UNIVERSAL FOREST PRODUCTS INC
Form 10-Q
July 28, 2006

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

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

For the quarterly period ended July 1, 2006

OR

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

Commission File Number 0-22684

UNIVERSAL FOREST PRODUCTS, INC.

(Exact name of registrant as specified in its charter)

Michigan	38-1465835
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
2801 East Beltline NE, Grand Rapids, Michigan	49525
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code (616) 364-6161

NONE

(Former name or former address, if changed since last report.)

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

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. (See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer þ Accelerated Filer o Non-Accelerated Filer o

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

Indicate the number of shares of each of the issuer s classes of common stock, as of the latest practicable date:

Class	Outstanding as of July 1, 2006
Common stock, no par value	18,836,034

TABLE OF CONTENTS

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(Unaudited)

(in thousands, except share data)

	July 1, 2006	December 31, 2005	June 25, 2005
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	$ 43,309	$ 46,215	$ 27,586
Accounts receivable, net	242,829	185,080	232,600
Inventories:			
Raw materials	139,250	144,361	134,699
Finished goods	107,560	109,408	113,130
	246,810	253,769	247,829
Other current assets	22,495	17,114	13,114
TOTAL CURRENT ASSETS	555,443	502,178	521,129
OTHER ASSETS	8,003	7,887	8,056
GOODWILL	132,588	131,556	127,756
OTHER INTANGIBLE ASSETS, net	15,313	10,966	6,617
PROPERTY, PLANT AND EQUIPMENT:			
Property, plant and equipment	430,933	412,475	398,729
Accumulated depreciation and amortization	(202,938)	(188,142)	(176,425)
PROPERTY, PLANT AND EQUIPMENT, NET	227,995	224,333	222,304
TOTAL ASSETS	$ 939,342	$ 876,920	$ 885,862
LIABILITIES AND SHAREHOLDERS EQUITY			
CURRENT LIABILITIES:			
Accounts payable	$ 146,409	$ 106,716	$ 139,393
Accrued liabilities:			
Compensation and benefits	66,750	69,528	58,746
Other	34,365	27,449	31,696
Current portion of long-term debt and capital lease obligations	902	458	21,937
TOTAL CURRENT LIABILITIES	248,426	204,151	251,772
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current portion	170,192	209,039	206,000
DEFERRED INCOME TAXES	13,067	12,914	18,061
MINORITY INTEREST	8,908	8,577	8,662
OTHER LIABILITIES	11,075	10,387	9,994

TOTAL LIABILITIES	451,668	445,068	494,489

3

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS CONTINUED

	July 1, 2006	December 31, 2005	June 25, 2005
SHAREHOLDERS EQUITY:			
Preferred stock, no par value; shares authorized 1,000,000; issued and outstanding, none			
Common stock, no par value; shares authorized 40,000,000; issued and outstanding, 18,836,034, 18,402,648 and 18,286,385	$ 18,836	$ 18,403	$ 18,286
Additional paid-in capital	112,488	97,372	92,190
Deferred stock compensation		4,212	4,257
Deferred stock compensation in rabbi trust		(2,117)	(2,087)
Retained earnings	355,023	312,878	278,536
Accumulated other comprehensive earnings	2,593	2,408	1,622
	488,940	433,156	392,804
Employee stock notes receivable	(1,266)	(1,304)	(1,431)
TOTAL SHAREHOLDERS EQUITY	487,674	431,852	391,373
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 939,342	$ 876,920	$ 885,862

See notes to consolidated condensed financial statements.

4

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
CONSOLIDATED CONDENSED STATEMENTS OF EARNINGS
(Unaudited)

(in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	July 1, 2006	June 25, 2005	July 1, 2006	June 25, 2005
NET SALES	$ 826,847	$ 779,552	$ 1,492,456	$ 1,316,712
COST OF GOODS SOLD	706,429	678,310	1,277,727	1,148,241
GROSS PROFIT	120,418	101,242	214,729	168,471
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	70,773	59,505	135,302	109,356
EARNINGS FROM OPERATIONS	49,645	41,737	79,427	59,115
OTHER EXPENSE (INCOME):				
Interest expense	3,744	4,266	7,543	8,041
Interest income	(352)	(270)	(781)	(419)
Net (gain) loss on sale of real estate	(63)	32	(63)	(1,240)
	3,329	4,028	6,699	6,382
EARNINGS BEFORE INCOME TAXES AND MINORITY INTEREST	46,316	37,709	72,728	52,733
INCOME TAXES	17,885	14,237	27,641	19,996
EARNINGS BEFORE MINORITY INTEREST	28,431	23,472	45,087	32,737
MINORITY INTEREST	(1,117)	(682)	(1,907)	(718)
NET EARNINGS	$ 27,314	$ 22,790	$ 43,180	$ 32,019
EARNINGS PER SHARE BASIC	$ 1.45	$ 1.24	$ 2.31	$ 1.75
EARNINGS PER SHARE DILUTED	$ 1.41	$ 1.20	$ 2.23	$ 1.69
WEIGHTED AVERAGE SHARES OUTSTANDING	18,851	18,323	18,729	18,255

WEIGHTED AVERAGE SHARES OUTSTANDING WITH COMMON STOCK EQUIVALENTS	19,432	18,984	19,355	18,978

See notes to consolidated condensed financial statements.

