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, 2019

OR

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

For the transition period from________ to ________

Commission File Number 0-51357

BUILDERS FIRSTSOURCE, INC.
(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**52-2084569** **(I.R.S. Employer Identification No.)**
2001 Bryan Street, Suite 1600 **Dallas, Texas** **(Address of principal executive offices)**	**75201** **(Zip Code)**

(214) 880-3500
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on Which Registered
Common stock, par value $0.01 per share	**BLDR**	**NASDAQ Stock Market LLC**

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 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 the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☒	Accelerated filer	☐
Non-accelerated filer	☐	Small 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 by Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The number of shares of the issuer's common stock, par value $0.01, outstanding as of October 30, 2019 was115,786,770.

BUILDERS FIRSTSOURCE, INC.

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PART I — FINANCIAL INFORMATION

Item 1. ***Financial Statements (unaudited)***

BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(Unaudited) (In thousands, except per share amounts)			
Sales	$ 1,981,035	$ 2,118,467	$ 5,516,858	$ 5,908,791
Cost of sales	1,439,893	1,595,686	4,016,585	4,478,630
Gross margin	541,142	522,781	1,500,273	1,430,161
Selling, general and administrative expenses	411,510	400,993	1,183,105	1,151,670
Income from operations	129,632	121,788	317,168	278,491
Interest expense, net	27,788	29,106	82,071	84,805
Income before income taxes	101,844	92,682	235,097	193,686
Income tax expense	23,714	19,354	54,655	40,516
Net income	$ 78,130	$ 73,328	$ 180,442	$ 153,170
Comprehensive income	$ 78,130	$ 73,328	$ 180,442	$ 153,170
Net income per share:				
Basic	$ 0.68	$ 0.64	$ 1.56	$ 1.34
Diluted	$ 0.67	$ 0.63	$ 1.54	$ 1.31
Weighted average common shares:				
Basic	115,732	114,707	115,639	114,480
Diluted	117,154	116,456	116,870	116,614

The accompanying notes are an integral part of these condensed consolidated financial statements.

BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET

	September 30, 2019	December 31, 2018
	(Unaudited) (In thousands, except per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 43,271	$ 10,127
Accounts receivable, less allowances of $14,280 and $13,054 at September 30, 2019 and December 31, 2018, respectively	721,134	654,170
Other receivables	49,526	68,637
Inventories, net	581,543	596,896
Other current assets	34,603	43,921
Total current assets	1,430,077	1,373,751
Property, plant and equipment, net	696,154	670,075
Operating lease right-of-use assets, net	286,971	—
Goodwill	754,765	740,411
Intangible assets, net	101,303	103,154
Deferred income taxes	5,055	22,766
Other assets, net	23,434	22,152
Total assets	$ 3,297,759	$ 2,932,309
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 499,360	$ 423,168
Accrued liabilities	289,735	292,526
Current portion of operating lease liabilities	60,280	—
Current maturities of long-term debt	14,370	15,565
Total current liabilities	863,745	731,259
Noncurrent portion of operating lease liabilities	232,475	—
Long-term debt, net of current maturities, debt discount, premium and issuance costs	1,350,467	1,545,729
Deferred income taxes	18,836	—
Other long-term liabilities	53,235	58,983
Total liabilities	2,518,758	2,335,971
Commitments and contingencies (Note 12)		
Stockholders' equity:		
Preferred stock, $0.01 par value, 10,000 shares authorized; zero shares issued and outstanding	—	—
Common stock, $0.01 par value, 200,000 shares authorized; 115,767 and 115,078 shares issued and outstanding at September 30, 2019 and December 31, 2018, respectively	1,158	1,151
Additional paid-in capital	570,373	560,221
Retained earnings	207,470	34,966
Total stockholders' equity	779,001	596,338
Total liabilities and stockholders' equity	$ 3,297,759	$ 2,932,309

The accompanying notes are an integral part of these condensed consolidated financial statements.

BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

	Nine Months Ended September 30, 2019	Nine Months Ended September 30, 2018
	(Unaudited) (In thousands)	
Cash flows from operating activities:		
Net income	$ 180,442	$ 153,170
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	71,771	72,691
Amortization of debt discount, premium and issuance costs	3,060	3,479
Loss on extinguishment of debt, net	4,654	—
Deferred income taxes	36,547	35,829
Stock compensation expense	9,380	9,929
Net gain on sale of assets and asset impairments	(1,502)	(480)
Changes in assets and liabilities, net of assets acquired and liabilities assumed:		
Receivables	(41,083)	(151,092)
Inventories	22,263	(86,639)
Other current assets	8,968	(1,786)
Other assets and liabilities	1,756	1,442
Accounts payable	73,913	(12,792)
Accrued liabilities	(9,905)	(14,219)
Net cash provided by operating activities	360,264	9,532
Cash flows from investing activities:		
Purchases of property, plant and equipment	(77,937)	(78,693)
Proceeds from sale of property, plant and equipment	5,474	1,890
Cash used for acquisitions	(33,931)	—
Net cash used in investing activities	(106,394)	(76,803)
Cash flows from financing activities:		
Borrowings under revolving credit facility	885,000	1,243,000
Repayments under revolving credit facility	(1,064,000)	(1,189,000)
Proceeds from long-term debt and other loans	478,375	3,818
Repayments of long-term debt and other loans	(502,062)	(11,173)
Payments of debt extinguishment costs	(2,301)	—
Payments of loan costs	(8,566)	—
Exercise of stock options	3,220	2,394
Repurchase of common stock	(10,392)	(4,855)
Net cash provided by (used in) financing activities	(220,726)	44,184
Net change in cash and cash equivalents	33,144	(23,087)
Cash and cash equivalents at beginning of the period	10,127	57,533
Cash and cash equivalents at end of the period	$ 43,271	$ 34,446

Supplemental disclosure of non-cash activities

Purchases of property, plant and equipment included in accounts payable were $2.1 million and $2.5 million for the nine months ended September 30, 2019 and 2018, respectively.

The Company purchased equipment which was financed through finance lease obligations of $11.7 million and capital lease obligations of $9.0 million in the nine months ended September 30, 2019 and 2018, respectively.

The accompanying notes are an integral part of these condensed consolidated financial statements.

BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock		Additional Paid in Capital	Retained Earnings (Accumulated Deficit)	Total
	Shares	Amount			
			(Unaudited) (In thousands)		
Balance at December 31, 2017	113,572	$ 1,136	$ 546,766	$ (171,693)	$ 376,209
Vesting of restricted stock units	766	7	(7)	—	—
Stock compensation expense	—	—	2,890	—	2,890
Exercise of stock options	517	5	2,036	—	2,041
Shares withheld for restricted stock units vested	(236)	(2)	(4,853)	—	(4,855)
Cumulative effect adjustment	—	—	—	1,468	1,468
Net income	—	—	—	23,220	23,220
Balance at March 31, 2018	114,619	1,146	546,832	(147,005)	400,973
Vesting of restricted stock units	6	1	(1)	—	—
Stock compensation expense	—	—	3,538	—	3,538
Exercise of stock options	46	—	338	—	338
Net income	—	—	—	56,622	56,622
Balance at June 30, 2018	114,671	$ 1,147	$ 550,707	$ (90,383)	$ 461,471
Vesting of restricted stock units	49	—	—	—	—
Stock compensation expense	—	—	3,501	—	3,501
Exercise of stock options	5	—	15	—	15
Net income	—	—	—	73,328	73,328
Balance at September 30, 2018	114,725	$ 1,147	$ 554,223	$ (17,055)	$ 538,315
Balance at December 31, 2018	115,078	$ 1,151	$ 560,221	$ 34,966	$ 596,338
Vesting of restricted stock units	662	7	(7)	—	—
Stock compensation expense	—	—	2,659	—	2,659
Exercise of stock options	59	—	216	—	216
Shares withheld for restricted stock units vested	(196)	(2)	(2,448)	—	(2,450)
Net income	—	—	—	35,708	35,708
Balance at March 31, 2019	115,603	1,156	560,641	70,674	632,471
Vesting of restricted stock units	11	—	—	—	—
Stock compensation expense	—	—	3,379	—	3,379
Exercise of stock options	266	3	1,674	—	1,677
Net income	—	—	—	66,604	66,604
Balance at June 30, 2019	115,880	$ 1,159	$ 565,694	$ 137,278	$ 704,131
Vesting of restricted stock units	59	—	—	—	—
Repurchase of common stock (1)	(460)	(4)	—	(7,938)	(7,942)
Stock compensation expense	—	—	3,342	—	3,342
Exercise of stock options	288	3	1,337	—	1,340
Net income	—	—	—	78,130	78,130
Balance at September 30, 2019	115,767	$ 1,158	$ 570,373	$ 207,470	$ 779,001

(1) During the three and nine months ended September 30, 2019 we repurchased and retired460,000 shares of our common stock at an average price of $17.24 per share for $7.9 million pursuant to the repurchase program authorized by our board of directors in February 2019.The primary purpose of the repurchase program is to offset dilution from employee stock awards.

The accompanying notes are an integral part of these consolidated financial statements.

BUILDERS FIRSTSOURCE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation

Builders FirstSource, Inc., a Delaware corporation formed in 1998, is a leading supplier and manufacturer of building materials, manufactured components and construction services to professional homebuilders, sub-contractors, remodelers and consumers. The Company operates approximately 400 locations in 40 states across the United States. In this quarterly report, references to the "Company," "we," "our," "ours" or "us" refer to Builders FirstSource, Inc. and its consolidated subsidiaries unless otherwise stated or the context otherwise requires.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements include all recurring adjustments and normal accruals necessary for a fair statement of the Company's financial position, results of operations and cash flows for the dates and periods presented. Results for interim periods are not necessarily indicative of the results to be expected during the remainder of the current year or for any future period. Intercompany transactions are eliminated in consolidation.

The condensed consolidated balance sheet as of December 31, 2018 is derived from the audited consolidated financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. This condensed consolidated balance sheet as of December 31, 2018 and the unaudited condensed consolidated financial statements included herein should be read in conjunction with the more detailed audited consolidated financial statements for the year ended December 31, 2018 included in our most recent annual report on Form 10-K. Accounting policies used in the preparation of these unaudited condensed consolidated financial statements are consistent with the accounting policies described in the Notes to Consolidated Financial Statements included in our Form 10-K, except as noted below relating to the adoption of updated guidance under the *Leases* topic of the Accounting Standards Codification ("Codification").

Recent Accounting Pronouncements

In June 2016, the FASB issued an update to existing guidance under the *Investments* topic of the Codification. This update introduces a new impairment model for financial assets, known as the current expected credit losses ("CECL") model that is based on expected losses rather than incurred losses. The CECL model requires an entity to estimate credit losses on financial assets, including trade accounts receivable, based on historical information, current information and reasonable and supportable forecasts. Under this guidance companies will record an allowance through earnings for expected credit losses upon initial recognition of the financial asset. The aspects of this guidance applicable to us will be required to be adopted on a modified retrospective basis. This update is effective for public companies for annual and interim periods beginning after December 15, 2019, with early adoption permitted for annual and interim periods beginning after December 15, 2018. While we are still evaluating the impact of this guidance on our financial statements, we do not currently expect it to have a material impact.

