Our results for the nine months ended September 30, 2015 included a gain on the sale of assets of \$0.4 million related to the sale of our Southwest Roofing Supply branch.

Net interest expense was \$1.6 million in 2016, compared to \$1.7 million in 2015. The decrease was primarily due to lower average debt and lower borrowing rates in 2016 compared to 2015.

Income tax expense of \$7.1 million was recognized for the nine-month period ended September 30, 2016, as compared to an income tax benefit of \$17.4 million in the nine-month period ended September 30, 2015. See Note 7 – “Income Taxes” of the Notes to Condensed Consolidated Financial Statements (unaudited) in Item 1 for more information.

As a result of the foregoing factors, we reported income from continuing operations of \$12.2 million in 2016 compared to \$28.7 million in 2015.

Shareholder Rights Plan

As previously disclosed, on May 18, 2016, the Company’s Board of Directors issued one preferred share purchase right (a “Right”) for each share of our common stock issued and outstanding as of the close of business on May 31, 2016 and adopted a shareholder rights plan, as set forth in the rights agreement entered into on the same date between the Company and Computershare Trust Company, N.A. (the “Rights Agreement”). The Rights Agreement will expire on the earliest of (i) the date of the Company’s 2017 Annual Meeting if the Company’s stockholders do not approve the Rights Agreement, (ii) May 18, 2019, (iii) the time at which the Rights are redeemed or exchanged, as provided for in the Rights Agreement, (iv) the repeal of Section 382 of the Internal Revenue Code if the Board determines that the Rights Agreement is no longer necessary for the preservation of the Company’s net operating loss carryforwards (“NOLs”), and (v) the beginning of a taxable year of the Company to which the Board determines that no NOLs may be carried forward.

See Note 9 – “Rights Agreement” of the Notes to Condensed Consolidated Financial Statements (unaudited) in Item 1 for more information on the Rights Agreement.

Discontinued Operations

We recorded \$4.3 million in after-tax income from discontinued operations in the first nine months of 2016 primarily as a result of payments received from settlement agreements with insurers, as well as with Crane Co., in connection with the declaratory action filed in the United States District court for the Eastern District of Missouri. We recorded a loss of \$3.1 million in the first nine months of 2015 due to environmental and related legal expenses.

Liquidity and Capital Resources

We depend on cash flow from operations and funds available under our credit facility to finance our operations, including seasonal working capital needs, capital expenditures and other capital needs. Our working capital requirements are generally greatest in the second and third quarters, which reflect the seasonal nature of our business. The second and third quarters are also typically our strongest operating quarters, largely due to more favorable weather throughout many of our markets compared to the first and fourth quarters. We typically generate cash from working capital reductions in the fourth quarter of the year and typically use cash as we build working capital during the first quarter in preparation for our second and third quarters. We also maintain significant inventories to meet the rapid delivery requirements of our customers and to enable us to obtain favorable pricing, delivery and service terms with our suppliers. Accounts receivable also typically increase during peak periods commensurate with the sales increase. At September 30, 2016 and September 30, 2015, inventories and accounts receivable constituted approximately 72% and 71% of our total assets, respectively. We closely monitor operating expenses and inventory levels during seasonally affected periods and, to the extent possible, manage variable operating costs to minimize seasonal effects on our profitability.

Operations. Cash provided by operating activities increased by \$3.0 million to \$2.1 million in the first nine months of 2016, compared to cash used in operating activities of \$0.9 million in the first nine months of 2015. In the first nine

