PATRICK INDUSTRIES INC
Form 10-Q
November 08, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 25, 2011

OR

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

For the transition period from ……………… to ………………

Commission file number 000-03922

PATRICK INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

INDIANA	35-1057796
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

107 WEST FRANKLIN STREET, P.O. Box 638, ELKHART, IN	46515
(Address of principal executive offices)	(ZIP Code)

(574) 294-7511

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

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

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

As of October 28, 2011, there were 9,841,495 shares of the registrant's common stock outstanding.

PATRICK INDUSTRIES, INC.
TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

	Page No.
ITEM 1. FINANCIAL STATEMENTS	
Condensed Consolidated Statements of Financial Position September 25, 2011 (Unaudited) and December 31, 2010	3
Condensed Consolidated Statements of Operations (Unaudited)Third Quarter and Nine Months Ended September 25, 2011 and September 26, 2010	4
Condensed Consolidated Statements of Cash Flows (Unaudited) Nine Months Ended September 25, 2011 and September 26, 2010	5
Notes to Condensed Consolidated Financial Statements (Unaudited)	6-18
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	19-33
ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	33
ITEM 4. CONTROLS AND PROCEDURES	33
PART II. OTHER INFORMATION	
ITEM 1A. RISK FACTORS	34
ITEM 6. EXHIBITS	34
SIGNATURES	35

Table of Contents

PART I: FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PATRICK INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(thousands)	As of (Unaudited) September 25, 2011	December 31, 2010
ASSETS		
Current Assets		
Cash and cash equivalents	$ 240	$ 1,957
Trade receivables, net	23,624	10,190
Inventories	25,656	22,723
Prepaid expenses and other	1,708	2,258
Total current assets	51,228	37,128
Property, Plant and Equipment, at cost	77,091	75,573
Less accumulated depreciation	54,452	52,401
Property, plant and equipment, net	22,639	23,172
Goodwill	4,128	2,966
Intangible assets, net of accumulated amortization (2011: $1,455; 2010: $917)	11,496	7,901
Deferred financing costs, net of accumulated amortization (2011: $271; 2010: $3,720)	2,005	325
Other non-current assets	573	3,325
TOTAL ASSETS	$ 92,069	$ 74,817
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Current maturities of long-term debt	$ 1,000	$ 16,983
Short-term borrowings	-	19,250
Accounts payable	19,539	8,204
Accrued liabilities	7,458	5,628
Total current liabilities	27,997	50,065
Long-term debt, less current maturities and discount	32,004	-
Deferred compensation and other	3,916	5,290
Deferred tax liabilities	1,326	1,326
TOTAL LIABILITIES	65,243	56,681
SHAREHOLDERS' EQUITY		
Common stock	54,068	53,798
Accumulated other comprehensive loss	(153)	(830)
Additional paid-in capital	893	148
Accumulated deficit	(27,982)	(34,980)
TOTAL SHAREHOLDERS' EQUITY	26,826	18,136
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 92,069	$ 74,817

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

PATRICK INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(thousands except per share data)	Third Quarter Ended Sept. 25, 2011	Sept. 26, 2010	Nine Months Ended Sept. 25, 2011	Sept. 26, 2010
NET SALES	$ 77,439	$ 72,785	$229,544	$ 220,150
Cost of goods sold	64,248	65,021	196,446	196,172
GROSS PROFIT	13,191	7,764	33,098	23,978
Operating expenses:				
Warehouse and delivery	3,537	3,110	10,155	8,884
Selling, general and administrative	4,226	3,785	12,157	11,190
Amortization of intangible assets	195	125	538	377
(Gain) loss on sale of fixed assets and acquisition of business	(11)	26	(263)	(2,794)
Total operating expenses	7,947	7,046	22,587	17,657
OPERATING INCOME	5,244	718	10,511	6,321
Stock warrants revaluation	(69)	(127)	(76)	(192)
Interest expense, net	777	1,474	3,589	4,348
Income (loss) before income taxes	4,536	(629)	6,998	2,165
Income taxes	-	-	-	-
NET INCOME (LOSS)	$ 4,536	$ (629)	$6,998	$ 2,165
BASIC NET INCOME (LOSS) PER COMMON SHARE	$ 0.46	$ (0.07)	$0.72	$ 0.23
DILUTED NET INCOME (LOSS) PER COMMON SHARE	$ 0.44	$ (0.07)	$0.68	$ 0.22
Weighted average shares outstanding - Basic	9,865	9,401	9,673	9,335
- Diluted	10,387	9,401	10,230	9,869