In February 2016, the FASB issued an update to the existing guidance under the *Leases* topic of the Codification. Under the new guidance, lessees are now required to recognize the following for all leases, with the exception of short-term leases, at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term.

We adopted this guidance on January 1, 2019 by applying the provisions of this guidance on a modified retrospective basis as of the effective date. As such, comparative periods have not been restated and the disclosures required under the new standard have not been provided for periods prior to January 1, 2019. We elected the package of practical expedients whereby we were not required to: i) reassess whether any expired or existing contracts are or contain leases, ii) reassess the lease classification of existing leases and iii) reassess initial direct costs for any existing leases. We did not elect the hindsight practical expedient or the practical expedient related to land easements. We have assessed and updated our business processes, systems and controls to ensure compliance with the recognition and disclosure requirements of the new standard.

Adoption of the new standard resulted in the recording of right-of-use assets and lease liabilities of $269.7 million and $267.5 million, respectively, as of January 1, 2019 to recognize operating leases, primarily related to real estate and rolling stock, which were not recognized on our balance sheet under previous guidance. Further, the adoption of this guidance had no impact to our remaining other finance obligations as they continue to fail to meet the sale-leaseback requirements of the new standard. The adoption of this guidance did not have a material impact on our condensed consolidated statement of operations and comprehensive income or on our condensed consolidated statement of cash flows as our leases retained their classifications as determined under previous guidance.

2. Revenue

The following table disaggregates our sales by product category (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Lumber & lumber sheet goods	$ 605,494	$ 818,693	$ 1,724,670	$ 2,273,761
Manufactured products	401,245	385,894	1,092,896	1,050,963
Windows, doors & millwork	407,397	372,453	1,151,836	1,080,120
Gypsum, roofing & insulation	149,676	146,648	408,983	400,797
Siding, metal & concrete products	201,068	196,591	542,275	528,290
Other building products & services	216,155	198,188	596,198	574,860
Net sales	$ 1,981,035	$ 2,118,467	$ 5,516,858	$ 5,908,791

Information regarding disaggregation of sales by segment is discussed in Note 13 to the condensed consolidated financial statements. Sales related to contracts with service elements represents less than 10% of the Company's net sales for each period presented.

The timing of revenue recognition, billings and cash collections results in accounts receivable, unbilled receivables, contract assets and contract liabilities. Contract asset balances were not significant as of September 30, 2019 or December 31, 2018. Contract liabilities consist of deferred revenue and customer advances and deposits. Contract liability balances are included in accrued liabilities on our consolidated balance sheet and were $48.3 million and $42.1 million as of September 30, 2019 and December 31, 2018, respectively.

3. Net Income per Common Share

Net income per common share ("EPS") is calculated in accordance with the *Earnings per Share* topic of the Codification, which requires the presentation of basic and diluted EPS. Basic EPS is computed using the weighted average number of common shares outstanding during the period. Diluted EPS is computed using the weighted average number of common shares outstanding during the period, plus the dilutive effect of potential common shares.

The table below presents the calculation of basic and diluted EPS (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Numerator:				
Net income	$ 78,130	$ 73,328	$ 180,442	$ 153,170
Denominator:				
Weighted average shares outstanding, basic	115,732	114,707	115,639	114,480
Dilutive effect of options and RSUs	1,422	1,749	1,231	2,134
Weighted average shares outstanding, diluted	117,154	116,456	116,870	116,614
Net income per share:				
Basic	$ 0.68	$ 0.64	$ 1.56	$ 1.34
Diluted	$ 0.67	$ 0.63	$ 1.54	$ 1.31
Antidilutive and contingent options and RSUs excluded from diluted EPS	151	1,035	488	578

4. Debt

Long-term debt consisted of the following (in thousands):

	September 30, 2019	December 31, 2018
2023 facility (1)	$ —	$ 179,000
2024 notes	503,923	696,361
2024 term loan (2)	157,075	458,250
2027 notes	475,000	—
Other finance obligations (Note 5)	222,606	227,071
Finance lease obligations (Note 5)	18,915	16,445
	1,377,519	1,577,127
Unamortized debt discount/premium and debt issuance costs	(12,682)	(15,833)
	1,364,837	1,561,294
Less: current maturities of long-term debt	14,370	15,565
Long-term debt, net of current maturities	$ 1,350,467	$ 1,545,729

(1) The weighted average interest rate was 4.4% and 3.9% as of September 30, 2019 and December 31, 2018, respectively.

(2) The weighted average interest rate was 5.6% and 5.2% as of September 30, 2019 and December 31, 2018, respectively.

2019 Debt Transactions

During the nine months ended September 30, 2019, the Company executed several debt transactions which are described in more detail below. These transactions include: (i) open market purchases of our 5.625% senior secured notes due 2024 (“2024 notes”), (ii) extension of the maturity of our $900.0 million revolving credit facility (“2023 facility”) and (iii) privately negotiated purchases of our 2024 notes and a partial repayment of our senior secured term loan facility due 2024 (“2024 term loan”) with the proceeds from the issuance of 6.75% senior secured notes due 2027 (“2027 notes”). These transactions collectively have extended our debt maturity profile and reduced the amount of long-term debt outstanding.

2024 Note Repurchase Transactions

In the first quarter of 2019, the Company executed a series of open market purchases of its 2024 notes. These transactions resulted in $20.4 million in aggregate principal amount of the 2024 notes being repurchased at prices ranging from 94.9% to 95.9% of par value.

These repurchases of the 2024 notes were considered to be debt extinguishments. As such, we recognized a gain on debt extinguishment of $0.7 million which was recorded as a component of interest expense in the first quarter of 2019. Of this gain, approximately $0.9 million was attributable to the repurchase of the notes at a discount to par value which was partially offset by a $0.2 million write-off of unamortized debt issuance costs associated with the 2024 notes repurchased.

Revolving Credit Facility Amendment

In April 2019, the Company extended the maturity date of its 2023 facility by 20 months to November 22, 2023. All other material terms of the 2023 facility remain unchanged from those of the previous agreement.

In connection with the 2023 facility amendment we incurred $1.2 million in lender and third-party fees which, together with $5.9 million in remaining unamortized debt issuance costs, have been recorded as other assets and are being amortized over the remaining contractual life of the 2023 facility on a straight-line basis.

Second Quarter 2019 Refinancing Transactions

In May 2019, we completed a private offering of $400.0 million in aggregate principal amount of 2027 notes at an issue price equal to 100% of their par value. The proceeds from the issuance of the 2027 notes were used, together with cash on hand, to purchase $97.0 million in aggregate principal amount of 2024 notes, to repay $300.0 million of the 2024 term loan and to pay related transaction fees and expenses.

In connection with the issuance of the 2027 notes, we incurred $6.1 million of various third-party fees and expenses. Of these costs, $2.1 million were recorded to interest expense in the second quarter of 2019. The remaining $4.0 million in costs incurred have been recorded as a reduction to long-term debt and are being amortized over the contractual life of the 2027 notes using the effective interest method. Further, we recorded an additional $2.2 million to interest expense in the second quarter of 2019 related to the write-off of unamortized debt discount and debt issuance costs in connection with the partial repayment of the 2024 term loan.

Third Quarter 2019 Refinancing Transactions

In July 2019, we completed a private offering of an additional $75.0 million in aggregate principal amount of 2027 notes at an issue price of 104.5% of their par value. The proceeds from the issuance of the 2027 notes were used together with cash on hand to redeem an additional $75.0 million in aggregate principal amount of 2024 notes and to pay related transaction fees and expenses.

The additional $3.4 million in proceeds received in excess of par value represents a debt premium which has been recorded as an increase to long-term debt. In connection with the issuance of the additional 2027 notes, we incurred $1.3 million of various third-party fees and expenses which have been recorded as a reduction to long-term debt. These third party costs and the debt premium will be amortized over the contractual life of the 2027 notes using the effective interest method.

The redemption of the 2024 notes was considered to be an extinguishment. As such, we recognized a loss on extinguishment of $3.1 million. Of this loss, $2.2 million was attributable to the call premium paid to the lenders and $0.9 million was attributable to the write-off of unamortized debt issuance costs associated with the extinguished 2024 notes.

Senior Secured Notes due 2027

As of September 30, 2019, we have $475.0 million outstanding in aggregate principal amount of the 2027 notes which mature on June 1, 2027. Interest accrues on the 2027 notes at a rate of 6.75% per annum and is payable semi-annually on June 1 and December 1 of each year, commencing on December 1, 2019.

The terms of the 2027 notes are governed by the indenture, dated as of the May 30, 2019 (the “Indenture”), among the Company, the guarantors named therein and Wilmington Trust, National Association, as trustee and as notes collateral agent. The 2027 notes, subject to certain exceptions, are guaranteed, jointly and severally, on a senior secured basis, by certain of the Company’s direct and indirect wholly owned subsidiaries (the “Guarantors”). All obligations under the 2027 notes, and the guarantees of those obligations, are secured by substantially all of the assets of the Company and the Guarantors subject to certain exceptions and permitted liens, including a first-priority security interest in such assets that constitute Notes Collateral (as defined below) and a second-priority security interest in such assets that constitute ABL Collateral (as defined below).

“ABL Collateral” includes substantially all presently owned and after-acquired accounts, inventory, rights of an unpaid vendor with respect to inventory, deposit accounts, investment property, cash and cash equivalents, and instruments and chattel paper and general intangibles, books and records and documents related to and proceeds of each of the foregoing. “Notes Collateral” includes all collateral which is not ABL Collateral.

The Indenture contains restrictive covenants that limit the ability of the Company and its restricted subsidiaries to, among other things, incur additional debt or issue preferred stock, create liens, create restrictions on the Company’s subsidiaries’ ability to make payments to the Company, pay dividends and make other distributions in respect of the Company’s and its subsidiaries’ capital stock, make certain investments or certain other restricted payments, guarantee indebtedness, designate unrestricted subsidiaries, sell certain kinds of assets, enter into certain types of transactions with affiliates, and effect mergers and consolidations.

