

HUTTIG BUILDING PRODUCTS INC

Form 10-Q

October 30, 2018

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, 2018

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, if any, every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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, 2018 was 26,040,012 shares.

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PART I 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,	
	2018	2017	2018	2017
Net sales	\$222.0	\$199.6	\$643.4	\$574.0
Cost of sales	177.4	158.3	515.1	455.0
Gross margin	44.6	41.3	128.3	119.0
Operating expenses	41.1	38.2	123.2	113.3
Operating income	3.5	3.1	5.1	5.7
Interest expense, net	1.8	0.9	4.6	2.2
Income from continuing operations before income taxes	1.7	2.2	0.5	3.5
Provision for (benefit from) income taxes	0.5	0.9	(0.4)	0.8
Income from continuing operations	1.2	1.3	0.9	2.7
Income from discontinued operations, net of taxes	—	0.1	—	—
Net income	\$1.2	\$1.4	\$0.9	\$2.7
Income from continuing operations per share - basic and diluted	\$0.05	\$0.05	\$0.03	\$0.10
Income from discontinued operations per share - basic				
and diluted	\$—	\$—	\$—	\$—
Net income per share - basic and diluted	\$0.05	\$0.05	\$0.03	\$0.10
Weighted average shares outstanding:				
Basic and diluted shares outstanding	25.1	24.9	25.1	24.8

See notes to condensed consolidated financial statements

HUTTIG BUILDING PRODUCTS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

(In Millions)

	September 30, 2018	December 31, 2017	September 30, 2017
ASSETS			
CURRENT ASSETS:			
Cash and equivalents	\$ 1.5	\$ 0.3	\$ 1.2
Trade accounts receivable, net	96.3	66.8	87.5
Inventories, net	153.7	111.9	108.1
Other current assets	13.1	11.4	12.1
Total current assets	264.6	190.4	208.9
PROPERTY, PLANT AND EQUIPMENT:			
Land	5.0	5.0	5.0
Buildings and improvements	32.4	31.1	30.8
Machinery and equipment	54.6	49.8	49.5
Gross property, plant and equipment	92.0	85.9	85.3
Less accumulated depreciation	59.1	56.4	55.5
Property, plant and equipment, net	32.9	29.5	29.8
OTHER ASSETS:			
Goodwill	9.5	9.5	9.5
Deferred income taxes	10.1	9.7	11.3
Other	6.1	6.8	7.0
Total other assets	25.7	26.0	27.8
TOTAL ASSETS	\$ 323.2	\$ 245.9	\$ 266.5

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, 2018	December 31, 2017	September 30, 2017
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Current maturities of long-term debt	\$ 1.5	\$ 1.2	\$ 1.2
Trade accounts payable	64.7	51.0	66.7
Accrued compensation	3.2	6.3	3.5
Other accrued liabilities	16.1	16.6	13.7
Total current liabilities	85.5	75.1	85.1
NON-CURRENT LIABILITIES:			
Long-term debt, less current maturities	166.8	101.8	102.3
Other non-current liabilities	2.2	2.5	3.4
Total non-current liabilities	169.0	104.3	105.7
SHAREHOLDERS' EQUITY:			
Preferred shares: \$.01 par (5,000,000 shares authorized)	—	—	—
Common shares: \$.01 par (75,000,000 shares authorized: 26,040,012; 25,843,166; and 25,879,812 shares issued at September 30, 2018, December 31, 2017 and September 30, 2017, respectively)	0.3	0.3	0.3
Additional paid-in capital	45.4	44.1	43.5
Retained earnings	23.0	22.1	31.9
Total shareholders' equity	68.7	66.5	75.7
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 323.2	\$ 245.9	\$ 266.5