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

PATRICK INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Nine Months Ended	
(thousands)	Sept. 25, 2011	Sept. 26, 2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$6,998	$ 2,165
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,048	3,343
Amortization of intangible assets	538	377
Stock-based compensation expense	247	144
Deferred compensation expense	176	181
Gain on sale of fixed assets and acquisition of business	(263)	(2,794)
Stock warrants revaluation	(76)	(192)
(Increase) decrease in cash surrender value of life insurance	135	(15)
Deferred financing amortization	834	1,117
Amortization of debt discount and bond costs	72	108
Interest paid-in-kind	116	487
Amortization of loss on interest rate swap agreements	677	238
Change in fair value of derivative financial instruments	(106)	14
Change in operating assets and liabilities, net of the effects of acquisitions:		
Trade receivables	(12,047)	(6,683)
Inventories	(2,525)	(5,428)
Prepaid expenses and other	547	61
Accounts payable and accrued liabilities	11,503	7,397
Payments on deferred compensation obligations	(348)	(312)
Net cash provided by operating activities	9,526	208
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(1,643)	(1,065)
Proceeds from sale of property, equipment and facilities	87	8,408
Business acquisitions	(6,213)	(5,690)
Insurance premiums paid	(119)	(43)
Net cash provided by (used in) investing activities	(7,888)	1,610
CASH FLOWS FROM FINANCING ACTIVITIES		
Long-term debt payments, net	(3,463)	(10,409)
Short-term debt borrowings, net	1,000	9,500
Proceeds from life insurance policy loans	2,736	-
Payment on termination of interest rate swap agreements	(1,137)	-
Payment of deferred financing/debt issuance costs	(2,514)	(45)
Proceeds from exercise of stock options	21	-
Proceeds from exercise of warrants to purchase common stock	2	-
Other	-	(21)
Net cash used in financing activities	(3,355)	(975)
Increase (decrease) in cash and cash equivalents	(1,717)	843
Cash and cash equivalents at beginning of year	1,957	60
Cash and cash equivalents at end of period	$240	$ 903

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

PATRICK INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. BASIS OF PRESENTATION

In the opinion of Patrick Industries, Inc. ("Patrick" or the "Company"), the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the Company's financial position as of September 25, 2011 and December 31, 2010, and its results of operations for the three and nine months ended September 25, 2011 and September 26, 2010, and cash flows for the nine months ended September 25, 2011 and September 26, 2010.

Patrick's unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"). The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to those rules or regulations. For a description of significant accounting policies used by the Company in the preparation of its consolidated financial statements, please refer to Note 2 of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2010. Operating results for the third quarter and nine months ended September 25, 2011 are not necessarily indicative of the results to be expected for the year ending December 31, 2011.

Certain amounts in the prior year financial statements and footnotes have been reclassified to conform to the current year presentation.

2. SIGNIFICANT ACCOUNTING POLICIES

Recent Accounting Pronouncements

Goodwill Impairment – Qualitative Assessment

In September 2011, the Financial Accounting Standards Board ("FASB") issued revised guidance on testing goodwill for impairment. Under the revised guidance, entities testing goodwill for impairment have the option of performing a qualitative assessment (i.e., Step 0) before calculating the fair value of the reporting unit (i.e., Step 1 of the goodwill impairment test). If the entity determines, based on qualitative factors, that the fair value of the reporting unit is more likely than not less than the carrying amount, the two-step impairment test would be required. The guidance does not change how goodwill is calculated or assigned to reporting units, nor does it revise the requirements to test goodwill annually for impairment. In addition, the guidance does not amend the requirement to test goodwill for impairment between annual tests if events or circumstances warrant; however, it does revise the examples of events and circumstances that an entity should consider. The guidance is effective for annual and interim goodwill impairment tests performed for annual periods beginning after December 15, 2011. Early adoption of the guidance is permitted. The Company is currently evaluating the provisions of this guidance and has not yet determined the impact, if any, that the implementation of this guidance will have on its results of operations or financial condition.