months of 2016, we recorded net income of \$16.5 million compared to \$25.6 million in the corresponding period in 2015. Accounts receivable increased by \$20.9 million during the first nine months of 2016, compared to an increase of \$25.6 million in the year-ago corresponding period. The increase in accounts receivable over the first nine months of the year was commensurate with sales activity including the seasonality of our sales. Days' sales outstanding was 37.2 days at both September 30, 2016 and September 30, 2015 based on annualized third quarter sales and quarter-end accounts receivable balances for the respective periods. Inventory increased by \$18.0 million in the first nine months of 2016 compared to an increase of \$5.2 million in the corresponding period of 2015. The increase in inventories over the first nine months of the year represented normal seasonality and anticipated increased sales activity in 2016 as compared to year-end 2015. Our inventory turns decreased to 7.4 turns in 2016 from 7.9 turns in 2015 based on annualized third quarter cost of goods sold and average inventory balances for the respective quarters. Accounts payable increased by \$12.7 million in the first nine months of 2016, compared to a \$12.6 million increase in the corresponding year-ago period. The increase was primarily a result of our inventory build for the respective periods. Days' payable outstanding increased to 34.5 days at September 30, 2016 from 32.8 days at September 30, 2015 based on annualized third quarter costs of goods sold and quarter-end accounts payable balances for the respective periods.

Investing. In the first nine months of 2016, net cash used in investing activities was \$20.0 million compared to \$0.1 million for the corresponding period in 2015. In the first nine months of 2016, we closed an acquisition and invested in property and equipment. In the first nine months of 2015 we received proceeds for the sale of assets offset by investments in machinery and equipment at various locations.

Financing. Cash provided by financing activities of \$18.7 million in the first nine months of 2016 reflected net borrowings of \$19.1 million offset by the Company's repurchase of 0.1 million shares of its common stock for \$0.4 million. Net borrowings included amounts borrowed to fund the acquisition. Cash provided from financing activities of \$3.3 million in the first nine months of 2015 reflected net borrowings of \$3.9 million offset by the Company's repurchase of 0.2 million shares of its common stock for \$0.6 million. The shares repurchased in both periods were retired.

The Company believes that cash generated from its operations and funds available under the credit facility will provide sufficient funds to meet the operating needs of the Company for at least the next twelve months. However, if the Company's availability falls below the required threshold and the Company does not meet the minimum fixed charge coverage ratio, its lenders would have the right to terminate the loan commitments and accelerate the repayment of the entire amount outstanding under the credit facility. The lenders could also foreclose on the Company's assets that secure the credit facility. If the credit facility is terminated, the Company would be forced to seek alternative sources of financing, which may not be available on terms acceptable to it, or at all.

Off-Balance Sheet Arrangements

In addition to funds available from operating cash flows and the credit facility as described above, we use operating leases as a principal off-balance sheet financing technique. Operating leases are employed as an alternative to purchasing certain property, plant and equipment. For a discussion of our off-balance sheet arrangements, see our Annual Report on Form 10-K for the year ended December 31, 2015 in Part II, Item 7 - "Management's Discussion and Analysis of Financial Condition and Results of Operations-Commitments and Contingencies." During the nine months ended September 30, 2016, there were no material changes to our off-balance sheet arrangements discussed in our Annual Report on Form 10-K for the year ended December 31, 2015.

Contingencies

We carry insurance policies on insurable risks with coverage and other terms that we believe to be appropriate. We generally have self-insured retention limits and have obtained fully insured layers of coverage above such self-insured retention limits. Accruals for self-insurance losses are made based on claims experience. Liabilities for existing and unreported claims are accrued for when it is probable that future costs will be incurred and can be reasonably estimated.

See Note 5 - "Contingencies" of the Notes to Condensed Consolidated Financial Statements (unaudited) in Item 1 for information on certain legal proceedings in which the Company is involved.

Cautionary Statement Relevant to Forward-looking Information for the Purpose of "Safe Harbor" Provisions of the Private Securities Litigation Reform Act of 1995

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. The words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "believe," "estimate," "project" or similar expressions may identify forward-looking statements, although not all forward-looking statements contain such words. Statements made in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K looking forward in time, including, but not limited to, statements regarding our current

views with respect to financial performance, future growth in the housing market, distribution channels, sales, favorable supplier relationships, inventory levels, the ability to meet customer needs, enhanced competitive posture, no material financial impact from litigation or contingencies, including environmental proceedings, are included pursuant to the “safe harbor” provision of the Private Securities Litigation Reform Act of 1995.