At any time prior to June 1, 2022, the Company may redeem the 2027 notes in whole or in part at a redemption price equal to 100% of the principal amount of the 2027 notes plus the “applicable premium” set forth in the Indenture. At any time on or after June 1, 2022, the Company may redeem the 2027 notes at the redemption prices set forth in the Indenture, plus accrued and unpaid interest, if any, to the redemption date. At any time and from time to time during the 36-month period following the Closing Date, the Company may redeem up to 10% of the aggregate principal amount of the 2027 notes during each twelve-month period commencing on the Closing Date at a redemption price of 103% of the aggregate principal amount thereof plus accrued and unpaid interest to the redemption date. In addition, at any time prior to June 1, 2022, the Company may redeem up to 40% of the aggregate principal amount of the 2027 notes with the net cash proceeds of one or more equity offerings, as described in the Indenture, at a price equal to 106.750% of the principal amount thereof, plus accrued and unpaid interest, if any, to the redemption date. If the Company experiences certain change of control events, holders of the 2027 notes may require it to repurchase all or part of their 2027 notes at 101% of the principal amount thereof, plus accrued and unpaid interest, if any, to the repurchase date.

Fair Value

As of September 30, 2019 and December 31, 2018, the Company does not have any financial instruments which are measured at fair value on a recurring basis. We have elected to report the value of our 2027 notes, 2024 notes, 2024 term loan and 2023 facility at amortized cost. The fair values of the 2027 notes, 2024 notes and the 2024 term loan at September 30, 2019 were approximately $512.1 million, $526.1 million and $157.6 million, respectively, and were determined using Level 2 inputs based on market prices.

We were not in violation of any covenants or restrictions imposed by any of our debt agreements at September 30, 2019.

5. Leases and Other Finance Obligations

We lease certain land, buildings, rolling stock and other types of equipment for use in our operations. These leases typically have initial terms ranging from one to 15 years. Many of our leases contain renewal options which are exercisable at our discretion. These renewal options generally have terms ranging from one to five years. We also lease certain properties from related parties, including current employees and non-affiliate stockholders. Leases with related parties are not significant as of or for the nine months ended September 30, 2019 or 2018.

We determine if an arrangement is a lease at the inception of the arrangement. Lease liabilities are recognized based on the present value of lease payments over the lease term at the arrangement's commencement date. Right-of-use assets are recognized based on the amount of the measurement of the lease liability adjusted for any lease payments made to the lessor at or before the commencement date, minus any lease incentives received and any initial direct costs incurred. Renewal options are included in the calculation of our right-of-use assets and lease liabilities when it is determined that they are reasonably certain of exercise based on an analysis of the relevant facts and circumstances. As the implicit rate of return of our lease agreements is usually not readily determinable, we generally use our incremental borrowing rate in determining the present value of lease payments. We determine our incremental borrowing rate based on information available to us at the lease commencement date. Certain of our lease arrangements contain lease and non-lease components. We have elected to account for non-lease components as a part of the related lease components for all of our leases. Leases with an initial term of 12 months or less are not recognized on our balance sheet. We recognize the expense for these leases on a straight-line basis over the lease term.

Certain of our leases are subject to variable lease payments based on various measures, such as rent escalations determined by percentage changes in the consumer price index. As these types of variable lease payments are determined on a basis other than an index or a rate, they are generally excluded from the calculation of lease liabilities and right-of-use assets and are expensed as incurred.

In addition, we have residual value guarantees on certain equipment leases. Under these leases, we have the option of (a) purchasing the equipment at the end of the lease term, (b) arranging for the sale of the equipment to a third party, or (c) returning the equipment to the lessor to sell the equipment. If the sales proceeds in any case are less than the residual value, we are required to reimburse the lessor for the deficiency up to a specified level as stated in each lease agreement. If the sales proceeds exceed the residual value, we are entitled to all of such excess amounts. The guarantees under these leases for the residual values of equipment at the end of the respective operating lease periods approximated $4.9 million as of September 30, 2019. Based upon the expectation that none of these leased assets will have a residual value at the end of the lease term that is materially less than the value specified in the related operating lease agreement or that we will purchase the equipment at the end of the lease term, we do not believe it is probable that we will be required to fund any amounts under the terms of these guarantee arrangements. Accordingly, these guarantees have not been recognized in the calculation of our right-of-use assets and lease liabilities. Our lease agreements do not impose any significant restrictions or covenants on us. As of September 30, 2019, we had future lease payments of $3.1 million related to leases which have been signed, but have not yet commenced. As such, these lease payments are not reflected on our condensed consolidated balance sheet as of September 30, 2019.

Right-of-use assets and lease liabilities consisted of the following (in thousands):

		September 30, 2019
Assets		
Operating lease right-of-use assets, net	$	286,971
Finance lease right-of-use assets, net (included in property, plant and equipment, net)		28,747
Total right-of-use assets	$	315,718
Liabilities		
Current		
Current portion of operating lease liabilities	$	60,280
Current portion of finance lease liabilities (included in current maturities of long-term debt)		10,330
Noncurrent		
Noncurrent portion of operating lease liabilities	$	232,475
Noncurrent portion of finance lease liabilities (included in long-term debt, net of current maturities)		8,585
Total lease liabilities	$	311,670

Total lease costs consisted of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019		2019	
Operating lease costs*	$	21,153	$	63,255
Finance lease costs:				
Amortization of finance lease right-of-use assets		1,353		3,686
Interest on finance lease liabilities		294		810
Variable lease costs		3,484		11,566
Total lease costs	$	26,284	$	79,317

* *Includes short-term lease costs and sublease income which were not material for the three and nine months ended September 30, 2019.*

Future maturities of lease liabilities as of September 30, 2019 were as follows (in thousands):

	Finance Leases		Operating Leases	
2019 (from October 1, 2019)	$	3,448	$	20,301
2020		9,658		74,964
2021		5,496		66,168
2022		1,507		51,749
2023		—		38,723
Thereafter		—		108,577
Total lease payments		20,109		360,482
Less: amount representing interest		(1,194)		(67,727)
Present value of lease liabilities		18,915		292,755
Less: current portion		(10,330)		(60,280)
Long-term lease liabilities, net of current portion	$	8,585	$	232,475

Weighted average lease terms and discount rates as of September 30, 2019 were as follows:

Weighted average remaining lease term (years)	
Operating leases	6.3
Finance leases	2.0
Weighted average discount rate	
Operating leases	6.7%
Finance leases	5.9%

Future maturities of lease obligations as of December 31, 2018 were as follows (in thousands):

	Capital Leases	Operating Leases
2019	$ 10,784	$ 77,297
2020	5,392	63,633
2021	1,242	51,804
2022	—	37,054
2023	—	23,327
Thereafter	—	57,000
Total minimum lease payments	17,418	$ 310,115
Less: amount representing interest	(973)	
Present value of lease liabilities	16,445	
Less: current portion	(10,039)	
Long-term lease liabilities, net of current portion	$ 6,406	

The following table presents cash paid for amounts included in the measurement of lease liabilities as well supplemental noncash information (in thousands):

	Nine Months Ended September 30, 2019
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	$ 60,977
Operating cash flows from finance leases	810
Financing cash flows from finance leases	8,181
Right-of-use assets obtained in exchange for new operating lease liabilities	64,632
Right-of-use assets obtained in exchange for new finance lease liabilities	11,653

Other Finance Obligations

In addition to the operating and finance lease arrangements described above, the Company is party to 140 individual property lease agreements with a single lessor as of September 30, 2019. These lease agreements have initial terms ranging from nine to 15 years (expiring through 2021) and renewal options in five-year increments providing for up to approximately 30-year total lease terms. A related agreement between the lessor and the Company gives the Company the right to acquire a limited number of the leased facilities at fair market value. These purchase rights represent a form of continuing involvement with these properties, which precluded sale-leaseback accounting. As a result, the Company treats all of the properties that it leases from this lessor as a financing arrangement. The Company is also party to certain additional agreements with the same lessor which commit the Company to perform certain repair and maintenance obligations under the leases in a specified manner and timeframe.

We were deemed the owner of certain of our facilities during their construction period based on an evaluation made in accordance with the *Leases* topic of the Codification. Effectively, a sale and leaseback of these facilities occurred when construction was completed and the lease term began. These transactions did not qualify for sale-leaseback accounting. As a result, the Company treats the lease of these facilities as a financing arrangement.

As of September 30, 2019, other finance obligations consist of $222.6 million, with cash payments of $15.8 million for the nine months ended September 30, 2019. These other finance obligations are included on the condensed consolidated balance sheet as part of long-term debt. The related assets are recorded as components of property, plant, and equipment on the condensed consolidated balance sheet.

Future maturities for other finance obligations as of September 30, 2019 were as follows (in thousands):

2019 (from October 1, 2019)	$	4,558
2020		18,094
2021		17,628
2022		17,475
2023		17,484
Thereafter		218,275
Total	$	293,514

6. Property, Plant and Equipment

Property, plant and equipment consisted of the following:

	September 30, 2019		December 31, 2018	
	(In thousands)			
Land	$	198,165	$	198,304
Buildings and improvements		366,593		358,411
Machinery and equipment		413,302		403,765
Furniture, fixtures and computer equipment		88,385		78,910
Construction in progress		29,448		20,810
Finance lease right-of-use assets		32,339		—
Property, plant and equipment		1,128,232		1,060,200
Less: accumulated depreciation		432,078		390,125
Property, plant and equipment, net	$	696,154	$	670,075

Depreciation expense was $20.3 million and $19.1 million, of which $5.0 million and $4.8 million was included in cost of sales, for the three months ended September 30, 2019 and 2018, respectively. Depreciation expense was $60.0 million and $55.2 million, of which $14.7 million and $13.9 million was included in cost of sales, for the nine months ended September 30, 2019 and 2018, respectively.

Included in property, plant and equipment are certain assets held under other finance obligations. These assets are recorded at the present value of the lease payments and include land, buildings and equipment. Amortization charges associated with assets held under other finance obligations are included in depreciation expense. The following balances held under other finance obligations are included on the accompanying consolidated balance sheet:

	September 30, 2019		December 31, 2018*	
	(In thousands)			
Land	$	118,683	$	118,677
Buildings and improvements		137,050		142,345
Machinery and equipment		—		27,188
Assets held under other finance obligations		255,733		288,210
Less: accumulated amortization		17,713		21,786
Assets held under other finance obligations, net	$	238,020	$	266,424

* *Totals as of December 31, 2018 included assets which, under previous guidance, were held under capital leases. As of September 30, 2019 these assets are now presented as finance lease right-of-use assets as reflected in the table above.*

7. Business Combination

On July 1, 2019, we acquired certain assets and the operations of Sun State Components ("Sun State") for $42.5 million in cash. This acquisition was funded with a combination of cash on hand and borrowings under our 2023 facility. Sun State is comprised of three truss locations, which are located in Las Vegas, Nevada; Surprise, Arizona; and Kingman, Arizona. Sun State manufactures roof trusses and floor trusses and distributes lumber and related products to residential homebuilders and commercial contractors.

This transaction was accounted for by the acquisition method, and accordingly the results of operations has been included in the Company's consolidated financial statements from the acquisition date. The purchase price was allocated to the assets acquired and liabilities assumed based on estimated fair values at the acquisition date, with the excess of purchase price over the estimated fair value of the net assets acquired recorded as goodwill. The fair value of acquired intangible assets of $10.0 million, primarily related to customer relationships, was estimated by applying an income approach. That measure is based on significant Level 3 inputs not observable in the market. Key assumptions developed based on the Company's historical experience, future projections and comparable market data include future cash flows, long-term growth rates, attrition rates and discount rates.