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,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Cash Flows From Operating Activities:				
Net income	\$1.2	\$1.4	\$0.9	\$2.7
Adjustments to reconcile net income to net cash used in				
operating activities:				
Income from discontinued operations	—	(0.1)	—	—
Depreciation and amortization	1.4	1.3	4.0	3.6
Non-cash interest expense	0.1	—	0.2	0.2
Stock-based compensation	0.6	0.5	1.8	1.6
Deferred income taxes	0.5	0.9	(0.4)	0.8
Changes in operating assets and liabilities:				
Trade accounts receivable	22.3	13.6	(29.5)	(28.2)
Inventories, net	(6.3)	(11.2)	(41.8)	(27.1)
Trade accounts payable	(3.7)	3.1	13.7	19.5
Other	(3.0)	(3.3)	(5.3)	(7.6)
Cash provided by (used in) continuing operating activities	13.1	6.2	(56.4)	(34.5)
Cash used in discontinued operating activities	(0.1)	(2.2)	(0.7)	(3.9)
Total cash provided by (used in) operating activities	13.0	4.0	(57.1)	(38.4)
Cash Flows From Investing Activities:				
Capital expenditures	(2.9)	(2.2)	(6.8)	(5.7)
Proceeds from Disposition of Assets	0.9	—	0.9	—
Total cash used in investing activities	(2.0)	(2.2)	(5.9)	(5.7)
Cash Flows From Financing Activities:				
Borrowings of debt, net	(11.1)	(1.6)	64.6	45.9
Repurchase of shares to satisfy employee tax withholdings	—	—	(0.4)	(0.9)
Total cash (used in) provided by financing activities	(11.1)	(1.6)	64.2	45.0
Net (decrease) increase in cash and equivalents	(0.1)	0.2	1.2	0.9
Cash and equivalents, beginning of period	1.6	1.0	0.3	0.3
Cash and equivalents, end of period	\$1.5	\$1.2	\$1.5	\$1.2
Supplemental Disclosure of Cash Flow Information:				
Interest paid	\$1.9	\$0.8	\$4.5	\$1.9
Income taxes paid	—	—	0.1	0.4
Non-cash financing activities:				
Assets acquired with debt obligations	1.2	0.5	1.8	1.6

See notes to condensed consolidated financial statements

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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, 2017.

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

Adoption of New Accounting Standards

On January 1, 2018, we adopted Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers (Topic 606)” and all of the related amendments. We adopted the standard using the full retrospective method, which did not require a cumulative effect adjustment to retained earnings. As a result of this adoption, there was no material impact on our revenue recognition practices, income from continuing operations after taxes, net income or earnings per share. See Note 3 for further discussion, including additional required qualitative and quantitative disclosures of our revenue recognition policies.

Accounting Standards Issued But Not Yet Adopted

In June 2018, the Financial Accounting Standards Board (“FASB”) issued ASU 2018-07, “Improvements to Nonemployee Share-Based Payment Accounting”. ASU 2018-07 more closely aligns the accounting for employee and nonemployee share-based payments. This ASU is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2018. Early adoption is permitted. We do not expect the standard to have a material impact on our consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, “Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.” ASU 2017-04 eliminates the two-step process that required identification of potential impairment and a separate measure of the actual impairment. The annual assessment of goodwill impairment will be determined by using the difference between the carrying amount and the fair value of the reporting unit. This guidance will be effective in the first quarter of 2020 on a prospective basis, and early adoption is permitted. We do not expect the standard to have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)”, which requires lessees to recognize leases on-balance sheet and disclose key information about leasing arrangements. The new standard establishes a right-of-use model (ROU) that requires a lessee to recognize a ROU asset and lease liability on the balance sheet for all leases with a term longer than 12 months. Leases will be classified as finance or operating, with classification affecting the pattern and classification of expense recognition in the income statement.

The new standard is effective for us on January 1, 2019, with early adoption permitted. We expect to adopt the standard on its effective date using the modified retrospective approach.

The standard provides several optional practical expedients in transition. We expect to elect the ‘package of practical expedients’, which permits us to forgo reassessment of our prior conclusions about lease identification, lease classification and initial direct costs for periods prior to the effective date. Consequently, financial information will not be updated and the disclosures required under the new standard will not be provided for dates and periods before January 1, 2019. We do not expect to elect the use-of-hindsight or land easement practical expedients, the latter not being applicable to us.