Comprehensive Income Presentation

In June 2011, the FASB issued guidance to eliminate the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. Under the new guidance, all non-owner changes in

stockholders' equity will be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. Under both approaches, the tax effect for each component must be disclosed in the notes to the financial statements or presented in the statement in which other comprehensive income is presented. The guidance is effective for financial statements issued for annual periods beginning after December 15, 2011. The Company is currently evaluating whether it will utilize the one-statement or two-statement approach to present the components of other comprehensive income.

Table of Contents

3. INVENTORIES

Inventories are stated at the lower of cost (First-In, First-Out (FIFO) Method) or market and consist of the following classes:

(thousands)	Sept. 25, 2011	Dec. 31, 2010
Raw materials	$ 14,354	$ 14,221
Work in process	2,116	926
Finished goods	1,858	1,569
Less: reserve for inventory obsolescence	(374)	(694)
Total manufactured goods, net	17,954	16,022
Materials purchased for resale (distribution products)	7,962	6,861
Less: reserve for inventory obsolescence	(260)	(160)
Total materials purchased for resale (distribution products), net	7,702	6,701
Total inventories	$ 25,656	$ 22,723

4. GOODWILL AND INTANGIBLE ASSETS

Goodwill and other intangible assets are allocated to the Company's reporting units at the date they are initially recorded. Goodwill and indefinite-lived intangible assets are not amortized but are subject to an annual (or under certain circumstances more frequent) impairment test based on their estimated fair value. Goodwill impairment testing is performed at the reporting unit level, one level below the business segment. The Company's Manufacturing segment includes goodwill originating from the acquisitions of Gravure and Quality Hardwoods Sales ("Quality Hardwoods"). While Gravure remains a reporting unit of the Company for which impairment is assessed, Quality Hardwoods is assessed for impairment as part of the Company's hardwood door reporting unit. The Company's Distribution segment includes goodwill originating from the acquisition of Blazon International Group ("Blazon"), which remains a reporting unit for which impairment is assessed.

Finite-lived intangible assets that meet certain criteria continue to be amortized over their useful lives and are also subject to an impairment test based on estimated undiscounted cash flows when impairment indicators exist. The Company performs the required impairment test of goodwill in the fourth quarter or more frequently if events or changes in circumstances indicate that the carrying value may exceed the fair value. No impairment was recognized during the third quarter and nine months ended September 25, 2011. There have been no material changes to the methods of evaluating goodwill and intangible asset impairments during 2011. The Company does not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions used to determine impairment in the foreseeable future.

In September 2011, the Company acquired certain assets of Syracuse, Indiana-based A.I.A. Countertops, LLC ("AIA"). The purchase was determined to be a business combination and the intangible assets recorded as a result of the acquisition included (in thousands): customer relationships - $2,751; trademarks - $641; non-compete agreements - $312; and goodwill - $1,162. The goodwill recognized is attributable to expected operating synergies, the acquired workforce and other factors. None of the goodwill is expected to be deductible for income tax purposes. The AIA reporting unit is included in the Manufacturing segment. See Note 5 for further details.

In June 2011, the Company acquired certain assets of Elkhart, Indiana-based Praxis Group ("Praxis"). The purchase was determined to be a business combination and the intangible assets recorded as a result of the acquisition included (in thousands): customer relationships - $399; and non-compete agreements - $30. See Note 5 for further details.