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
(Unaudited)

(in thousands, except share and per share data)

	Common Stock	Additional Paid-In Capital	Deferred Stock Compen-sation	Deferred Compen-sation Rabbi Trust	Retained Earnings	Accumulated Other Comprehensive Earnings	Employees Stock Notes Receivable	Total
Balance at December 25, 2004	**$ 18,002**	**$ 89,269**	**$ 3,423**	**($1,331)**	**$ 247,427**	**$ 1,525**	**($1,546)**	**$ 356,769**
Comprehensive earnings:								
Net earnings					32,019			
Foreign currency translation adjustment						97		
Total comprehensive earnings								32,116
Cash dividends $.050 per share					(910)			(910)
Issuance of 315,418 shares under employee stock plans	315	3,182						3,497
Issuance of 3,170 shares under stock grant programs	3	130						133
Issuance of 21,144 shares under deferred compensation plans	21	765	(30)	(756)				0
Received 57,207 shares for the exercise of stock options	(57)	(2,137)						(2,194)
Tax benefits from non-qualified stock options exercised		921						921
Accrued expense under deferred compensation plans			864					864

Issuance of 1,605 shares in exchange for employee stock notes receivable	2	60					(62)	0
Payments received on employee stock notes receivable							177	177
Balance at June 25, 2005	**$ 18,286**	**$ 92,190**	**$ 4,257**	**($2,087)**	**$ 278,536**	**$ 1,622**	**($1,431)**	**$ 391,373**

6

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
CONTINUED

	Common Stock	Additional Paid-In Capital	Deferred Stock Compen-sation	Deferred Compen-sation Rabbi Trust	Retained Earnings	Accumulated Other Comprehensive Earnings	Employees Stock Notes Receivable	Total
Balance at December 31, 2005	**$ 18,403**	**$ 97,372**	**$ 4,212**	**($2,117)**	**$ 312,878**	**$ 2,408**	**($1,304)**	**$ 431,852**
Comprehensive earnings:								
Net earnings					43,180			
Foreign currency translation adjustment						185		
Total comprehensive earnings								43,365
Cash dividends $.055 per share					(1,035)			(1,035)
Reversal of deferred compensation upon adoption of SFAS 123(R)		2,095	(4,212)	2,117				0
Issuance of 327,195 shares under employee stock plans	327	5,151						5,478
Issuance of 3,058 shares under stock grant programs	3	173						176
Issuance of 101,278 shares under deferred compensation plans	101	(101)						0
Received 1,367 shares for the exercise of stock options	(1)	(89)						(90)
Tax benefits from non-qualified stock options exercised		4,247						4,247

Expense associated with share-based compensation arrangements		522						522
Accrued expense under deferred compensation plans		2,917						2,917
Issuance of 3,222 shares in exchange for employee stock notes receivable	3	201					(204)	0
Payments received on employee stock notes receivable							242	242
Balance at July 1, 2006	**$ 18,836**	**$ 112,488**	**$ 0**	**$ 0**	**$ 355,023**	**$ 2,593**	**($1,266)**	**$ 487,674**

See notes to consolidated condensed financial statements.

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

(in thousands)

	Six Months Ended	
	July 1, 2006	June 25, 2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings	$ 43,180	$ 32,019
Adjustments to reconcile net earnings to net cash from operating activities:		
Depreciation	16,730	15,200
Amortization of intangibles	2,151	1,190
Expense associated with share-based compensation arrangements	522	
Expense associated with stock grant plans	177	133
Deferred income taxes	(867)	(516)
Minority interest	1,907	718
Net gain on sale or impairment of property, plant, and equipment	(183)	(1,133)
Changes in:		
Accounts receivable	(57,246)	(80,206)
Inventories	7,768	(31,838)
Accounts payable	39,426	50,881
Accrued liabilities and other	8,237	17,131
Excess tax benefits from share-based compensation arrangements	(3,866)	
NET CASH FROM OPERATING ACTIVITIES	57,936	3,579
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(16,234)	(21,985)
Acquisitions, net of cash received	(11,298)	(7,500)
Proceeds from sale of property, plant and equipment	565	2,318
Insurance proceeds	38	3,013
Collections of notes receivable	1,600	
Advances on notes receivable	(2,473)	
Other assets, net		458
NET CASH FROM INVESTING ACTIVITIES	(27,802)	(23,696)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (repayments) borrowings under revolving credit facilities	(40,000)	21,140
Repayment of long-term debt	(325)	(454)
Proceeds from issuance of common stock	5,389	2,865
Distributions to minority shareholder	(930)	(369)
Dividends paid to shareholders	(1,035)	(910)
Repurchase of common stock		
Excess tax benefits from share-based compensation arrangements	3,866	
Other	(5)	157
NET CASH FROM FINANCING ACTIVITIES	(33,040)	22,429