We anticipate this standard will have a material effect on our financial statements. While we continue to assess the effects of adoption, we believe the most significant effects will relate to the recognition of new ROU assets and liabilities on our balance sheet for vehicle and equipment leases, and new disclosures about our leasing activities. We do not expect a significant change in our leasing activities between now and adoption.

In August 2018, the SEC adopted amendments to certain disclosure requirements in Securities Act Release No. 33-10532, “Disclosure Update and Simplification”. The amendments will become effective on November 5, 2018. Among the amendments is the requirement to present the changes in shareholders’ equity in the interim financial statements (either in a separate statement or footnote) in quarterly reports on Form 10-Q. This reporting requirement will be effective for us beginning with the quarterly report for the period ended March 31, 2019.

3. REVENUE

Revenue is recognized when performance obligations with our customer are satisfied. A performance obligation is a promise to transfer a distinct good to the customer and is the unit of account in Accounting Standards Codification (“ASC”) Topic 606. The transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. All of our contracts have a single performance obligation as the promise to transfer the individual good is not separately identifiable from other promises and is, therefore, not distinct. Our performance obligations are satisfied at a point in time and revenue is recognized when the customer accepts the delivery of our product or takes possession of our product with rights and rewards of ownership.

Revenue is measured as the amount of consideration we expect to receive in exchange for transferring goods. We report revenue, including our direct sales, on a net basis, which includes gross revenue adjustments for estimated returns, cash payment discounts based on the satisfaction of outstanding receivables, and volume purchase rebates.

As it relates to direct sales, we are the principal of these arrangements, as we are responsible for fulfilling the promise to provide specific goods to our customers including product specifications, pricing and modifications before it is delivered to our customers.

The following table disaggregates our revenue by product classification:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Millwork products	\$104.8	\$97.6	\$303.5	\$288.8
Building products	96.9	82.6	281.9	229.6
Wood products	20.3	19.4	58.0	55.6
Net sales	\$222.0	\$199.6	\$643.4	\$574.0

4. DEBT

Debt consisted of the following (in millions):

	September 30, 2018	December 31, 2017	September 30, 2017
Revolving credit facility	\$ 163.6	\$ 99.2	\$ 99.6
Other obligations	4.7	3.8	3.9
Total debt	168.3	103.0	103.5
Less current maturities of long-term debt	1.5	1.2	1.2
Long-term debt, less current maturities	\$ 166.8	\$ 101.8	\$ 102.3

Credit Facility — In July 2017, the Company amended and extended its asset-based senior secured revolving credit facility (“credit facility”) with Wells Fargo Capital Finance, Bank of America and JPMorgan Chase. The amendment, among other things, increased the borrowing capacity from \$160.0 million to \$250.0 million, reduced the minimum fixed charge coverage ratio (the “FCCR”) and extended the maturity to July 14, 2022. The amended facility may be increased to \$300.0 million, through an uncommitted \$50.0 million accordion feature, subject to certain conditions. 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.

At September 30, 2018, the Company had revolving credit borrowings of \$163.6 million outstanding at a weighted average interest rate of 4.1% per annum, letters of credit outstanding totaling \$3.3 million, primarily used as collateral for health and workers’ compensation insurance, and \$35.8 million of excess committed borrowing availability. The Company pays an unused commitment

fee of 0.25% per annum. In addition, the Company had \$4.7 million of capital lease and other obligations outstanding at September 30, 2018.

The sole financial covenant in the credit facility is the minimum FCCR of 1.00:1.00, which must be tested by the Company if the excess committed borrowing availability falls below an amount in a range between \$17.5 million to \$31.3 million, depending on the Company's borrowing base. The FCCR must also be tested on a pro forma basis prior to consummation of certain transactions outside the ordinary course of the Company's business, as defined in the credit agreement. In the third quarter of 2018, the minimum FCCR was not required to be tested, as excess committed borrowing availability was greater than the minimum threshold. However, if the Company's excess borrowing availability had fallen below that threshold, we would not have met the minimum FCCR.

5. CONTINGENCIES

The Company carries insurance policies on insurable risks with coverage and other terms that it believes to be appropriate. The Company 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.

Environmental and Legal Matters

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 and other legal matters. It is possible, however, that actual expenses could 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.