Pro forma results of operations as well as net sales and income attributable to Sun State are not presented as this acquisition did not have a material impact on our results of operations. We did not incur any significant acquisition related costs attributable to this transaction.

The following table summarizes the aggregate fair values of the assets acquired and liabilities assumed at the acquisition date (in thousands):

Accounts receivable	$	5,721
Inventory		6,909
Other current assets		83
Property, plant and equipment (includes finance lease right-of-use assets)		8,177
Operating lease right-of-use assets		4,180
Goodwill (Note 8)		14,354
Intangible assets (Note 9)		9,950
Total assets acquired		49,374
Accounts payable and accrued liabilities		(9,146)
Operating lease liabilities		(4,180)
Finance lease liabilities		(2,117)
Total liabilities assumed		(15,443)
Total net assets acquired	$	33,931

In connection with the acquisition of Sun State, we entered into real estate leases with the sellers for Sun State's three operating locations. Of the $42.5 million in cash consideration, $33.9 million was paid to the sellers at closing with the remaining amount payable to the sellers on the first anniversary of the acquisition date. The remaining amount payable to the sellers is included in accounts payable and accrued liabilities in the table above.

8. Goodwill

The following table sets forth the change in the carrying amount of goodwill by reportable segment for the nine months ended September 30, 2019 (in thousands):

	Northeast	Southeast	South	West	Total
Balance as of December 31, 2018					
Goodwill	$ 97,102	$ 60,691	$ 329,662	$ 297,592	$ 785,047
Accumulated impairment losses	(494)	(615)	(43,527)	—	(44,636)
	96,608	60,076	286,135	297,592	740,411
Acquisition	—	—	—	14,354	14,354
Balance as of September 30, 2019					
Goodwill	$ 97,102	$ 60,691	$ 329,662	$ 311,946	$ 799,401
Accumulated impairment losses	(494)	(615)	(43,527)	—	(44,636)
	$ 96,608	$ 60,076	$ 286,135	$ 311,946	$ 754,765

In 2019, the change in the carrying amount of goodwill is attributable to our acquisition of Sun State. The amount allocated to goodwill is attributable to the assembled workforce of Sun State as well as expected growth from the new markets we entered into as a result of the Sun State acquisition. All of the goodwill recognized from this acquisition is expected to be deductible for tax purposes and will be amortized ratably over a 15-year period for tax purposes.

9. Intangible Assets

The following table presents intangible assets as of:

	September 30, 2019		December 31, 2018	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Customer relationships	$ 158,645	$ (73,421)	$ 149,045	$ (63,187)
Trade names	51,361	(35,603)	51,361	(34,065)
Non-compete agreements	1,729	(1,408)	1,379	(1,379)
Favorable lease intangibles	—	—	6,409	(6,409)
Total intangible assets	$ 211,735	$ (110,432)	$ 208,194	$ (105,040)
Unfavorable lease obligations (included in Accrued liabilities and Other long-term liabilities)	$ —	$ —	$ (19,597)	$ 19,597

In connection with the acquisition of Sun State, we recorded intangible assets of $10.0 million, which includes $9.6 million of customer relationships and $0.4 million of non-compete agreements. The weighted average useful lives of the acquired assets are 7.2 years in total, 7.3 years for customer relationships and 5.0 years for non-compete agreements, respectively.

During the three and nine months ended September 30, 2019, we recorded net amortization expense in relation to the above-listed intangible assets of $4.1 million and $11.8 million, respectively. During the three and nine months ended September 30, 2018, we recorded net amortization expense in relation to the above-listed intangible assets of $6.0 million and $17.5 million, respectively.

The following table presents the estimated amortization expense for these intangible assets for the years ending December 31 (in thousands):

2019 (from October 1, 2019)	$ 3,918
2020	14,958
2021	13,533
2022	12,351
2023	11,280
Thereafter	45,263
Total future net intangible amortization expense	$ 101,303

10. Employee Stock-Based Compensation

Time Based Restricted Stock Unit Grants

In the first nine months of 2019, our board of directors granted 751,000 RSUs to employees and eligible directors under our 2014 Incentive Plan for which vesting is based solely on continuous employment over the requisite service period. 618,000 of the RSUs vest at 33% per year at each anniversary of the grant date over the next three years, 73,000 of the RSUs cliff vest on the fourth anniversary of the grant date and 60,000 of the RSUs cliff vest on the first anniversary of the grant date. The weighted average grant date fair value for these RSUs was $14.20 per unit, which was based on the closing stock price on the grant date.

Performance, Market and Service Condition Based Restricted Stock Unit Grants

In the first nine months of 2019, our board of directors granted 397,000 RSUs to employees under our 2014 Incentive Plan, that cliff vest on the third anniversary of the grant date based on the Company's level of achievement of performance goals relating to return on invested capital ("ROIC") over a three-year period ("performance condition") as well as continued employment during the performance period. The total number of shares of common stock that may be earned from the performance condition ranges from zero to 200% of the RSUs granted. The number of shares earned from the performance condition may be further increased by 10% or decreased by 10% based on the Company's total shareholder return relative to a peer group during the performance period ("market condition"). The average grant date fair value for these RSUs, with consideration of the market condition, was $14.42 per unit, which was determined using the Monte Carlo simulation model using the following assumptions:

Expected volatility (company)	38.3%
Expected volatility (peer group median)	33.2%
Correlation between the company and peer group median	0.5
Expected dividend yield	0.0%
Risk-free rate	2.6%

The expected volatilities and correlation are based on the historical daily returns of our common stock and the common stocks of the constituents of the Company's peer group over the most recent period equal to the measurement period. The expected dividend yield is based on our history of not paying regular dividends in the past and our current intention to not pay regular dividends in the foreseeable future. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant and has a term equal to the measurement period.

11. Income Taxes

A reconciliation of the statutory federal income tax rate to our effective rate for continuing operations is provided below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Statutory federal income tax rate	21.0%	21.0%	21.0%	21.0%
State income taxes, net of federal income tax	4.5	5.0	4.4	5.0
Stock compensation windfall benefit	(0.8)	—	(0.5)	(2.2)
Permanent differences - credits	(2.2)	(6.3)	(2.4)	(3.9)
Permanent differences and other	0.8	1.2	0.7	1.0
	23.3%	20.9%	23.2%	20.9%

We base our estimate of deferred tax assets and liabilities on current tax laws and rates. In certain cases, we also base our estimate on business plan forecasts and other expectations about future outcomes. Changes in existing tax laws or rates could affect our actual tax results, and future business results may affect the amount of our deferred tax liabilities or the valuation of our deferred tax assets over time. Due to uncertainties in the estimation process, particularly with respect to changes in facts and circumstances in future reporting periods, as well as the residential homebuilding industry's cyclicality and sensitivity to changes in economic conditions, it is possible that actual results could differ from the estimates used in previous analyses.

Accounting for deferred taxes is based upon estimates of future results. Differences between the anticipated and actual outcomes of these future results could have a material impact on our consolidated results of operations or financial position.

12. Commitments and Contingencies

As of September 30, 2019, we had outstanding letters of credit totaling $82.2 million under our 2023 facility that principally support our self-insurance programs.

The Company has a number of known and threatened construction defect legal claims. While these claims are generally covered under the Company's existing insurance programs to the extent any loss exceeds the deductible, there is a reasonable possibility of loss that is not able to be estimated at this time because (i) many of the proceedings are in the discovery stage, (ii) the outcome of future litigation is uncertain, and/or (iii) the complex nature of the claims. Although the Company cannot estimate a reasonable range of loss based on currently available information, the resolution of these matters could have a material adverse effect on the Company's financial position, results of operations or cash flows.

In addition, we are involved in various other claims and lawsuits incidental to the conduct of our business in the ordinary course. We carry insurance coverage in such amounts in excess of our self-insured retention as we believe to be reasonable under the circumstances and that may or may not cover any or all of our liabilities in respect of such claims and lawsuits. Although the ultimate disposition of these other proceedings cannot be predicted with certainty, management believes the outcome of any such claims that are pending or threatened, either individually or on a combined basis, will not have a material adverse effect on our consolidated financial position, cash flows or results of operations. However, there can be no assurances that future adverse judgments and costs would not be material to our results of operations or liquidity for a particular period.

13. Segment Information

We offer an integrated solution to our customers providing manufacturing, supply, and installation of a full range of structural and related building products. We provide a wide variety of building products and services directly to homebuilder customers. We manufacture floor trusses, roof trusses, wall panels, stairs, millwork, windows, and doors. We also provide a full range of construction services. These product and service offerings are distributed across approximately 400 locations operating in 40 states across the United States, which are organized intonine geographical regions. Centralized financial and operational oversight, including resource allocation and assessment of performance on an income before income taxes basis, is performed by our CEO, whom we have determined to be our chief operating decision maker ("CODM").

The Company has nine operating segments aligned with its nine geographical regions (Regions 1 through 9). While all of our operating segments have products, distribution methods and customers of a similar nature, certain of our operating segments have been aggregated due to also containing similar economic characteristics, resulting in the following composition of reportable segments:

- Regions 1 and 2 have been aggregated to form the "Northeast" reportable segment
- Regions 3 and 5 have been aggregated to form the "Southeast" reportable segment
- Regions 4 and 6 have been aggregated to form the "South" reportable segment
- Region 7, 8 and 9 have been aggregated to form the "West" reportable segment

In addition to our reportable segments, our consolidated results include corporate overhead, other various operating activities that are not internally allocated to a geographical region nor separately reported as a single unit to the CODM, and certain reconciling items primarily related to allocations of corporate overhead and rent expense, which have collectively been presented as "All Other". The accounting policies of the segments are consistent with those referenced in Note 1, except for noted reconciling items.