NET CHANGE IN CASH AND CASH EQUIVALENTS	(2,906)	2,312
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	46,215	25,274
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 43,309	$ 27,586
SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 8,292	$ 7,851
Income taxes	24,824	8,438

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
CONSOLIDATED CONDENSED STATEMENT OF CASH FLOWS CONTINUED

	Six Months Ended	
	July 1, 2006	June 25, 2005
NON-CASH OPERATING ACTIVITIES:		
Accounts receivable exchanged for note receivable	$ 431	$ 765
Deferred purchase price of acquisition exchanged for current payable	53	994
Deferred purchase price of acquisition exchanged for long-term liability	721	
NON-CASH INVESTING ACTIVITIES:		
Property, plant & equipment exchanged for debt	$ 1,303	
NON-CASH FINANCING ACTIVITIES:		
Common stock issued under deferred compensation plans	$ 2,917	$ 761

See notes to consolidated condensed financial statements.

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

A. BASIS OF PRESENTATION

The accompanying unaudited, interim, consolidated, condensed financial statements (the Financial Statements) include our accounts and those of our wholly-owned and majority-owned subsidiaries and partnerships, and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, the Financial Statements do not include all of the information and footnotes normally included in the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States. All significant intercompany transactions and balances have been eliminated.

In our opinion, the Financial Statements contain all material adjustments necessary to present fairly our consolidated financial position, results of operations and cash flows for the interim periods presented. All such adjustments are of a normal recurring nature. These Financial Statements should be read in conjunction with the annual consolidated financial statements, and footnotes thereto, included in our Annual Report to Shareholders on Form 10-K for the fiscal year ended December 31, 2005.

Certain reclassifications have been made to the Financial Statements for 2005 to conform to the classifications used in 2006.

B. REVENUE RECOGNITION

Earnings on construction contracts are reflected in operations using either percentage-of-completion accounting, which includes the cost to cost and units of delivery methods, or completed contract accounting, depending on the nature of the business at individual operations. Under percentage-of-completion using the cost to cost method, revenues and related earnings on construction contracts are measured by the relationships of actual costs incurred related to the total estimated costs. Under percentage-of-completion using the units of delivery method, revenues and related earnings on construction contracts are measured by the relationships of actual units produced related to the total number of units. Revisions in earnings estimates on the construction contracts are recorded in the accounting period in which the basis for such revisions becomes known. Projected losses on individual contracts are charged to operations in their entirety when such losses become apparent. Under the completed contract method, revenues and related earnings are recorded when the contracted work is complete and losses are charged to operations in their entirety when such losses become apparent.

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

The following table presents the balances of percentage-of-completion accounts:

	July 1, 2006	June 25, 2005
Cost and Earnings in Excess of Billings	$ 7,454	$ 2,386
Billings in Excess of Cost and Earnings	8,412	2,539

C. EARNINGS PER COMMON SHARE

A reconciliation of the changes in the numerator and the denominator from the calculation of basic EPS to the calculation of diluted EPS follows (in thousands, except per share data):

	Three Months Ended 07/01/06			Three Months Ended 06/25/05		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Net Earnings	$ 27,314			$ 22,790		
EPS Basic						
Income available to common stockholders	27,314	18,851	$ 1.45	22,790	18,323	$ 1.24
Effect of dilutive securities						
Options		581			661	
EPS Diluted						
Income available to common stockholders and assumed options exercised	$ 27,314	19,432	$ 1.41	$ 22,790	18,984	$ 1.20

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

	Six Months Ended 07/01/06			Six Months Ended 06/25/05		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Net Earnings	$ 43,180			$ 32,019		
EPS Basic						
Income available to common stockholders	43,180	18,729	$ 2.31	32,019	18,255	$ 1.75
Effect of dilutive securities						
Options		626			723	
EPS Diluted						
Income available to common stockholders and assumed options exercised	$ 43,180	19,355	$ 2.23	$ 32,019	18,978	$ 1.69

No outstanding options were excluded from the computation of diluted EPS for the quarters and six months ended July 1, 2006 or June 25, 2005.

D. SALE OF ACCOUNTS RECEIVABLE

On March 8, 2006 we entered into a new accounts receivable sale agreement with a bank. The terms of this new agreement are substantially the same as the agreement that was in place in the first six months of 2005 and subsequently cancelled on October 25, 2005. Under the terms of these agreements:

We sell specific receivables to the bank at an agreed-upon price at terms ranging from one month to one year.

We service the receivables sold and outstanding on behalf of the bank at a rate of 0.50% per annum.