These statements present management’s expectations, beliefs, plans and objectives regarding our future business and financial performance. These forward-looking statements are based on current projections, estimates, assumptions and judgments, and involve known and unknown risks and uncertainties. We disclaim any obligation to publicly update or revise any of these forward-looking statements, whether as a result of new information, future events or otherwise.

There are a number of factors, some of which are beyond our control that could cause our actual results to differ materially from those expressed or implied in the forward-looking statements. These factors include, but are not limited to: the strength of construction, home improvement and remodeling markets and the recovery of the homebuilding industry to levels consistent with the historical average of total housing starts; the cyclical nature of our industry; the cost of environmental compliance, including remediation of the Missoula site in accordance with regulatory requirements and cost estimates and actual expenses we may incur to resolve proceedings we are involved in arising out of the Missoula site; any limitations on our ability to utilize our deferred tax assets to reduce future tax liabilities; our ability to comply with, and the restrictive effect of, the financial covenant applicable under our credit facility; the loss of a significant customer; deterioration of our customers' creditworthiness or our inability to forecast such deteriorations; commodity prices; termination of key supplier relationships; competition with existing or new industry participants; goodwill impairment; the seasonality of our operations; significant uninsured claims; federal and state transportation regulations; fuel cost increases; our failure to attract and retain key personnel; deterioration in our relationship with our unionized employees, including work stoppages or other disputes; funding requirements for multi-employer pension plans for our unionized employees; product liability claims and other legal proceedings; the integration of any business we acquire; and those set forth under Item 1A-"Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. These factors may not constitute all factors that could cause actual results to differ from those discussed in any forward-looking statement. Accordingly, forward-looking statements should not be relied upon as a predictor of actual results.

ITEM 4 — CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures – As required by Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), the Company, under the supervision and with the participation of our Disclosure Committee and management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective as of September 30, 2016.

Changes in Internal Control of Financial Reporting – There have been no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2016, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 1 — LEGAL PROCEEDINGS

See Note 5 – Contingencies of the Notes to Condensed Consolidated Financial Statements (unaudited) in Item 1 for information on legal proceedings in which the Company is involved. See also Part I, Item 3-“Legal Proceedings” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015.

ITEM 6 — EXHIBITS

The exhibits filed as part of this Report on Form 10-Q are listed in the Exhibit Index immediately preceding the exhibits.

SIGNATURES

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

HUTTIG BUILDING PRODUCTS, INC.

/s/ Jon P. Vrabely

Date: October 27, 2016

Jon P. Vrabely
President and Chief Executive Officer
(Principal Executive Officer)

HUTTIG BUILDING PRODUCTS, INC.

/s/ Oscar A. Martinez

Date: October 27, 2016

Oscar A. Martinez
Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

Exhibit

Number Description

- 2.1 Distribution Agreement dated December 6, 1999 between Crane Co. and the Company. (Incorporated by reference to Exhibit No. 2.1 of Amendment No. 4 to the Company’s Registration Statement on Form 10 (File No. 1-14982) filed with the Securities and Exchange Commission on December 6, 1999 (the “Form 10”).)
- 3.1 Restated Certificate of Incorporation of the Company (Incorporated by reference to Exhibit 3.1 to the Form 10 filed with the Securities and Exchange Commission on September 21, 1999).
- 3.2 Amended and Restated Bylaws of the Company (as of September 26, 2007) (Incorporated by reference to Exhibit 3.1 to the Form 8-K filed with the Securities and Exchange Commission on September 28, 2007).
- 3.3 Amended and Restated Certificate of Designation of Series A Junior Participating Preferred Stock, as filed with the Secretary of State of Delaware on May 18, 2016 (Incorporated by reference to Exhibit 3.01 to the Form 8-K filed with the Securities and Exchange Commission on May 20, 2016).
- 4.1 Rights Agreement, dated May 18, 2016, by and between Huttig Building Products, Inc. and Computershare Trust Company, N.A., as Rights Agents (Incorporated by reference to Exhibit 4.01 to the Form 8-K filed with the Securities and Exchange Commission on May 20, 2016).
- 31.1 Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification by Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Scheme Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