The following tables present net sales, income before income taxes and certain other measures for the reportable segments, reconciled to total consolidated operations, for the periods indicated (in thousands):

	Three months ended September 30, 2019			
Reportable segments	Net Sales	Depreciation & Amortization	Interest	Income before income taxes
Northeast	$ 359,972	$ 3,267	$ 5,323	$ 19,639
Southeast	416,994	3,193	5,370	23,388
South	473,473	4,747	5,463	29,639
West	660,779	7,247	9,998	39,475
Total reportable segments	1,911,218	18,454	26,154	112,141
All other	69,817	5,928	1,634	(10,297)
Total consolidated	$ 1,981,035	$ 24,382	$ 27,788	$ 101,844

	Three months ended September 30, 2018			
Reportable segments	Net Sales	Depreciation & Amortization	Interest	Income before income taxes
Northeast	$ 357,184	$ 3,390	$ 6,453	$ 13,462
Southeast	455,565	3,053	6,958	19,951
South	538,373	5,271	6,946	33,553
West	701,126	6,979	11,354	38,924
Total reportable segments	2,052,248	18,693	31,711	105,890
All other	66,219	6,411	(2,605)	(13,208)
Total consolidated	$ 2,118,467	$ 25,104	$ 29,106	$ 92,682

	Nine months ended September 30, 2019			
Reportable segments	Net Sales	Depreciation & Amortization	Interest	Income before income taxes
Northeast	$ 996,952	$ 9,730	$ 15,717	$ 45,224
Southeast	1,225,558	9,339	16,516	64,737
South	1,409,106	14,486	17,230	87,663
West	1,697,989	20,237	28,032	73,550
Total reportable segments	5,329,605	53,792	77,495	271,174
All other	187,253	17,979	4,576	(36,077)
Total consolidated	$ 5,516,858	$ 71,771	$ 82,071	$ 235,097

	Nine months ended September 30, 2018			
Reportable segments	Net Sales	Depreciation & Amortization	Interest	Income before income taxes
Northeast	$ 997,701	$ 10,074	$ 17,978	$ 26,922
Southeast	1,299,752	8,561	19,354	47,790
South	1,541,656	15,403	19,562	76,769
West	1,884,624	20,077	30,875	84,517
Total reportable segments	5,723,733	54,115	87,769	235,998
All other	185,058	18,576	(2,964)	(42,312)
Total consolidated	$ 5,908,791	$ 72,691	$ 84,805	$ 193,686

Asset information by segment is not reported internally or otherwise reviewed by the CODM nor does the Company earn revenues or have long-lived assets located in foreign countries.

14. Related Party Transactions

Certain members of the Company's board of directors also serve on the board of directors of one of our suppliers, PGT, Inc. Further, the Company has entered into certain leases of land and buildings with certain employees or non-affiliate stockholders. Activity associated with these related party transactions was not significant as of or for the nine months ended September 30, 2019 or 2018.

Transactions between the Company and other related parties occur in the ordinary course of business. However, the Company carefully monitors and assesses related party relationships. Management does not believe that any of these transactions with related parties had a material impact on the Company's results for the nine months ended September 30, 2019 or 2018.

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

The following discussion of our financial condition and results of operations should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and notes thereto for the year ended December 31, 2018 included in our most recent annual report on Form 10-K. The following discussion and analysis should also be read in conjunction with the unaudited condensed consolidated financial statements appearing elsewhere in this report. In this quarterly report on Form 10-Q, references to the "company," "we," "our," "ours" or "us" refer to Builders FirstSource, Inc. and its consolidated subsidiaries unless otherwise stated or the context otherwise requires.

Cautionary Statement

Statements in this report and the schedules hereto that are not purely historical facts or that necessarily depend upon future events, including statements about expected market share gains, forecasted financial performance or other statements about anticipations, beliefs, expectations, hopes, intentions or strategies for the future, may be forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. Readers are cautioned not to place undue reliance on forward-looking statements. In addition, oral statements made by our directors, officers and employees to the investor and analyst communities, media representatives and others, depending upon their nature, may also constitute forward-looking statements. As with the forward-looking statements included in this report, these forward-looking statements are by nature inherently uncertain, and actual results may differ materially as a result of many factors. All forward-looking statements are based upon information available to Builders FirstSource, Inc. on the date this report was submitted. Builders FirstSource, Inc. undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Any forward-looking statements involve risks and uncertainties that could cause actual events or results to differ materially from the events or results described in the forward-looking statements, including risks or uncertainties related to the Company's growth strategies, including gaining market share, or the Company's revenues and operating results being highly dependent on, among other things, the homebuilding industry, lumber prices and the economy. Builders FirstSource, Inc. may not succeed in addressing these and other risks. Further information regarding factors that could affect our financial and other results can be found in the risk factors section of Builders FirstSource, Inc.'s most recent annual report on Form 10-K filed with the Securities and Exchange Commission. Consequently, all forward-looking statements in this report are qualified by the factors, risks and uncertainties contained therein.

COMPANY OVERVIEW

We are a leading supplier and manufacturer of building materials, manufactured components and construction services to professional contractors, sub-contractors and consumers. The Company operates approximately 400 locations in 40 states across the United States. Given the span and depth of our geographical reach, our locations are organized into nine geographical regions (Regions 1 through 9), which are also our operating segments, and these are further aggregated into four reportable segments: Northeast, Southeast, South and West. All of our segments have similar customers, products and services, and distribution methods. Our financial statements contain additional information regarding segment performance which is discussed in Note 13 to the condensed consolidated financial statements included in Item 1 of this quarterly report on Form 10-Q.

We offer an integrated solution to our customers providing manufacturing, supply and installation of a full range of structural and related building products. Our manufactured products include our factory-built roof and floor trusses, wall panels and stairs, vinyl windows, custom millwork and trim, as well as engineered wood that we design, cut, and assemble for each home. We also assemble interior and exterior doors into pre-hung units. Additionally, we supply our customers with a broad offering of professional grade building products not manufactured by us, such as dimensional lumber and lumber sheet goods and various window, door and millwork lines. Our full range of construction-related services includes professional installation, turn-key framing and shell construction, and spans all our product categories.

We group our building products into six product categories:

- *Lumber & Lumber Sheet Goods.* Lumber & lumber sheet goods include dimensional lumber, plywood, and OSB products used in on-site house framing.
- *Manufactured Products.* Manufactured products consist of wood floor and roof trusses, steel roof trusses, wall panels, stairs, and engineered wood.
- *Windows, Door & Millwork.* Windows & doors are comprised of the manufacturing, assembly, and distribution of windows and the assembly and distribution of interior and exterior door units. Millwork includes interior trim and custom features that we manufacture under the Synboard ® brand name.
- *Gypsum, Roofing & Insulation.* Gypsum, roofing, & insulation include wallboard, ceilings, joint treatment and finishes.

- *Siding, Metal, and Concrete.* Siding, metal, and concrete includes vinyl, composite, and wood siding, exterior trim, other exteriors, metal studs and cement.
- *Other Building Products & Services.* Other building products & services are comprised of products such as cabinets and hardware as well as services such as turn-key framing, shell construction, design assistance, and professional installation spanning the majority of our product categories.

Our operating results are dependent on the following trends, events and uncertainties, some of which are beyond our control:

- *Homebuilding Industry.* Our business is driven primarily by the residential new construction market and the residential repair and remodel market, which are in turn dependent upon a number of factors, including demographic trends, interest rates, consumer confidence, employment rates, housing affordability, household formation, land development costs, the availability of skilled construction labor, and the health of the economy and mortgage markets. According to the U.S. Census Bureau, the seasonally adjusted annualized rates for U.S. total housing starts and U.S. single-family housing starts were 1.3 million and 0.9 million, respectively, as of September 30, 2019. However, both total and single-family housing starts remain below the normalized historical annual averages (from 1959 through 2018) of 1.5 million and 1.1 million, respectively. Due to the lower levels in housing starts versus historical norms, increased competition for homebuilder business and cyclical fluctuations in commodity prices, we may experience pressure on our gross margins. In addition to these factors, there has been a trend of consolidation within the building products supply industry. However, our industry remains highly fragmented and competitive and we will continue to face significant competition from local and regional suppliers. We still believe there are several meaningful trends that indicate U.S. housing demand will continue to trend towards recovering to the historical average. These trends include relatively low interest rates, the aging of housing stock, and normal population growth due to immigration and birthrate exceeding death rate. While the rate of market growth has recently eased, industry forecasters, including the National Association of Homebuilders ("NAHB"), expect to see continued increases in housing demand over the next year.
- *Targeting Large Production Homebuilders.* In recent years, the homebuilding industry has undergone consolidation, and the larger homebuilders have increased their market share. We expect that trend to continue as larger homebuilders have better liquidity and land positions relative to the smaller, less capitalized homebuilders. Our focus is on maintaining relationships and market share with these customers while balancing the competitive pressures we are facing in servicing large homebuilders with certain profitability expectations. Additionally, we have been successful in expanding our custom homebuilder base while maintaining acceptable credit standards.
- *Repair and remodel end market.* Although the repair and remodel end market is influenced by housing starts to a lesser degree than the homebuilding market, the repair and remodel end market is still dependent upon some of the same factors as the homebuilding market, including demographic trends, interest rates, consumer confidence, employment rates and the health of the economy and home financing markets. We expect that our ability to remain competitive in this space will depend on our continued ability to provide a high level of customer service coupled with a broad product offering.
- *Use of Prefabricated Components.* Homebuilders are increasingly using prefabricated components in order to realize increased efficiency, overcome skilled construction labor shortages and improve quality. Shortening cycle time from start to completion is a key imperative of the homebuilders during periods of strong consumer demand. We continue to see the demand for prefabricated components increasing within the residential new construction market as the availability of skilled construction labor remains limited.
- *Economic Conditions.* Economic changes both nationally and locally in our markets impact our financial performance. The building products supply industry is highly dependent upon new home construction and subject to cyclical market changes. Our operations are subject to fluctuations arising from changes in supply and demand, national and local economic conditions, labor costs and availability, competition, government regulation, trade policies and other factors that affect the homebuilding industry such as demographic trends, interest rates, housing starts, the high cost of land development, employment levels, consumer confidence, and the availability of credit to homebuilders, contractors, and homeowners.
- *Housing Affordability.* The affordability of housing can be a key driver in demand for our products. Home affordability is influenced by a number of economic factors, such as the level of employment, consumer confidence, consumer income, the supply of houses, the availability of financing and interest rates. Changes in the inventory of available homes as well as economic factors relative to home prices could result in changes to the affordability of homes. As a result, homebuyer demand may shift towards smaller, or larger, homes creating fluctuations in demand for our products.

- *Cost of Materials.* Prices of wood products, which are subject to cyclical market fluctuations, may adversely impact operating income when prices rapidly rise or fall within a relatively short period of time. We purchase certain materials, including lumber products, which are then sold to customers as well as used as direct production inputs for our manufactured and prefabricated products. Short-term changes in the cost of these materials, some of which are subject to significant fluctuations, are oftentimes passed on to our customers, but our pricing quotation periods may limit our ability to pass on such price changes. We may also be limited in our ability to pass on increases on in-bound freight costs on our products. Our inability to pass on material price increases to our customers could adversely impact our operating results.
- *Controlling Expenses.* Another important aspect of our strategy is controlling costs and striving to be a low-cost building materials supplier in the markets we serve. We pay close attention to managing our working capital and operating expenses. Further, we pay careful attention to our logistics function and its effect on our shipping and handling costs.
- *Multi-Family and Light Commercial Business.* Our primary focus has been, and continues to be, on single-family residential new construction and the repair and remodel end market. However, we will continue to identify opportunities for profitable growth in the multi-family and light commercial markets.
- *Capital Structure:* As a result of our historical growth through acquisitions, we have substantial indebtedness. We strive to optimize our capital structure to ensure that our financial needs are met in light of economic conditions, business activities, organic investments, opportunities for growth through acquisition and the overall risk characteristics of our underlying assets. In addition to these factors, we also evaluate our capital structure on the basis of our leverage ratio, our liquidity position, our debt maturity profile and market interest rates. As such, we may enter into various debt or equity transactions in order to appropriately manage and optimize our capital structure.