We receive an incentive servicing fee, which we account for as a retained interest in the receivables sold. Our retained interest is determined based on the fair market value of anticipated collections in excess of the Agreed Base Value of the receivables sold. Appropriate valuation allowances are recorded against the retained interest.

The maximum amount of receivables, net of retained interest, which may be sold and outstanding at any point in time under this arrangement is $50 million.

On July 1, 2006 and June 25,2005, $54.1 million of receivables were sold and outstanding, and we recorded $4.1 million of retained interest in other current assets. A summary of the transactions we completed for the first six months of 2006 and 2005 are presented below (in thousands).

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

	Six Months Ended July 1, 2006	Six Months Ended June 25, 2005
Accounts receivable sold	$ 270,474	$ 230,200
Retained interest in receivables	(4,054)	(2,595)
Expense from sale	(1,190)	(809)
Servicing fee received	99	95
Discounts and sales allowances	0	(1,926)
Net cash received from sale	$ 265,329	$ 224,965

E. GOODWILL AND OTHER INTANGIBLE ASSETS

The following amounts were included in other intangible assets, net (in thousands):

	July 1, 2006		June 25, 2005	
	Assets	Accumulated Amortization	Assets	Accumulated Amortization
Non-compete agreements	$ 15,511	($7,401)	$ 9,806	($4,997)
Licensing agreements	2,510	(2,223)	2,760	(1,936)
Trade name	2,340			
Customer relationships	5,927	(1,380)	1,285	(301)
Backlog	644	(615)	190	(190)
Total	$ 26,932	($11,619)	$ 14,041	($7,424)

Estimated amortization expense for intangible assets as of July 1, 2006 for each of the five succeeding fiscal years is as follows
(in thousands):

2006	$ 2,459
2007	3,635
2008	3,178
2009	2,119
2010	1,155
Thereafter	2,767

The changes in the net carrying amount of goodwill for the six months ended July 1, 2006 and June 25, 2005 are as follows (in thousands):

Balance as of December 31, 2005	$ 131,556
Acquisitions	6,701
Final purchase price allocation of DecKorators	(5,925)
Other, net	256
Balance as of July 1, 2006	$ 132,588

13

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

Balance as of December 25, 2004	$ 123,845
Acquisition	3,931
Other, net	(20)
Balance as of June 25, 2005	$ 127,756

F. BUSINESS COMBINATIONS

On June 5, 2006, one of our subsidiaries acquired the assets of Dura-Bilt Mfg. Co. (Dura-Bilt) located in Riverbank, CA, a roof and floor truss manufacturer for the site-built construction market in Northern California. The purchase price was approximately $9.2 million, consisting of $8.4 million paid on the date we closed the transaction and $0.8 million to be paid in the future, allocating $2.6 million to tangible net assets and $6.6 million to goodwill. The purchase price allocation for this acquisition is preliminary and will be revised as final estimates of intangible asset values are made in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations*. Dura-Bilt had net sales in fiscal 2005 totaling approximately $16 million.

On April 3, 2006, one of our subsidiaries, which at the time owned a 75% interest in Shawnlee Construction, LLC (Shawnlee), acquired an additional 5% interest for approximately $0.8 million, allocating $0.5 million to tangible assets, $0.1 million to customer relationship related intangibles, $0.1 million to a non-compete agreement and $0.1 million to goodwill. In addition, as previously agreed, we will purchase the remaining 20% in 5% increments over the next four years.

On January 9, 2006, one of our subsidiaries acquired the assets of Classic Truss Company, Inc. (Classic), a facility which supplies the site-built construction market in Fort Pierce, FL. The purchase price was approximately $2.1 million, allocating $1.7 million to tangible net assets and $0.4 million to a non-compete agreement. Classic had net sales in fiscal 2005 totaling approximately $6.0 million.

On November 14, 2005, one of our subsidiaries acquired the assets of DecKorators, Inc. (DecKorators) which designs, imports, markets and distributes decorative balusters and accessories for residential decks and porches, and is located in Crestwood and St. Louis, MO. The purchase price was approximately $7.7 million, consisting of $7.0 million paid on the date we closed the transaction and $0.7 million paid in January 2006, allocating $0.8 million to tangible net assets, $2.9 million to non-compete agreements, $0.9 million to customer relationship related intangibles, $2.3 million to trade name and related intangibles and $0.8 to goodwill. DecKorators had net sales in fiscal 2004 totaling approximately $9.1 million.

On June 27, 2005, one of our subsidiaries, which at the time owned a 50% interest in Shawnlee, acquired an additional 25% interest for approximately $3.5 million, allocating $1.2 million to tangible assets, $0.8 million to customer relationship related intangibles, $0.7 million to a non-compete agreement, $0.2 million to backlog and $0.6 million to goodwill. In addition, we agreed to purchase the remaining 25% in 5% increments over the

UNIVERSAL FOREST PRODUCTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

next five years. In addition, Shawnlee acquired the assets of Shepardville Construction, Inc. (Shepardville) and AW Construction, LLC (AW), which install interior products for commercial and multi-family construction. The purchase price was approximately $2.0 million, allocating $0.9 million to tangible assets, $0.8 million to customer relationship related intangibles, and $0.3 million to backlog. Shepardville had net sales in fiscal 2004 totaling approximately $4.8 million. AW had net sales in 2004 totaling approximately $7.9 million.