Environmental Matters

As described in Note 7 — "Commitments and Contingencies" in the notes to our audited consolidated financial statements under Part II, Item 8 of the Company's Annual Report on Form 10-K for the year ended December 31, 2017, 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"). In September 2015, the remedial action work plan ("RAWP") was approved.

The Company paid \$0.7 million in the first nine months of 2018 implementing the RAWP. The Company estimates the total remaining cost of implementing the RAWP to be \$2.8 million at September 30, 2018. As of September 30, 2018, 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 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, 2018 by a material amount. If actual costs are materially higher, the

incremental expenses over the amount currently accrued could have a material adverse effect on our liquidity, financial condition and operating results.

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

Legal Matters

See Note 7 – “Commitments and Contingencies” in the notes to our consolidated financial statements under Part II, Item 8 of the Company's Annual Report on Form 10-K for the year ended December 31, 2017 and Note 5 “Contingencies” in the notes to the Condensed Consolidated Financial Statements (unaudited) in Item 1 of the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2018.

6. EARNINGS (LOSS) PER SHARE

The Company calculates its basic income (loss) per share by dividing net income (loss) allocated to common shares outstanding by the weighted average number of common shares outstanding. Unvested shares of restricted stock 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, 2018		Nine Months Ended September 30, 2017	
Earnings allocated to participating shareholders	\$—	\$—	\$—	\$0.1
Number of participating securities	0.9	1.1	1.0	1.2

The diluted earnings per share calculations include the effect of the assumed exercise using the treasury stock method for 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 (loss) per share from continuing operations (in millions).

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Weighted-average number of common shares-basic	25.1	24.9	25.1	24.8
Dilutive potential common shares	—	—	—	—
Weighted-average number of common shares-dilutive	25.1	24.9	25.1	24.8

7. INCOME TAXES

The Company's effective tax rate from continuing operations was a benefit of 72% and expense of 23% in the nine month periods ended September 30, 2018 and 2017, respectively. The 2018 year-to-date tax rate was impacted by the vesting of restricted stock which provided an income tax deduction in excess of the compensation deduction for GAAP purposes. This excess tax benefit increased the benefit reported on first and second quarter losses.

As of September 30, 2018, the Company had a \$7.1 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 COMPENSATION

The Company recognized \$0.6 million and \$0.5 million in non-cash, stock-based compensation expense in the third quarter of 2018 and 2017, respectively. The Company recognized \$1.8 million and \$1.6 million in non-cash, stock-based compensation expense for the nine-month periods ended September 30, 2018 and 2017, respectively. During the first nine months of 2018, the Company granted an aggregate of 406,743 shares of restricted stock at a weighted average value of \$6.84 per share under its 2005 Executive Incentive Compensation Plan, as amended and restated. Most restricted shares vest in three equal installments on the first, second and third anniversaries of the grant date or cliff vest in five years. During the first nine months of 2018, the Company granted an aggregate of 33,732 shares of restricted stock under its Non-Employee Directors' Restricted Stock Plan, as amended, at an average fair market value of \$7.12 per share. The directors' restricted shares vest over one year. 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, 2018 and 2017, the total compensation expense not yet recognized related to all outstanding restricted stock awards was \$3.8 million and \$4.0, respectively.

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

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. We cannot guarantee that any forward-looking statements will be realized or achieved. 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; the cyclical nature of our industry; the uncertainties resulting from changes to United States and foreign laws, regulations and policies, the cost of environmental compliance, including actual expenses we may incur to resolve proceedings we are involved in arising out of the formerly owned facility in Montana; any limitations on our ability to utilize our deferred tax assets to reduce future taxable income and 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; dumping duties; tariffs; risks associated with our private brands; termination of key supplier relationships; risks of international suppliers; 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 the liabilities of such businesses; and those set forth under Part I, Item 1A-“Risk Factors” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. 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.

Overview

The Company 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, 2018		2017		Nine Months Ended September 30, 2018		2017	
Millwork products (1)	47 %	49 %	47 %	50 %	47 %	50 %	47 %	50 %
Building products (2)	44 %	41 %	44 %	40 %	44 %	40 %	44 %	40 %
Wood products (3)	9 %	10 %	9 %	10 %	9 %	10 %	9 %	10 %
Total net product sales	100%	100 %	100%	100 %	100%	100 %	100%	100 %

(1) Millwork products 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.