RECENT DEVELOPMENTS

During the nine months ended September 30. 2019, the Company executed several debt transactions, including extending the maturity of our $900.0 million revolving credit facility (“2023 facility”), redemption of $192.4 million in aggregate principal amount of our 5.625% senior secured notes due 2024 (“2024 notes”), and repayment of $301.2 million of our senior secured term loan facility due 2024 (“2024 term loan”). The repayments of our 2024 notes and 2024 term loan were funded with the proceeds from the issuance of $475.0 million in aggregate principal amount of our 6.75% senior secured notes due 2027 (“2027 notes”) and cash on hand. Collectively, these transactions have extended our debt maturity profile and reduced the amount of long-term debt outstanding.

These transactions are described in Note 4 to the condensed consolidated financial statements included in Item 1 of this quarterly report on Form 10-Q. From time to time, based on market conditions and other factors and subject to compliance with applicable laws and regulations, the Company may repurchase or call our notes, repay debt, repurchase shares of our common stock or otherwise enter into transactions regarding its capital structure.

On July 1, 2019, we acquired certain assets and the operations of Sun State Components (“Sun State”) for $42.5 million in cash. Sun State is comprised of three truss locations, which are located in Las Vegas, Nevada; Surprise, Arizona; and Kingman, Arizona. Sun State manufactures roof trusses and floor trusses and distributes lumber and related products to residential homebuilders and commercial contractors.

CURRENT OPERATING CONDITIONS AND OUTLOOK

For the third quarter of 2019, actual U.S. total housing starts were 0.3 million, a 4.1% increase compared to the third quarter of 2018. Actual U.S. single-family starts were 0.2 million in the third quarter of 2019, a 3.7% increase compared to the same quarter a year ago. For the nine months ended September 30, 2019 actual U.S. total housing starts were 1.0 million, a 1.3% decrease compared to the nine months ended September 30, 2018. Actual U.S. single-family starts were 0.7 million in the first nine months of 2019, a 1.8% decrease compared to the same period a year ago. A composite of third party sources, including the NAHB, are forecasting 1.3 million U.S. total housing starts for the full year 2019, an increase of 0.8% from 2018, and 0.9 million U.S single family housing starts, a decrease of 0.1% from 2018. In addition, in its September 2019 semi-annual forecast, the Home Improvement Research Institute (“HIRI”) forecasted sales in the professional repair and remodel end market to increase approximately 4.5% in 2019 compared to 2018.

Our net sales for the third quarter of 2019 decreased 6.5% from the same period last year. Commodity price deflation decreased our sales in the third quarter of 2019 by an estimated 17.4%. In the third quarter of 2019, we had one additional selling day compared to the third quarter of 2018, which increased sales by 1.5%. Excluding the impact of commodity price deflation and the additional selling day, we achieved 9.4% sales growth in the single-family, multi-family and repair and remodel/other end markets, primarily as a result of sales volume growth in our manufactured products and windows, doors & millwork categories. Our gross margin percentage increased by 2.6% during the third quarter of 2019 compared to the third quarter of 2018. This increase in gross margin percentage is primarily attributable to an improved product mix, the decline in the cost of commodities relative to our customer pricing commitments and continued pricing discipline. In addition, sales growth in our value-add higher margin product categories, primarily our manufactured products and windows, doors & millwork categories, contributed to increased gross profit dollars and percentage compared to the third quarter of 2018. Our selling, general and administrative expenses, as a percentage of net sales, were 20.8% in the third quarter of 2019, a 1.9% increase from 18.9% in the third quarter of 2018. This increase was largely due to the effects of commodity price deflation on our net sales and an increase in variable compensation related to increased sales volume and gross margin in the third quarter of 2019 compared to the third quarter of 2018.

We believe the long-term outlook for the housing industry is positive due to growth in the underlying demographics. We feel we are well-positioned to take advantage of the construction activity in our markets and to increase our market share, which may include strategic acquisitions. We will continue to focus on working capital by closely monitoring the credit exposure of our customers, remaining focused on maintaining the right level of inventory and by working with our vendors to improve payment terms and pricing on our products. We strive to achieve the appropriate balance of short-term expense control while maintaining the expertise and capacity to grow the business as market conditions warrant. In addition, optimization of our capital structure will continue to be a key area of focus for the Company.

SEASONALITY AND OTHER FACTORS

Our first and fourth quarters have historically been, and are generally expected to continue to be, adversely affected by weather causing reduced construction activity during these quarters. In addition, quarterly results historically have reflected, and are expected to continue to reflect, fluctuations from period to period arising from the following:

- The volatility of lumber prices;
- The cyclical nature of the homebuilding industry;
- General economic conditions in the markets in which we compete;
- The pricing policies of our competitors;
- The production schedules of our customers; and
- The effects of weather.

The composition and level of working capital typically change during periods of increasing sales as we carry more inventory and receivables. Working capital levels typically increase in the first and second quarters of the year due to higher sales during the peak residential construction season. These increases may result in negative operating cash flows during this peak season, which historically have been financed through available cash and borrowing availability under credit facilities. Generally, collection of receivables and reduction in inventory levels following the peak building and construction season positively impact cash flow.

RESULTS OF OPERATIONS

The following table sets forth, for the three and nine months ended September 30, 2019 and 2018, the percentage relationship to net sales of certain costs, expenses and income items:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	72.7%	75.3%	72.8%	75.8%
Gross margin	27.3%	24.7%	27.2%	24.2%
Selling, general and administrative expenses	20.8%	18.9%	21.4%	19.5%
Income from operations	6.5%	5.8%	5.8%	4.7%
Interest expense, net	1.4%	1.4%	1.5%	1.4%
Income tax expense	1.2%	0.9%	1.0%	0.7%
Net income	3.9%	3.5%	3.3%	2.6%

Three Months Ended September 30, 2019 Compared with the Three Months Ended September 30, 2018

Net Sales. Net sales for the three months ended September 30, 2019 were $1,981.0 million, a 6.5% decrease from net sales of $2,118.5 million for the three months ended September 30, 2018. Commodity price deflation decreased our sales in the third quarter of 2019 by an estimated 17.4%. In the third quarter of 2019, we had one additional selling day compared to the third quarter of 2018 which increased sales by 1.5%. Excluding the impact of commodity price deflation and the additional selling day, we achieved 9.4% sales growth in the single-family, multi-family and repair and remodel/other end markets primarily as a result of sales volume growth in our manufactured products and windows, doors & millwork categories.

The following table shows net sales classified by product category (dollars in millions):

	Three Months Ended September 30,				
	2019		2018		
	Net Sales	% of Net Sales	Net Sales	% of Net Sales	% Change
Lumber & lumber sheet goods	$ 605.5	30.6%	$ 818.7	38.6%	(26.0)%
Manufactured products	401.2	20.2%	385.9	18.2%	4.0%
Windows, doors & millwork	407.4	20.6%	372.5	17.6%	9.4%
Gypsum, roofing & insulation	149.7	7.6%	146.6	6.9%	2.1%
Siding, metal & concrete products	201.0	10.1%	196.6	9.3%	2.3%
Other building products & services	216.2	10.9%	198.2	9.4%	9.1%
Net sales	$ 1,981.0	100.0%	$ 2,118.5	100.0%	(6.5)%

The decrease in net sales in our lumber and lumber sheet goods category resulted from the impact of commodity price deflation in the third quarter of 2019 compared to the prior year, which offset increased volume in the category. We achieved increased sales in our remaining product categories due to higher sales volume.

Gross Margin. Gross margin increased $18.4 million to $541.1 million. Our gross margin percentage increased to 27.3% in the third quarter of 2019 from 24.7% in the third quarter of 2018, a 2.6% increase. Our gross margin percentage increase was primarily attributable to an improved product mix, the decline in the cost of commodities relative to our customer pricing commitments and continued pricing discipline. In addition, sales growth in our value-add higher margin product categories, primarily our manufactured products and windows, doors & millwork categories, contributed to increased gross profit dollars and percentage compared to the third quarter of 2018.

Selling, General and Administrative Expenses. In the third quarter of 2019, selling, general and administrative expenses increased $10.5 million, or 2.6%, and as a percentage of sales increased to 20.8% from 18.9% in the third quarter of 2018. This increase was primarily due to increases in variable compensation related to increased sales volume and gross margin. The increase as a percentage of net sales was also attributable to the effect of commodity price deflation on our net sales.

Interest Expense, Net. Interest expense was $27.8 million in the third quarter of 2019, a decrease of $1.3 million from the third quarter of 2018. This decrease in interest expense is primarily due to lower outstanding debt balances during the third quarter of 2019 compared to the third quarter of 2018. However, this decrease was partially offset by $3.1 million in one-time charges related to the debt financing transactions executed in the third quarter of 2019 as well as the effect of higher interest rates.

Income Tax Expense. We recorded income tax expense of $23.7 million and $19.4 million in the third quarters of 2019 and 2018, respectively. Our effective tax rate was 23.3% and 20.9% in the third quarters of 2019 and 2018, respectively.

Nine Months Ended September 30, 2019 Compared with the Nine Months Ended September 30, 2018

Net Sales. Net sales for the nine months ended September 30, 2019 were $5,516.9 million, a 6.6% decrease over net sales of $5,908.8 million for the nine months ended September 30, 2018. Commodity price deflation decreased our sales in the first nine months of 2019 by an estimated 12.9%. Excluding the impact of commodity price deflation, we achieved 6.3% sales growth in the single-family, multi-family and repair and remodel/other end markets, primarily as a result of sales volume growth in our manufactured products and windows, doors & millwork categories.

The following table shows net sales classified by product category (dollars in millions):

	Nine Months Ended September 30,				
	2019		2018		
	Net Sales	% of Net Sales	Net Sales	% of Net Sales	% Change
Lumber & lumber sheet goods	$ 1,724.7	31.3%	$ 2,273.8	38.5%	(24.1)%
Manufactured products	1,092.9	19.8%	1,051.0	17.8%	4.0%
Windows, doors & millwork	1,151.8	20.9%	1,080.1	18.3%	6.6%
Gypsum, roofing & insulation	409.0	7.4%	400.8	6.8%	2.0%
Siding, metal & concrete products	542.3	9.8%	528.3	8.9%	2.6%
Other building products & services	596.2	10.8%	574.8	9.7%	3.7%
Net sales	$ 5,516.9	100.0%	$ 5,908.8	100.0%	(6.6)%

The decrease in net sales in our lumber and lumber sheet goods category resulted from the impact of commodity price deflation in the first nine months of 2019 compared to the prior year, which offset increased volume in the category. We achieved increased sales in our remaining product categories due to higher sales volume.