On June 2, 2005, one of our subsidiaries acquired the assets of Maine Ornamental Woodworkers, Inc. (Maine Ornamental), which manufactures, imports and distributes decorative caps used on decking and fence posts, and is based in Winthrop, ME and Bainbridge Island, WA. The purchase price was approximately $8.4 million, consisting of $7.5 million paid on the date we closed the transaction and $0.9 million paid in August 2005, allocating $4.4 million to tangible net assets, $1.7 million to non-compete agreements, $2.1 million to customer relationship related intangibles and $0.2 million to goodwill. Maine Ornamental had net sales in fiscal 2004 totaling approximately $12.4 million.

The business combinations mentioned above were not significant to our operating results individually or in aggregate, and thus pro forma results are not presented.

G. EMPLOYEE STOCK NOTES RECEIVABLE

Employee stock notes receivable represents notes issued to us by certain employees and officers to finance the purchase of our common stock. Directors and executive officers do not, and are not allowed to, participate in this program.

H. STOCK-BASED COMPENSATION

Prior to January 1, 2006, we accounted for our stock option plans and our Employee Stock Purchase Plan using the intrinsic value method of accounting provided under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, (APB 25) and related Interpretations, as permitted by Financial Accounting Standards Board (FASB) Statement No. 123, *Accounting for Stock-Based Compensation*, (SFAS 123) under which no compensation expense was recognized for stock option grants and issuance of stock pursuant to the Employee Stock Purchase Plan. Accordingly, share-based compensation was included as a pro forma disclosure in the financial statement footnotes and continues to be provided for periods prior to fiscal 2006.

Effective January 1, 2006, we adopted the fair value recognition provisions of FASB Statement No. 123(R), *Share-Based Payment*, (SFAS 123(R)) using the modified-prospective-transition method. Under that transition method, compensation cost recognized in the first six months of 2006 includes: a) compensation cost for all share-based payments granted through December 31, 2005, but for which the requisite service period had not been completed as of December 31, 2005, based on the grant date fair market value estimated in accordance with the original provisions of SFAS 123, and b) compensation cost for all share-based payments granted

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). Results for prior periods have not been restated.

As a result of adopting SFAS 123(R) on January 1, 2006, our earnings before income taxes and net earnings for the second quarter of 2006, are $307,000 and $204,000 lower, respectively, than if we had continued to account for share-based compensation under APB 25. Basic and diluted earnings per share for the second quarter of 2006 are $0.01 and $0.01 lower, respectively, than if we had continued to account for share-based compensation under APB 25.

As a result of adopting SFAS 123(R) on January 1, 2006, our earnings before income taxes and net earnings for the first six months of 2006, are $522,000 and $355,000 lower, respectively, than if we had continued to account for share-based compensation under APB 25. Basic and diluted earnings per share for the first six months of 2006 are $0.02 and $0.02 lower, respectively, than if we had continued to account for share-based compensation under APB 25.

Prior to the adoption of SFAS 123(R), we presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the Consolidated Condensed Statement of Cash Flows. SFAS 123(R) requires the cash flows resulting from the tax benefits resulting from the tax deductions in excess of the compensation cost recognized for those options (excess tax benefits from share-based compensation arrangements) to be classified as financing cash flows. The $3,866,000 excess tax benefit from share-based compensation arrangements classified as a financing cash inflow for the first six months of 2006 would have been classified as an operating cash inflow if we had not adopted SFAS 123(R).

We provide compensation benefits to employees and non-employee directors under several share-based payment arrangements including various employee stock option plans, the Employee Stock Purchase Plan, the Director Retainer Stock Plan, the Directors Stock Grant Plan, and the Conditional Share Grant Agreement.

Stock Option Plans

On April 28, 1999, our shareholders approved the Long Term Stock Incentive Plan (the 1999 Plan) to succeed the 1997 Long Term Stock Incentive Plan (the 1997 Plan). The 1999 Plan reserves a maximum of 1,000,000 shares, plus 406,029 shares remaining under the 1997 Plan, plus an annual increase of no more than 200,000 shares which may be added on the date of the annual meeting of shareholders each year. The term of the 1999 Plan is ten years. The 1999 Plan provides for the granting of stock options, reload options, stock appreciation rights, restricted stock, performance shares and other stock-based rewards. To date, we have only issued options under this plan. Vesting requirements for awards under this plan will vary by individual grant and are time-based vesting. The contractual life of all of the options granted under this plan will be no greater than 15 years.