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Industry Conditions

New housing activity in 2018 is still below the historical average of 1.4 million total housing starts from 1959 to 2017 based on statistics tracked by the United States Census Bureau, although above 2017 corresponding levels. Total housing starts were approximately 1.2 million in 2017. Through September 30, 2018, based on the most recent data provided by the United States Census Bureau, total new housing starts were 6.4% above 2017 levels for the corresponding nine-month period.

Various factors 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, dumping duties, tariffs, 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 quarters 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.

Strategic Initiatives

Our strategy is to increase shareholder value through the growth and diversification of our business. To accomplish this, we developed strategic initiatives that require investments in our infrastructure, working capital, and our people and technology platform.

To accelerate this growth and diversification, we have made strategic operating investments to execute our product line expansion and market segment penetration. The national expansion of our Huttig-Grip product line, which is sourced both domestically and internationally, expands the breadth and geographical coverage of our private label specialty building product lines. We believe that through our investments in automated, high-capacity pre-finish door lines and segment-focused sales resources, further penetration of the home improvement, repair and remodel market diversifies our business to be less dependent on new home construction, reinforces our position as the largest, value-add door fabricator to the professional residential construction market in the country, and accelerates our growth in higher value, and higher gross margin products.

Critical Accounting Policies

We prepare our condensed consolidated financial statements in accordance with GAAP, which requires 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, 2017 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, 2018, 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, 2017.

Results of Operations

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Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017

Net sales were \$222.0 million in the third quarter of 2018, which was \$22.4 million, or 11.2%, higher than the third quarter of 2017. The increase in net sales was primarily attributed to an increase in residential construction activity as well as organic growth derived from the execution of our strategic growth initiatives.

Millwork product sales increased 7.4% in the third quarter of 2018 to \$104.8 million, compared to \$97.6 million in the third quarter of 2017. Building products sales increased 17.3% in the third quarter of 2018 to \$96.9 million, compared to \$82.6 million in the third quarter of 2017, and wood product sales increased 4.6% in the third quarter of 2018 to \$20.3 million, compared to \$19.4 million in the third quarter of 2017. The proportionate increase in building products is generally consistent with the growth derived from our strategic growth initiatives.

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Gross margin was \$44.6 million in the third quarter of 2018, compared to \$41.3 million in the third quarter of 2017. The increase in gross margin was largely due to higher overall sales volumes. As a percentage of sales, gross margin was 20.1% in the third quarter of 2018, compared to 20.7% in the third quarter of 2017. The reduction in gross margin percent was primarily attributed to a higher proportionate increase in direct sales volumes for the third quarter of 2018 compared to the third quarter of 2017, as well as the higher proportional increase in building product sales as compared to the growth of other higher margin product categories.

Operating expenses increased \$2.9 million to \$41.1 million in the third quarter of 2018, compared to \$38.2 million in the third quarter of 2017. Personnel costs increased approximately \$1.5 million, primarily as a result of wage increases, increased variable compensation, higher healthcare costs, and hiring additional sales and warehouse personnel related to the execution of our strategic growth initiatives. Non-personnel costs increased approximately \$1.4 million, primarily as a result of higher fuel prices, increased contract hauling costs, and higher facility costs. As a percentage of sales, operating expenses were 18.5% in the third quarter of 2018, compared to 19.1% in the third quarter of 2017. Absent litigation costs related to the PrimeSource Building Products, Inc. ("PrimeSource") legal matter which was settled in June 2018, our operating expense ratio would have been 18.5% in both years.

Net interest expense was \$1.8 million in the third quarter of 2018 compared to \$0.9 million in the third quarter of 2017. The increase was primarily due to higher average outstanding borrowings on our credit facility as well as higher interest rates in the third quarter of 2018 compared to the third quarter of 2017.

Income tax expense was \$0.5 million for the quarter ended September 30, 2018, as compared to \$0.9 million for the third quarter of 2017.