Gross Margin. Gross margin increased $70.1 million to $1,500.3 million. Our gross margin percentage increased to 27.2% in the first nine months of 2019 from 24.2% in the first nine months of 2018, a 3.0% increase. Our gross margin percentage increase was primarily attributable to an improved product mix, the decline in the cost of commodities relative to our customer pricing commitments and continued pricing discipline. In addition, sales growth in our value-add higher margin product categories, primarily our manufactured products and windows, doors & millwork categories, contributed to increased gross profit dollars and percentage compared to the nine months ended September 30, 2018.

Selling, General and Administrative Expenses. For the nine months ended September 30, 2019, selling, general and administrative expenses increased $31.4 million, or 2.7%, and as a percentage of sales increased to 21.4% from 19.5% in the first nine months of 2018. This increase was primarily due to increases in variable compensation related to increased sales volume and gross margin, as well as an increase in insurance costs. The increase as a percentage of net sales was also attributable to the effect of commodity price deflation on our net sales.

Interest Expense, Net. Interest expense was $82.1 million for the nine months ended September 30, 2019, a decrease of $2.7 million compared to the nine months ended September 30, 2018. This decrease in interest expense is primarily due to lower outstanding debt balances during the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018. However, this decrease was partially offset by $6.8 million in one-time charges related to the debt financing transactions executed in the first nine months of 2019 as well as the effect of higher interest rates.

Income Tax Expense. We recorded income tax expense of $54.7 million and $40.5 million for the nine months ended September 30, 2019 and 2018, respectively. Our effective tax rate was 23.2% and 20.9% in the first nine months of 2019 and 2018, respectively.

Results by Reportable Segment

The following tables show net sales and income before income taxes by reportable segment excluding the "All Other" caption as shown in Note 13 to the condensed consolidated financial statements included in Item 1 of this quarterly report on Form 10-Q (dollars in thousands):

	Three months ended September 30,									
	Net sales					Income before income taxes				
	2019	% of net sales	2018	% of net sales	% change	2019	% of net sales	2018	% of net sales	% change
Northeast	$ 359,972	18.8%	$ 357,184	17.4%	0.8%	$ 19,639	5.5%	$ 13,462	3.8%	45.9%
Southeast	416,994	21.8%	455,565	22.2%	(8.5)%	23,388	5.6%	19,951	4.4%	17.2%
South	473,473	24.8%	538,373	26.2%	(12.1)%	29,639	6.3%	33,553	6.2%	(11.7)%
West	660,779	34.6%	701,126	34.2%	(5.8)%	39,475	6.0%	38,924	5.6%	1.4%
	$ 1,911,218	100.0%	$ 2,052,248	100.0%		$ 112,141	5.9%	$ 105,890	5.2%	

	Nine months ended September 30,									
	Net sales					Income before income taxes				
	2019	% of net sales	2018	% of net sales	% change	2019	% of net sales	2018	% of net sales	% change
Northeast	$ 996,952	18.7%	$ 997,701	17.4%	(0.1)%	$ 45,224	4.5%	$ 26,922	2.7%	68.0%
Southeast	1,225,558	23.0%	1,299,752	22.7%	(5.7)%	64,737	5.3%	47,790	3.7%	35.5%
South	1,409,106	26.4%	1,541,656	26.9%	(8.6)%	87,663	6.2%	76,769	5.0%	14.2%
West	1,697,989	31.9%	1,884,624	33.0%	(9.9)%	73,550	4.3%	84,517	4.5%	(13.0)%
	$ 5,329,605	100.0%	$ 5,723,733	100.0%		$ 271,174	5.1%	$ 235,998	4.1%	

We have four reportable segments based on an aggregation of the geographic regions in which we operate. While there is some geographic similarity between our reportable segments and the regions as defined by the U.S. Census Bureau, our reportable segments do not necessarily fully align with any single U.S. Census Bureau region.

According to the U.S. Census Bureau, actual single-family housing starts in the third quarter of 2019 decreased 2.2%, 0.3% and 1.0% in the Northeast, Midwest and West regions, respectively, compared to the third quarter of 2018. However, single-family housing starts increased 8.1% in the South region over the same period. For the third quarter of 2019, our net sales declined in our Southeast, South and West reportable segments due to the impact of commodity price deflation. Net sales increased slightly in our Northeast reportable segment largely due to an increase in sales volume in our manufactured products and windows, doors & millwork categories, offsetting the impact of commodity price deflation. We achieved increased profitability in our Northeast, Southeast and West reportable segments largely due to an improved product mix, the decline in the cost of commodities relative to our customer pricing commitments and continued pricing discipline. However, profitability declined in our South reportable segment largely due to the impact of commodity price deflation offsetting the improvement in gross margin percentage.

According to the U.S. Census Bureau, actual single-family housing starts in the first nine months of 2019 decreased 9.3%, 5.4% and 8.6% in the Northeast, Midwest and West regions, respectively, compared to the first nine months of 2018. However, single-family housing starts increased 3.4% in the South region over the same period. For the nine months ended September 30, 2019, our net sales declined in all of our reportable segments primarily due to the impact of commodity price deflation. We achieved increased profitability in our Northeast, Southeast and South reportable segments largely due to an improved product mix, the decline in the cost of commodities relative to our customer pricing commitments and continued pricing discipline. However, profitability declined in our West reportable segment largely due the impact of commodity price deflation offsetting the improvement in gross margin percentage.

LIQUIDITY AND CAPITAL RESOURCES

Our primary capital requirements are to fund working capital needs and operating expenses, meet required interest and principal payments, and to fund capital expenditures and potential future acquisitions. Our capital resources at September 30, 2019 consist of cash on hand and borrowing availability under our 2023 facility.

Our 2023 facility will be primarily used for working capital, general corporate purposes, and funding acquisitions. In addition, we may use the 2023 facility to facilitate debt consolidation. Availability under the 2023 facility is determined by a borrowing base. Our borrowing base consists of trade accounts receivable, inventory, other receivables which include progress billings and credit card receivables, and qualified cash that all meet specific criteria contained within the credit agreement, minus agent specified reserves. Net excess borrowing availability is equal to the maximum borrowing amount minus outstanding borrowings and letters of credit.

The following table shows our borrowing baseand excess availability as of September 30, 2019 and December 31, 2018 (in millions):

	As of	
	September 30, 2019	December 31, 2018
Accounts Receivable Availability	$ 491.3	$ 431.9
Inventory Availability	384.4	395.4
Other Receivables Availability	28.4	18.8
Gross Availability	904.1	846.1
Less:		
Agent Reserves	(28.4)	(25.5)
Plus:		
Cash in Qualified Accounts	20.0	26.0
Borrowing Base	895.7	846.6
Aggregate Revolving Commitments	900.0	900.0
Maximum Borrowing Amount (lesser of Borrowing Base and Aggregate Revolving Commitments)	895.7	846.6
Less:		
Outstanding Borrowings	—	(179.0)
Letters of Credit	(82.2)	(82.2)
Net Excess Borrowing Availability on Revolving Facility	$ 813.5	$ 585.4

As of September 30, 2019, we had no outstanding borrowings under our 2023 facility and our net excess borrowing availability was $813.5 million after being reduced by outstanding letters of credit of approximately $82.2 million. Excess availability must equal or exceed a minimum specified amount, currently $89.6 million, or we are required to meet a fixed charge coverage ratio of 1:00 to 1:00. We were not in violation of any covenants or restrictions imposed by any of our debt agreements at September 30, 2019.

Liquidity

Our liquidity at September 30, 2019 was $856.8 million, which consists of net borrowing availability under the 2023 facility and cash on hand.

We have substantial indebtedness following our historical acquisitions, which increased our interest expense and could have the effect of, among other things, reducing our flexibility to respond to changing business and economic conditions. From time to time, based on market conditions and other factors and subject to compliance with applicable laws and regulations, the Company may repurchase or call our notes, repay debt, repurchase shares or otherwise enter into transactions regarding its capital structure.

Should the current industry conditions deteriorate or we pursue additional acquisitions, we may be required to raise additional funds through the sale of capital stock or debt in the public capital markets or in privately negotiated transactions. There can be no assurance that any of these financing options would be available on favorable terms, if at all. Alternatives to help supplement our liquidity position could include, but are not limited to, idling or permanently closing additional facilities, adjusting our headcount in response to current business conditions, attempts to renegotiate leases or other contractual arrangements, managing our working capital and/or divesting of non-core businesses. There are no assurances that these steps would prove successful or materially improve our liquidity position.

Consolidated Cash Flows

Cash provided by operating activities was $360.3 million for the nine months ended September 30, 2019 compared to cash provided by operating activities of $9.5 million for the nine months ended September 30, 2018. The $350.7 million increase in cash provided by operations was largely the result of a working capital decrease of $54.2 million in the first nine months of 2019 compared to a working capital increase of $266.5 million for the first nine months of 2018. This change in working capital was primarily due to the timing and impact of changes in commodity prices on the value of cash received from customers, inventory purchases and cash paid to vendors in the first nine months of 2018 compared to the first nine months of 2019.

Cash used in investing activities was $106.4 million and $76.8 million for the nine months ended September 30, 2019 and 2018, respectively. This increase in cash used in investing activities was primarily due to our acquisition of Sun State in the third quarter of 2019. Ourcapital expenditures in the first nine months of 2019 were consistent with the first nine months of 2018.

Cash used in financing activities was $220.7 million for the nine months ended September 30, 2019 compared to cash provided by financing activities of $44.2 million for the nine months ended September 30, 2018. Cash used in financing activities for the first nine months of 2019 was primarily due to $502.1 million in long-term debt repayments, largely consisting of $301.2 million in repayments of the 2024 term loan and $191.5 million in cash repayments of our 2024 notes. In addition, we had $179.0 million in net repayments on our 2023 facility in the first nine months of 2019. These payments were offset by $478.4 million in proceeds received from the issuance of 2027 notes. In connection with our debt transactions executed in the first nine months of 2019 we paid $10.9 million in debt issuance and extinguishment costs. Further, in the first nine months of 2019 we paid $7.9 million to repurchase and retire 460,000 shares of our common stock pursuant to a repurchase program authorized by our board of directors. Cash provided by financing activities for the first nine months of 2018 were primarily due to $54.0 million in net borrowings on the 2023 facility.

RECENT ACCOUNTING PRONOUNCEMENTS

Information regarding recent accounting pronouncements is discussed in Note 1 to the condensed consolidated financial statements included in Item 1 of this quarterly report on Form 10-Q.