The fair value of each option award is estimated as of the date of grant using the Black-Scholes option pricing model. Expected volatility assumptions used were based on historical volatility

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

of our stock. We utilize historical data to estimate option exercise and employee termination behavior within the valuation model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The risk-free rate for the expected term of the option award was based on the U.S. Treasury yield curve in effect at the time of the grant. No new option awards were granted in the first six months of 2006 and therefore no specific valuation assumptions are presented.

The following summary presents information regarding outstanding options as of July 1, 2006 and changes during the six months then ended with regard to options under all stock option plans:

	Stock Under Option	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2006	1,384,879	$ 19.08		
Exercised	(317,867)	$ 15.66		
Forfeited or expired	(10,031)	$ 21.22		
Outstanding at July 1, 2006	1,056,981	$ 20.08	5.22	$ 45,088,000
Vested or expected to vest at July 1, 2006	819,633	$ 20.07	5.57	$ 34,993,000
Exercisable at July 1, 2006	224,500	$ 15.63	3.96	$ 10,574,000

The total intrinsic value of options exercised during the first six months of 2006 was $16,354,000.

Employee Stock Purchase Plan

In April 1994, our shareholders approved the Employee Stock Purchase Plan (Stock Purchase Plan) and Director Retainer Stock Plan (Stock Retainer Plan). In April 2002, our shareholders approved the 2002 Employee Stock Purchase Plan (2002 Stock Purchase Plan) to succeed the Stock Purchase Plan. The plans allow eligible employees to purchase shares of our stock at a share price equal to 85% of fair market value on the purchase date.

For the six months ending July 1, 2006, 9,328 shares were issued under this plan. The weighted average fair value of employee stock purchase rights pursuant to this plan was $9.13 per share. The fair value of the stock purchase rights was calculated as the difference between the stock price and the employee purchase price.

Director Retainer Stock Plan

The Stock Retainer Plan allows eligible members of the Board of Directors to defer their retainer fees and receive shares of our stock at the time of their retirement, disability or death. The number of shares to be received is equal to the amount of the retainer fee deferred multiplied by 110% divided by the fair market value of a share of our stock at the time of

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

deferral, is increased for dividends declared and may only be distributed in kind. We recognized the fair market value of the shares issued under this plan, calculated using the number of shares issued and the stock price on the issuance date, as expense and recorded the related obligation in shareholders equity. We recognized approximately $117,000 in expense for shares issued under this program in the first six months of 2006.

Directors Stock Grant Program

In January 1997, we instituted a Directors Stock Grant Program. In lieu of a cash increase in the amount of Director fees, each outside Director receives 100 shares of stock for each board meeting attended up to a maximum of 400 shares per year. In the first six months of 2006, we recognized the fair market value of the shares issued under this plan, calculated using the number of shares issued and the stock price on the issuance date, as an expense totaling approximately $142,000.

Conditional Share Grant Agreement

On April 17, 2002, under the 1999 Plan, a Conditional Share Grant Agreement was executed which will grant our Chief Executive Officer 10,000 shares of common stock immediately upon the satisfaction of the terms and conditions set forth in the Agreement. We recognize the fair value of the award estimated as of the date of grant using the Black-Scholes option pricing model. We recognized approximately $100,000 in expense for shares issuable under this program in the first six months of 2006.

All Share-Based Payment Arrangements

The total share-based compensation cost and the related total income tax benefit that has been recognized in results of operations was approximately $781,000 and $266,000, respectively for the first six months of 2006.

As of July 1, 2006, there was $1.8 million of total unrecognized compensation cost related to share-based compensation arrangements. That cost is expected to be recognized over a weighted average period of 2.59 years.

Cash received from option exercises and share issuances under the Stock Purchase Plan was $5,389,000 during the first six months of fiscal 2006. The actual tax benefit realized for the tax deductions from option exercises totaled $4,247,000 during that period.

Pro Forma Net Earnings

The following table provides pro forma net earnings and earnings per share had we applied the fair value method of SFAS 123 for the second quarter and first six months of 2005 (in thousands, except per share data):

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

	Three Months Ended June 25, 2005	Six Months Ended June 25, 2005
Net Earnings:		
As reported	$ 22,790	$ 32,019
Deduct: Stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(161)	(400)
Pro Forma	$ 22,629	$ 31,619
EPS Basic:		
As reported	$ 1.24	$ 1.75
Pro forma	$ 1.24	$ 1.73
EPS Diluted:		
As reported	$ 1.20	$ 1.69
Pro forma	$ 1.19	$ 1.68

I. COMMITMENTS, CONTINGENCIES, AND GUARANTEES

We are self-insured for environmental impairment liability through a wholly owned subsidiary, UFP Insurance Ltd., a licensed captive insurance company. We own and operate a number of facilities throughout the United States that chemically treat lumber products. In connection with the ownership and operation of these and other real properties, and the disposal or treatment of hazardous or toxic substances, we may, under various federal, state, and local environmental laws, ordinances, and regulations, be potentially liable for removal and remediation costs, as well as other potential costs, damages, and expenses. Insurance reserves, calculated with no discount rate, have been established to cover remediation activities at our Union City, GA; Stockertown, PA; Elizabeth City, NC; Auburndale, FL; Schertz, TX; and Janesville, WI wood preservation facilities. In addition, a small reserve was established for our Thornton, CA property to remove asbestos and certain lead containing materials which existed on the property at the time of purchase.