As a result of the foregoing factors, we reported income from continuing operations of \$1.2 million for the quarter ended September 30, 2018, compared to income from continuing operations of \$1.3 million for the quarter ended September 30, 2017.

Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017

Net sales were \$643.4 million in 2018, which was \$69.4 million, or 12.1%, higher than 2017. The increase in net sales was primarily attributed to an increase in residential construction activity as compared to 2017 levels as well as organic growth derived from the execution of our strategic growth initiatives.

Millwork product sales increased 5.1% in 2018 to \$303.5 million, compared to \$288.8 million in 2017. Building products sales increased 22.8% in 2018 to \$281.9 million, compared to \$229.6 million in 2017, and wood product sales increased 4.3% in 2018 to \$58.0 million, compared to \$55.6 million in 2017. The year-over-year increase in building product sales is generally consistent with the growth derived from our strategic growth initiatives.

Gross margin was \$128.3 million in 2018, compared to \$119.0 million in 2017. The increase in gross margin was largely due to higher overall sales volumes. As a percentage of sales, gross margin was 19.9% in 2018, compared to 20.7% in 2017. The reduction in gross margin percent was primarily attributed to a higher proportionate increase in direct sales volumes, as well as the higher proportional increase in building product sales as compared to the growth of other higher margin product categories.

Operating expenses increased \$9.9 million to \$123.2 million for 2018, compared to \$113.3 million in 2017. Personnel costs increased approximately \$5.1 million, primarily as a result of wage increases, increased variable compensation, higher healthcare costs, and hiring additional sales and warehouse personnel related to the execution of our strategic growth initiatives. Non-personnel expenses increased approximately \$4.8 million, primarily as a result of higher fuel prices, increased contract hauling costs, higher facility costs, and expenses associated with the PrimeSource litigation and settlement. As a percentage of sales, operating expenses decreased to 19.1% in 2018 compared to 19.7% in 2017. Excluding expenses associated with the PrimeSource matter, operating expenses would have been

approximately 18.6% and 19.3% of sales for the nine months ended September 30, 2018 and 2017, respectively.

Net interest expense was \$4.6 million in 2018 compared to \$2.2 million in 2017. The increase was primarily due to higher average outstanding borrowings on our credit facility as well as higher interest rates in 2018 compared to 2017.

Income tax benefit was \$0.4 million in 2018, as compared to an expense of \$0.8 million in 2017.

As a result of the foregoing factors, we reported income from continuing operations of \$0.9 million for the nine months ended September 30, 2018, compared to income from continuing operations of \$2.7 million for the nine months ended September 30, 2017.

Liquidity and Capital Resources

We depend on our cash flows from operations and funds available under our revolving credit facility to finance seasonal working capital needs, capital expenditures, additional investments in our product lines, including Huttig-Grip, and any acquisitions that we

may undertake. Typically, our working capital requirements are greatest in the second and third quarters, which reflect the seasonal nature of our business. The second and third quarters also tend to be 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 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.

Cash provided by operating activities was \$13.1 million for the quarter ended September 30, 2018, compared to \$6.2 million for the quarter ended September 30, 2017. In the third quarter of 2018, cash was primarily derived from a reduction in net working capital.

During the first nine months of 2018, our working capital was impacted significantly, as we continued to invest in inventory related to the national expansion of our Huttig-Grip product line. Sourcing Huttig-Grip products internationally requires longer lead-times and higher inventory levels to ensure available supply, and generally requires shorter payment terms to suppliers, but it also provides an opportunity for higher margins. At September 30, 2018, inventories and accounts receivable constituted approximately 77% of our total assets. We also 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.

At September 30, 2018, the Company had \$35.8 million of excess committed borrowing availability.