Table of Contents

Changes in the carrying amount of goodwill for the nine months ended September 25, 2011 by segment are as follows:

(thousands)	Manufacturing	Distribution	Total
Balance – January 1, 2011	$ 2,861	$ 105	$ 2,966
Acquisition	1,162	-	1,162
Balance – September 25, 2011	$ 4,023	$ 105	$ 4,128

As of September 25, 2011, the remaining intangible assets balance of $11.5 million is comprised of $2.0 million of trademarks which have an indefinite life, and therefore, no amortization expense has been recorded, and $9.5 million pertaining to customer relationships and non-compete agreements which are being amortized over periods ranging from 2 to 19 years.

Other intangible assets, net consist of the following as of September 25, 2011 and December 31, 2010:

(thousands)	Sept. 25, 2011	Dec. 31, 2010
Trademarks	$ 2,041	$ 1,400
Customer relationships	10,082	6,932
Non-compete agreements	828	486
	12,951	8,818
Less: accumulated amortization	(1,455)	(917)
Other intangible assets, net	$ 11,496	$ 7,901

Changes in the carrying value of other intangible assets for the nine months ended September 25, 2011 by segment are as follows:

(thousands)	Manufacturing	Distribution	Total
Balance – January 1, 2011	$ 7,167	$ 734	$ 7,901
Acquisitions	3,704	429	4,133
Amortization	(377)	(161)	(538)
Balance – September 25, 2011	$ 10,494	$ 1,002	$ 11,496

The intangible assets within the Manufacturing segment related to the AIA acquisition will be amortized beginning in the fourth quarter of 2011.

5. ACQUISITIONS

AIA

In September 2011, the Company acquired certain assets of AIA, a fabricator of countertops, backsplashes, tables, signs, and other products for the recreational vehicle and commercial markets. This acquisition expanded the Company's product offerings to its existing customer base in the recreational vehicle industry and industrial market sectors.

The acquisition was primarily funded through borrowings under the Company's revolving credit facility and subordinated financing provided by Northcreek Mezzanine Fund I, L.P. ("Northcreek") and an affiliate of Northcreek, in the form of secured senior subordinated notes. In addition, certain former members of AIA's ownership group will carry a note receivable from the Company. See Note 10 for further details.

Assets acquired and liabilities assumed in the acquisition were recorded on the Company's condensed consolidated statements of financial position at their estimated fair values as of the date of the acquisition. The purchase price allocation and all required purchase accounting adjustments will be finalized during the fourth quarter of 2011. In addition to the goodwill and other intangible assets of $4.9 million acquired and noted in Note 4, the Company acquired typical working capital items of trade receivables, inventories, property, plant and equipment, and prepaid expenses, net of accounts payable assumed and accrued liabilities, as noted in the table below, resulting in a total purchase price of approximately $5.7 million.

Table of Contents

The results of operations for AIA are included in the Company's condensed consolidated financial statements and the Manufacturing operating segment from the date of acquisition and resulted in the inclusion of $0.4 million of revenues in the third quarter and nine month periods ended September 25, 2011.   AIA did not contribute significantly to operating income for the same periods.

(thousands)		
Trade receivables	$	1,246
Inventories		186
Property, plant and equipment		667
Prepaid expenses		26
Accounts payable		(1,263)
Accrued liabilities		(37)
Intangible assets		3,704
Goodwill		1,162
Total purchase price	$	5,691

Praxis

In June 2011, the Company acquired certain assets of Praxis, a manufacturer and distributor of countertops, foam products, shower doors and furniture products to the recreational vehicle industry. This acquisition expanded the Company's product offerings to its existing customer base in the recreational vehicle industry. The fair value of the identifiable assets acquired and liabilities assumed of $0.7 million exceeded the fair value of the purchase price of the business of $0.5 million. As a result, the Company recognized a gain of $0.2 million, net of tax, associated with the acquisition. The gain is included in the line item "Gain on sale of fixed assets and acquisition of business" in the condensed consolidated statements of operations for the nine months ended September 25, 2011.