Including amounts from our wholly owned captive insurance company, we have reserved approximately $1.7 million on July 1, 2006 and $1.8 million on June 25, 2005, representing the estimated costs to complete future remediation efforts without reduction for an insurance receivable.

The manufacturers of CCA preservative voluntarily discontinued the registration of CCA for certain residential applications as of December 31, 2003. Our wood preservation facilities

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

have been converted to alternate preservatives, either ACQ or borates. In March 2005, one facility began using CCA to treat certain marine products and panel goods for which ACQ is not a suitable preservative.

In November 2003, the EPA published its report on the risks associated with the use of CCA in children s playsets. While the study observed that the range of potential exposure to CCA increased by the continuous use of playsets, the EPA concluded that the risks were not sufficient to require removal or replacement of any CCA treated structures. The EPA did refer a question on the use of sealants to a scientific advisory panel. The panel issued a report which provides guidance to the EPA on the use of various sealants but does not mandate their use. The results of the EPA study are consistent with a prior Consumer Products Safety Commission (CPSC) study which reached a similar conclusion. The EPA and CPSC studies with respect to sealants are ongoing, and additional reports are expected in the near future.

In addition, various special interest environmental groups have petitioned certain states requesting restrictions on the use or disposal of CCA treated products. The wood preservation industry trade groups are working with the individual states and their regulatory agencies to provide an accurate, factual background which demonstrates that the present method of uses and disposal is scientifically supported.

We have been requested by a customer to defend it from purported class action lawsuits. One such lawsuit is currently pending in Illinois. The purported class action lawsuit seeks unspecified damages from this customer, based on generalized claims under a purported theory of violation of individual state Consumer Protection Act statutes. To date, none of these cases have been certified as a class action. The Illinois case was previously dismissed without prejudice. Based on an alleged violation of the Consumer Protection Act, the claim has been restated and filed. The case does not allege personal injury or property damage. The judge in this case denied class certification for this case in December 2005. As previously stated, our vendors believe and scientific studies support the fact that CCA treated lumber poses no unreasonable risks, and we intend to vigorously defend this position. While our customer has charged us for certain costs incurred in the defense of these claims and we have expensed them accordingly, we have not formally accepted liability of these costs.

We believe that based on current facts, laws, and existing scientific evidence, as well as the favorable disposition of the above referenced lawsuits, that the likelihood of a material adverse financial impact from the remaining claims is remote. Therefore, we have not accrued for any potential loss related to the contingencies above. However, potential liabilities of this nature are not conducive to precise estimates and are subject to change. To the extent we are required to defend these actions, we intend to do so vigorously and will monitor these facts on an ongoing basis.

In addition, on July 1, 2006, we were parties either as plaintiff or a defendant to a number of lawsuits and claims arising through the normal course of our business. In the opinion of

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

management, our consolidated financial statements will not be materially affected by the outcome of these contingencies and claims.

On July 1, 2006, we had outstanding purchase commitments on capital projects of approximately $13.2 million.

We provide a variety of warranties for products we manufacture. Historically, warranty claims have not been material.

In certain cases we jointly bid on contracts with framing companies to supply building materials to site-built construction projects. In some of these instances we are required to post payment and performance bonds to insure the owner that the products and installation services are completed in accordance with our contractual obligations. We have agreed to indemnify the surety for claims made against the bonds. Historically, we have not had any claims for indemnity from our sureties. As of July 1, 2006, we had approximately $25.3 million in outstanding payment and performance bonds, which expire during the next two years. In addition, approximately $16.3 million in payment and performance bonds are outstanding for completed projects which are still under warranty.

We have entered into operating leases for certain assets that include a guarantee of a portion of the residual value of the leased assets. If at the expiration of the initial lease term we do not exercise our option to purchase the leased assets and these assets are sold by the lessor for a price below a predetermined amount, we will reimburse the lessor for a certain portion of the shortfall. These operating leases will expire periodically over the next five years. The estimated maximum aggregate exposure of these guarantees is approximately $2.1 million.

Under our sale of accounts receivable agreement, we guarantee that Universal Forest Products RMS, LLC, as accounts servicer, will remit collections on receivables sold to the bank. (See Note D, Sale of Accounts Receivable.)

On July 1, 2006, we had outstanding letters of credit totaling $39.2 million, primarily related to certain insurance contracts and industrial development revenue bonds, as further described below.

In lieu of cash deposits, we provide irrevocable letters of credit in favor of our insurers to guarantee our performance under certain insurance contracts. We currently have irrevocable letters of credit outstanding totaling approximately $20.4 million for these types of insurance arrangements. We have reserves recorded on our balance sheet, in accrued liabilities, that reflect our expected future liabilities under these insurance arrangements.