Operations. Cash used in operating activities was \$57.1 million during the first nine months of 2018, compared to cash used in operating activities of \$38.4 million during the first nine months of 2017. Accounts receivable increased by \$29.5 million during the first nine months of 2018, compared to an increase of \$28.2 million in the prior-year corresponding period. The increase in accounts receivable over the first nine months of the year is commensurate with our sales activity as a result of the normal seasonality of our business, coupled with the increased revenue generated through our growth initiatives. Our inventory levels increased \$41.8 million during the first nine months of 2018 driven largely by the expansion of our Huttig-Grip product line along with the normal seasonal build for increased sales activity. These working capital increases were offset by an increase in accounts payable of \$13.7 million, primarily a result of our inventory build for the respective periods. The accounts payable increase relative to the increase in inventories is mitigated in part by shorter payment terms to suppliers on internationally sourced products.

Investing. During the first nine months of 2018, net cash used in investing activities was \$5.9 million compared to \$5.7 million for the corresponding period in 2017 and was largely used for additional investments in machinery and equipment at various distribution centers, including additional investments related to our strategic growth initiatives.

Financing. Cash provided by financing activities of \$64.2 million during the first nine months of 2018 reflected net borrowings of \$64.6 million offset by \$0.4 million for the repurchase of shares to satisfy employee tax withholdings on stock-based awards. Cash provided by financing activities of \$45.0 million in the first nine months of 2017 reflected net borrowings of \$45.9 million offset by \$0.9 million for the repurchase of shares to satisfy employee tax withholdings on stock-based awards.

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. At September 30, 2018, the minimum FCCR was not required to be tested, as excess borrowing availability was greater than the minimum threshold. However, if the Company's availability had fallen below that threshold, we would not have met the minimum FCCR. If we are unable to maintain excess borrowing availability of more than the applicable amount in the range of \$17.5 million to \$31.3 million and we do not meet the minimum FCCR, the 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 were 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 our credit facility as described above, we use operating leases, which are considered to be off-balance sheet arrangements. 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, 2017 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, 2018, 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, 2017.

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 the Condensed Consolidated Financial Statements (unaudited) in Item 1 for information on legal proceedings in which the Company is involved.

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ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risk from the information provided in “Item 7A. Quantitative and Qualitative Disclosures About Market Risk” in our Annual Report on Form 10-K for the year ended December 31, 2017.

ITEM 4 — CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures – The Company, under the supervision and with the participation of our Disclosure Committee and management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e)) under the Securities Exchange Act of 1934, as amended (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, 2018 in all material respects to (a) causing information required to be disclosed by us in reports that we file or submit under the Exchange Commission’s rules and forms and (b) causing such information to be accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Control systems must reflect resource constraints and be cost-effective, can be undercut by simple errors and misjudgments, and can be circumvented by individuals within an organization. Because of these and other inherent limitations in all control systems, no matter how well they are designed, our disclosure controls and procedures and internal controls can provide reasonable, but not absolute, protection from error and fraud.

Management’s Report on Internal Control Over Financial Reporting – The Company’s management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management’s assessment included an evaluation of the design of the Company’s internal control over financial reporting and testing of the operational effectiveness of its internal control over financial reporting. Management reviewed the results of its assessment with the Audit Committee of our Board of Directors. Based on our evaluation under the framework in Internal Control-Integrated Framework (2013), our management concluded that our internal control over financial reporting was effective as of September 30, 2018.

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, 2018, 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 the Condensed Consolidated Financial Statements (unaudited) in Item 1 for information on legal proceedings in which the Company is involved. See also Note 7 – “Commitments and Contingencies” in the notes to our consolidated financial statements under Part II, Item 8 the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 and Note 5 “Contingencies” in the Notes to the Condensed Consolidated Financial Statements (unaudited) in Item 1 of the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2018.

ITEM 1A — RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2017, which could materially affect our business, financial condition, and future results. These described risks are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, and operating results. There have been no material changes to the risk factors set forth in our Annual Report on Form 10-K for the year ended December 31, 2017.

ITEM 6 — EXHIBITS

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).
- 3.1 Second Amended and Restated Certificate of Incorporation of the Company (Incorporated by reference to Exhibit 3.1 to the Form 10-Q filed with the Securities and Exchange Commission on May 2, 2017).
- 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

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 30, 2018

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

HUTTIG BUILDING PRODUCTS, INC.

/s/ Philip W. Keipp

Date: October 30, 2018

Philip W. Keipp
Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)