The assets acquired and liabilities assumed in the acquisition were recorded on the Company's condensed consolidated statements of financial position at their estimated fair values as of the date of the acquisition. The results of operations for Praxis are included in the Company's condensed consolidated financial statements and the Manufacturing and Distribution operating segments from the date of acquisition. In addition to the intangible assets of $0.4 million acquired and noted in Note 4, the Company acquired typical working capital items of trade receivables and inventories, net of accounts payable assumed, of $0.1 million, and property, plant and equipment of $0.2 million.

Quality Hardwoods

In January 2010, the Company acquired certain assets of the cabinet door business of Quality Hardwoods, a limited liability company, for $2.0 million. This acquisition added new products and expanded the Company's existing cabinet door business. The assets acquired in the acquisition, including inventories of $0.7 million, goodwill of $0.7 million, and other intangible assets of $0.6 million, were recorded on the Company's condensed consolidated statements of financial position at their estimated fair values as of the date of the acquisition. The results of operations for Quality Hardwoods are included in the Company's condensed consolidated financial statements and the Manufacturing operating segment from the date of acquisition.

Blazon

In August 2010, the Company acquired certain assets of Blazon, a Bristol, Indiana-based distributor of wiring, electrical, plumbing and other building products to the recreational vehicle and manufacturing housing industries. This acquisition added new products and expanded the Company's existing recreational vehicle and manufactured housing distribution presence. The results of operations for Blazon are included in the Company's

condensed consolidated financial statements and the Distribution operating segment from the date of acquisition.

9

Table of Contents

Assets acquired and liabilities assumed in the acquisition were recorded on the Company's condensed consolidated statements of financial position at their estimated fair values as of the date of the acquisition. In addition to the goodwill and other intangible assets acquired, the Company acquired typical working capital items of trade receivables, inventories and prepaid expenses, net of accounts payable assumed, as noted in the table below, resulting in a final total purchase price of approximately $3.8 million.

(thousands)	
Trade receivables	$ 1,247
Inventories	2,612
Prepaid expenses	22
Accounts payable	(1,019)
Intangible assets	795
Goodwill	105
Total purchase price	$ 3,762

The following unaudited pro forma information assumes the AIA and Blazon acquisitions occurred as of the beginning of the periods presented. The pro forma information contains the actual operating results of AIA and Blazon combined with the results prior to the acquisition date, adjusted to reflect the pro forma impact of the acquisitions occurring at the beginning of the period. In addition, the pro forma information includes amortization expense related to intangible assets acquired in the AIA acquisition of approximately (i) $95,000 for each of the third quarters ended September 25, 2011 and September 26, 2010 and (ii) $284,000 for each of the nine month periods ended September 25, 2011 and September 26, 2010. Amortization expense of approximately $46,000 and $138,000 related to intangible assets acquired in the Blazon acquisition is included in the pro forma information for the third quarter and nine months ended September 26, 2010, respectively. Pro forma information related to the Praxis and the Quality Hardwoods acquisitions is not included in the table below as their financial results were not considered to be significant to the Company's operating results for the periods presented.

	Third Quarter Ended		Nine Months Ended	
(thousands except per share data)	Sept. 25, 2011	Sept. 26, 2010	Sept. 25 2011	Sept. 26, 2010
Revenue	$81,670	$79,469	$244,476	$244,695
Net income (loss)	5,237	(601)	8,853	2,983
Income (loss) per share - basic	0.53	(0.06)	0.92	0.32
Income (loss) per share - diluted	0.50	(0.06)	0.87	0.30

The pro forma information is presented for informational purposes only and is not necessarily indicative of the results of operations that actually would have been achieved had the acquisition been consummated as of that time, nor is it intended to be a projection of future results.

6. STOCK-BASED COMPENSATION

The Company accounts for stock-based compensation in accordance with fair value recognition provisions. The Company recorded compensation expense of $0.1 million for both the third quarter ended September 25, 2011 and September 26, 2010 for its stock-based compensation plans on the condensed consolidated statements of operations. For the comparable nine months periods, the Company recorded $0.2 million and $0.1 million, respectively.