We are required to provide irrevocable letters of credit in favor of the bond trustees for all of the industrial development revenue bonds that we have issued. These letters of credit guarantee principal and interest payments to the bondholders. We currently have irrevocable letters of credit outstanding totaling approximately $18.5 million related to our outstanding

UNIVERSAL FOREST PRODUCTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

industrial development revenue bonds. These letters of credit have varying terms but may be renewed at the option of the issuing banks.

Certain wholly owned domestic subsidiaries have guaranteed the indebtedness of Universal Forest Products, Inc. in certain debt agreements, including the Series 1998-A Senior Notes, Series 2002-A Senior Notes and our revolving credit facility. The maximum exposure of these guarantees is limited to the indebtedness outstanding under these debt arrangements and this exposure will expire concurrent with the expiration of the debt agreements.

Our treating operations utilize Subpart W drip pads, defined as hazardous waste management units by the EPA. The rules regulating drip pads require that the pad be closed at the point that it is no longer used to manage hazardous waste. Closure involves identification and disposal of all contamination from the wood treating operations. The ultimate cost of closure is dependent upon a number of factors including, but not limited to, identification and removal of contamination, cleanup standards that vary from state to state, and the time period over which the cleanup would be completed. Based on our knowledge of existing circumstances, it is considered probable that these costs will approximate $465,000. As a result, this amount is recorded in other long-term liabilities on July 1, 2006.

We did not enter into any new guarantee arrangements during the second quarter of 2006 which would require us to recognize a liability on our balance sheet.

J. SALE OF REAL ESTATE

On January 3, 2005, we sold real estate located in Stockton, CA for $2.3 million and recorded a pre-tax gain totaling approximately $1.2 million.

K. SUBSEQUENT EVENT

On July 10, 2006, one of our subsidiaries acquired a 50% interest in United Lumber & Reman LLC (United), an industrial wood manufacturing plant located in Muscle Shoals, Alabama. The purchase price was approximately $4.9 million. United had net sales totaling approximately $26 million in 2005.

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Included in this report are certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The forward-looking statements are based on the beliefs and assumptions of management, together with information available to us when the statements were made. Future results could differ materially from those included in such forward-looking statements as a result of, among other things, the factors set forth below and certain economic and business factors which may be beyond our control. Investors are cautioned that all forward-looking statements involve risks and uncertainty.

OVERVIEW

We are pleased to report strong results for the second quarter of 2006, which was highlighted by:

- Strong organic sales growth in our site-built and industrial markets.

- Flat unit sales to the manufactured housing market as sales and market share increases with HUD code producers were offset by a soft modular market.

- A 1% unit sales increase to the DIY/retail market as sales increases and market share gains by our Consumer Products and Western divisions were offset by a decline in sales in our Northeast and Midwest regions.

- A 19.9% increase in net earnings over the second quarter of 2005, which exceeded our 8% unit sales increase, primarily due to:
  - § An increase in sales of higher-margin, value-added products to 55.6% of total sales from 49.9% of total sales last year
  - § Economies of scale related to strong organic growth
  - § Cost reductions achieved through our company-wide innovation program.

- Improved cash flows from operating activities due to a combination of strong earnings growth, effective working capital management, and a new sale of receivables program which was completed on March 8, 2006.

- A reduction in interest-bearing debt to $171.1 million from $227.9 million due to strong cash flows.

- Our purchase of Dura-Bilt Mfg. Co. in Riverbank, CA in June 2006.

Table of Contents

UNIVERSAL FOREST PRODUCTS, INC.
MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS CONTINUED

In summary, we remain optimistic about the future of our business, markets and strategies, and our employees remain focused on adding value for our customers, executing our strategies and meeting our goals. We continue to target a range for annual net earnings growth of 15% 20% and a range for annual sales growth of 10% 15% for 2006 subject to the following key assumptions:

- Stable housing markets where we have a strong site-built presence and continued opportunities for market share gains.
- Stability in our D-I-Y/retail and manufacturing housing markets, as well as in lumber prices.
- Favorable weather conditions for building and home improvement activities, particularly in the fourth quarter.
- Continuing to gain market share and realize strong unit sales growth in the industrial market.
- The completion of strategic business acquisitions.

We continue to pursue acquisition opportunities and believe that acquisitions will, as they have in the past, play an important role in our long-term growth strategy.

HISTORICAL LUMBER PRICES

The following table presents the Random Lengths framing lumber composite price for the three months ended July 1, 2006 and June 25, 2005:

	Random Lengths Composite Average $/MBF	
	2006	2005
January	$ 382	$ 381
February	377	420
March	368	422
April	369	407
May	341	386
June	326	405
Second quarter average	$ 345	$ 399
Year-to-date average	$ 361	$ 404
Second quarter percentage change from 2005		