Item 3. *Quantitative and Qualitative Disclosures About Market Risk*

We may experience changes in interest expense if changes in our debt occur. Changes in market interest rates could also affect our interest expense. Our 2024 notes and 2027 notes bear interest at a fixed rate, therefore, our interest expense related to these notes would not be affected by an increase in market interest rates. Borrowings under the 2023 facility and the 2024 term loan bear interest at either a base rate or eurodollar rate, plus, in each case, an applicable margin. A 1.0% increase in interest rates on the 2023 facility would result in no additional interest expense annually as we had no outstanding borrowings as of September 30, 2019. The 2023 facility also assesses variable commitment and outstanding letter of credit fees based on quarterly average loan utilization. A 1.0% increase in interest rates on the 2024 term loan would result in approximately $1.6 million in additional interest expense annually as of September 30, 2019.

We purchase certain materials, including lumber products, which are then sold to customers as well as used as direct production inputs for our manufactured products that we deliver. Short-term changes in the cost of these materials and the related in-bound freight costs, some of which are subject to significant fluctuations, are sometimes, but not always, passed on to our customers. Delays in our ability to pass on material price increases to our customers can adversely impact our operating results.

Item 4. *Controls and Procedures*

Disclosure Controls Evaluation and Related CEO and CFO Certifications. Our management, with the participation of our principal executive officer (“CEO”) and principal financial officer (“CFO”), conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this quarterly report.

Certifications of our CEO and our CFO, which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended (“Exchange Act”), are attached as exhibits to this quarterly report. This “Controls and Procedures” section includes the information concerning the controls evaluation referred to in the certifications, and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

Limitations on the Effectiveness of Controls. We do not expect that our disclosure controls and procedures will prevent all errors and all fraud. A system of controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the system are met. Because of the limitations in all such systems, no evaluation can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Furthermore, the design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how unlikely. Because of these inherent limitations in a cost-effective system of controls and procedures, misstatements or omissions due to error or fraud may occur and not be detected.

Scope of the Controls Evaluation. The evaluation of our disclosure controls and procedures included a review of their objectives and design, and the effect of the controls and procedures on the information generated for use in this quarterly report. In the course of the evaluation, we sought to identify whether we had any data errors, control problems or acts of fraud and to confirm that appropriate corrective action, including process improvements, were being undertaken if needed. This type of evaluation is performed on a quarterly basis so that conclusions concerning the effectiveness of our disclosure controls and procedures can be reported in our quarterly reports on Form 10-Q. Many of the components of our disclosure controls and procedures are also evaluated by our internal audit department, our legal department and by personnel in our finance organization. The overall goals of these various evaluation activities are to monitor our disclosure controls and procedures on an ongoing basis, and to maintain them as dynamic systems that change as conditions warrant.

Conclusions regarding Disclosure Controls. Based on the required evaluation of our disclosure controls and procedures, our CEO and CFO have concluded that, as of September 30, 2019, we maintain disclosure controls and procedures that are effective in providing reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting. During the period covered by this report, there have been no changes in our internal control over financial reporting identified in connection with the evaluation described above 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***

The Company has a number of known and threatened construction defect legal claims. While these claims are generally covered under the Company's existing insurance programs to the extent any loss exceeds the deductible, there is a reasonable possibility of loss that is not able to be estimated at this time because (i) many of the proceedings are in the discovery stage, (ii) the outcome of future litigation is uncertain, and/or (iii) the complex nature of the claims. Although the Company cannot estimate a reasonable range of loss based on currently available information, the resolution of these matters could have a material adverse effect on the Company's financial position, results of operations or cash flows.

In addition, we are involved in various other claims and lawsuits incidental to the conduct of our business in the ordinary course. We carry insurance coverage in such amounts in excess of our self-insured retention as we believe to be reasonable under the circumstances and that may or may not cover any or all of our liabilities in respect of such claims and lawsuits. Although the ultimate disposition of these other proceedings cannot be predicted with certainty, management believes the outcome of any such claims that are pending or threatened, either individually or on a combined basis, will not have a material adverse effect on our consolidated financial position, cash flows or results of operations. However, there can be no assurances that future adverse judgments and costs would not be material to our results of operations or liquidity for a particular period.

Although our business and facilities are subject to federal, state and local environmental regulation, environmental regulation does not have a material impact on our operations. We believe that our facilities are in material compliance with such laws and regulations. As owners and lessees of real property, we can be held liable for the investigation or remediation of contamination on such properties, in some circumstances without regard to whether we knew of or were responsible for such contamination. Our current expenditures with respect to environmental investigation and remediation at our facilities are minimal, although no assurance can be provided that more significant remediation may not be required in the future as a result of spills or releases of petroleum products or hazardous substances or the discovery of unknown environmental conditions.

Item 1A. ***Risk Factors***

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part 1, "Item 1A. Risk Factors" in our annual report on Form 10-K for the year ended December 31, 2018, which could materially affect our business, financial condition or future results. The risks described in our annual report on Form 10-K are not the only risks facing our company. 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/or operating results.

Other than as described below, there were no material changes to the risk factors reported in Part 1, "Item 1A. Risk Factors" in our annual report on Form 10-K for the year ended December 31, 2018.

The interest rates on our 2023 facility and 2024 term loan may be impacted by the phase out of the London Interbank Offered Rate ("LIBOR")

Interest rates on borrowings under our 2023 facility and 2024 term loan may be based on LIBOR. In July 2017, the United Kingdom Financial Conduct Authority announced the desire to phase out the use of LIBOR by the end of 2021. At this time, there is no definitive information regarding the future utilization of LIBOR or of any particular replacement rate. The phase out of LIBOR may have an adverse impact on the cost of our borrowings under our 2023 facility and 2024 term loan.

Item 2. ***Unregistered Sales of Equity Securities and Use of Proceeds***

Unregistered Sales of Equity Securities

(a) None

Use of Proceeds

(b) Not applicable

Company Stock Repurchases

(c) The following table provides information with respect to our purchases of Builders FirstSource, Inc. common stock during the third quarter of fiscal year 2019:

Period	**Total Number of Shares Purchased**		**Average Price Paid per Share**	**Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs**		**Maximum Dollar Value of Shares That May Yet be Purchased Under the Plans or Programs**
July 1, 2019 — July 31, 2019	360,000	$	16.88	360,000	$	13,914,912
August 1, 2019 — August 31, 2019	100,000		18.54	100,000		12,058,592
September 1, 2019 — September 30, 2019	—		—	—		12,058,592
Total	460,000	$	17.24	460,000	$	12,058,592

The shares repurchased and retired in the third quarter of 2019 were repurchased pursuant to a program authorized by our board of directors in February 2019. Under this program we are authorized to repurchase up to $20.0 million of our common stock.

Item 3. ***Defaults Upon Senior Securities***

(a) None

(b) None

Item 4. ***Mine Safety Disclosures***

Not applicable.

Item 5. ***Other Information***

(a) None

(b) None

Item 6. ***Exhibits***

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation of Builders FirstSource, Inc. (incorporated by reference to Exhibit 3.1 to Amendment No. 4 to the Registration Statement of the Company on Form S-1, filed with the Securities and Exchange Commission on June 6, 2005, File Number 333-122788)
3.2	Amended and Restated By-Laws of Builders FirstSource, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on November 6, 2017, File Number 0-51357)
4.1	Indenture, dated as of August 22, 2016, among Builders FirstSource, Inc., the guarantors party thereto, and Wilmington Trust, National Association, as trustee and notes collateral agent (form of note included therein) (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on August 23, 2016, File Number 0-51357)
4.2	Indenture, dated as of May 30, 2019, among Builders FirstSource, Inc., the guarantors party thereto, and Wilmington Trust, National Association, as trustee and notes collateral agent (form of note included therein) (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on May 31, 2019, File Number 0-51357)
4.3	First Supplemental Indenture, dated as of July 25, 2019, among the Company, the guarantors named therein and Wilmington Trust, National Association, as trustee and as notes collateral agent (incorporated by reference to Exhibit 4.3 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on July 30, 2019, File Number 0-51357)
10.1	Purchase Agreement, dated as of July 11, 2019, by and among Builders FirstSource, Inc., as issuer, certain of its subsidiaries, as guarantors, and Credit Suisse Securities (USA) LLC for itself and on behalf of several initial purchasers (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on July 12, 2019, File Number 0-51357)
31.1*	Certification of Chief Executive Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, signed by M. Chad Crow as Chief Executive Officer
31.2*	Certification of Chief Financial Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, signed by Peter M. Jackson as Chief Financial Officer
32.1**	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, signed by M. Chad Crow as Chief Executive Officer and Peter M. Jackson as Chief Financial Officer
101.1*	The following financial information from Builders FirstSource, Inc.'s Form 10-Q filed on November 1, 2019 formatted in Inline eXtensible Business Reporting Language ("Inline XBRL"): (i) Condensed Consolidated Statement of Operations and Comprehensive Income for the three and nine months ended September 30, 2019 and 2018, (ii) Condensed Consolidated Balance Sheet as of September 30, 2019 and December 31, 2018, (iii) Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2019 and 2018, (iv) Condensed Consolidated Statements of Changes in Stockholders' Equity for the three and nine months ended September 30, 2019 and 2018 and (v) the Notes to Condensed Consolidated Financial Statements.
104*	The cover page from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2019 has been formatted in Inline XBRL.

* Filed herewith.

** Builders FirstSource, Inc. is furnishing, but not filing, the written statement pursuant to Title 18 United States Code 1350, as added by Section 906 of the Sarbanes-Oxley Act of 2002, of M. Chad Crow our Chief Executive Officer, and Peter M. Jackson, our Chief Financial Officer.

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.

BUILDERS FIRSTSOURCE, INC.

/s/ M. CHAD CROW
M. Chad Crow
President and Chief Executive Officer
(Principal Executive Officer)

November 1, 2019

/s/ PETER M. JACKSON
Peter M. Jackson
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

November 1, 2019

/s/ JAMI COULTER
Jami Coulter
Senior Vice President and Chief Accounting Officer
(Principal Accounting Officer)

November 1, 2019

Exhibit 31.1

Certification of Chief Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, M. Chad Crow, certify that:

1. I have reviewed this report on Form 10-Q of Builders FirstSource, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ M. CHAD CROW
M. Chad Crow
President and Chief Executive Officer

Date: November 1, 2019

Exhibit 31.2

Certification of Chief Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Peter M. Jackson, certify that:

1. I have reviewed this report on Form 10-Q of Builders FirstSource, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ PETER M. JACKSON
Peter M. Jackson
Senior Vice President and Chief Financial Officer

Date: November 1, 2019

Exhibit 32.1

Certification of CEO and CFO Pursuant to 18 U.S.C. Section 1350
(Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002)

In connection with the quarterly report of Builders FirstSource, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, M. Chad Crow, as Chief Executive Officer of the Company, and Peter M. Jackson, as Senior Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to our knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ M. CHAD CROW
M. Chad Crow
President and Chief Executive Officer

/s/ PETER M. JACKSON
Peter M. Jackson
Senior Vice President and Chief Financial Officer

Date: November 1, 2019

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.