The Company estimates the fair value of (i) all stock grants as of the grant date using the closing price per share of the Company's common stock on such date, and (ii) all stock option awards as of the grant date by applying the

Black-Scholes option pricing model. The Board of Directors approved the following share grants in 2010 and 2011: 131,000 shares on May 20, 2010, 140,000 shares on March 1, 2011, 21,000 shares on May 26, 2011, and 3,500 shares on August 18, 2011.

Table of Contents

As of September 25, 2011, there was approximately $0.5 million of total unrecognized compensation cost related to stock-based compensation arrangements granted under incentive plans. That cost is expected to be recognized over a weighted-average period of 17 months.

7. GAIN ON SALE OF FIXED ASSETS

In the fourth quarter of 2009, the Company entered into a listing agreement to sell its manufacturing and distribution facility in Woodburn, Oregon. Approximately $3.2 million of carrying value for this facility was classified as assets held for sale as of December 31, 2009. The net proceeds from the sale of this facility of $4.0 million exceeded the carrying value when it was sold in February 2010, resulting in a pretax gain on sale of $0.8 million. The pretax gain was recognized into earnings in the first quarter of 2010. The Company operated in the same facility under a license agreement with the purchaser for the use of a portion of the square footage previously occupied until December 31, 2010. The Company subsequently entered into a short-term lease agreement with the purchaser with respect to a portion of this facility in a separate and distinct transaction on January 1, 2011. The current lease term expires in December 2011. The Company expects to renew the lease agreement for an additional one year period.

During the fourth quarter of 2008, the Company entered into a listing agreement to sell its remaining manufacturing and distribution facility in Fontana, California. Approximately $1.6 million of carrying value for this facility was classified as assets held for sale as of December 31, 2009. The net proceeds from the sale of this facility of $4.3 million exceeded the carrying value when it was sold in March 2010, resulting in a total pretax gain on sale of $2.7 million. In connection with the sale, the Company entered into a lease agreement with the purchaser which allowed the Company to continue operating in a portion of the facility. Since the Company determined that it has less than substantially all of the use of the property, the pretax gain in excess of the present value of the rent of $2.0 million was recognized immediately into earnings in the first quarter of 2010. The remaining $0.7 million of the pretax gain was deferred and is being offset against future lease payments (beginning in the second quarter of 2010) over the 24-month term of the lease in proportion to the related gross rentals. The lease term will expire in March 2012. The deferred gain recognized during both the third quarter ended September 25, 2011 and September 26, 2010 was $0.1 million. The deferred gain recognized for the comparable nine months periods was $0.3 million and $0.2 million, respectively.

8. INCOME PER COMMON SHARE

Basic net income per common share is computed by dividing net income by the weighted-average number of common shares outstanding. Diluted net income per common share is computed by dividing net income by the weighted-average number of common shares outstanding, plus the dilutive effect of stock options and warrants. The dilutive effect of stock options and warrants is calculated under the treasury stock method using the average market price for the period. Certain common stock equivalents related to options were not included in the computation of diluted net income per share because those option exercise prices were greater than the average market price of the common shares.

Basic and diluted earnings per common share for the third quarter and nine months periods were calculated using the weighted average shares as follows:

	Third Quarter Ended		Nine Months Ended	
(thousands)	Sept. 25, 2011	Sept. 26, 2010	Sept. 25, 2011	Sept. 26, 2010
Weighted average common shares outstanding - basic	9,865	9,401	9,673	9,335
Effect of potentially dilutive securities	522	-	557	534
Weighted average common shares outstanding - diluted	10,387	9,401	10,230	9,869

For the third quarter ended September 26, 2010, there is no difference in basic and diluted earnings per share since a net loss was recorded in this period resulting in all common stock equivalents having no dilutive effect. In the third quarter of 2010, potentially dilutive securities totaling approximately 178,800 shares related to stock options and 246,700 shares related to stock warrants were excluded from diluted earnings per common share because of their anti-dilutive effect.