PATRICK INDUSTRIES INC
Form 10-K
April 15, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2008

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 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 W. 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)

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

Common stock, without par value	Nasdaq Stock Market LLC
(Title of each class)	(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No x

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form

10 K or any amendment to this Form 10-K. 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 (Do not check if a smaller reporting company) Smaller reporting company x

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

The aggregate market value of the voting stock held by non-affiliates of the registrant on June 27, 2008 (based upon the closing price on the Nasdaq Stock Market LLC and an estimate that 39.6% of the shares are owned by non-affiliates) was $23,194,490. The closing market price was $6.50 on that day and 9,018,618 shares of the Company s common stock were outstanding. As of March 13, 2009, there were 9,025,939 shares of the registrant s common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement for its Annual Meeting of Shareholders scheduled to be held on May 21, 2009 are incorporated by reference into Part III of this Form 10-K.

PATRICK INDUSTRIES, INC.

FORM 10-K

FISCAL YEAR ENDED DECEMBER 31, 2008

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FINANCIAL SECTION

INFORMATION CONCERNING FORWARD-LOOKING STATEMENTS

This Form 10-K contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to financial condition, results of operations, business strategies, operating efficiencies or synergies, competitive position, growth opportunities for existing products, plans and objectives of management, markets for the common stock of Patrick Industries, Inc. and other matters. Statements in this Form 10-K as well as other statements contained in the annual report and statements contained in future filings with the Securities and Exchange Commission and publicly disseminated press releases, and statements which may be made from time to time in the future by management of the Company in presentations to shareholders, prospective investors, and others interested in the business and financial affairs of the Company, which are not historical facts, are forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially from those set forth in the forward-looking statements. Patrick Industries, Inc. does not undertake to publicly update or revise any forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made, except as required by law. You should consider forward-looking statements, therefore, in light of various important factors, including those set forth in the reports and documents that Patrick Industries, Inc. files with the Securities and Exchange Commission, including this Annual Report on Form 10-K for the year ended December 31, 2008.

There are a number of factors, many of which are beyond the control of Patrick Industries, Inc., which could cause actual results and events to differ materially from those described in the forward-looking statements. These factors include pricing pressures due to competition, costs and availability of raw materials, availability of retail and wholesale financing for manufactured homes, availability and costs of labor, inventory levels of retailers and manufacturers, levels of repossessed manufactured homes, the financial condition of our customers, the ability to generate cash flow or obtain financing to fund growth, future growth rates in the Company s core businesses, interest rates, oil and gasoline prices, the outcome of litigation, adverse weather conditions impacting retail sales, and our ability to remain in compliance with our credit agreement covenants. In addition, national and regional economic conditions and consumer confidence may affect the retail sale of recreational vehicles and manufactured homes.

Any projections of financial performance or statements concerning expectations as to future developments should not be construed in any manner as a guarantee that such results or developments will, in fact, occur. There can be no assurance that any forward-looking statement will be realized or that actual results will not be significantly different from that set forth in such forward-looking statement. See Part I, Item 1A Risk Factors below for further discussion.

PART I

ITEM 1. BUSINESS

Company Overview

Patrick Industries, Inc. (collectively, the Company, we, our or Patrick), which was founded in 1959 and incorporated in Indiana in 1961, is a major manufacturer and supplier of building products and materials to the manufactured housing (MH) and recreational vehicle (RV) industries. In addition, we are a supplier to certain other industrial markets, such as kitchen cabinet, home and office furniture, commercial fixtures and furnishings, marine, architectural, and the automotive aftermarket. We manufacture a variety of products including decorative vinyl and paper panels, wrapped moldings, hardwood, cabinet doors and components, slotwall and slotwall components, components for electronic desks, countertops, and printed decorative vinyl.

We are also an independent wholesale distributor of pre-finished wall and ceiling panels, drywall and drywall finishing products, floor covering products, vinyl and cement siding, interior passage doors, roofing products, ceramic tile, electronics, insulation, and other related products. We have a nationwide network of manufacturing and distribution centers for our products, thereby reducing in-transit delivery time and cost to the regional manufacturing plants of our customers. We believe that we are one of the few suppliers to the MH and RV industries that has such a nationwide network. We maintain four manufacturing plants and a distribution facility near our principal offices in Elkhart, Indiana, and operate nine other warehouse and distribution centers and ten other manufacturing plants in thirteen other states.

Beginning in 2007 and continuing throughout 2008, we explored, initiated and completed a number of cost reduction and efficiency improvements designed to address the downturn in general worldwide economic conditions that adversely affected demand for our products and services and to leverage our position to drive future growth. These improvements included the restructuring and integration of operations, consolidation of facilities, disposition of non-core operations, streamlining of administrative and support activities**,** and the management of inventory levels. The Company also continued to enhance its products and services through the integration of new and expanded product lines designed to create additional scale advantages and offer both increased breadth and depth of products and services. In the Executive Summary section of Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, we provide an overview of the impact that the deterioration in macroeconomic conditions had on our operations and in the RV, MH, and residential housing industries in 2008.

In the first quarter of 2009, we completed the divestiture of one of our non-core operations, American Hardwoods, Inc. (American Hardwoods), and in 2008 made the decision to divest our aluminum extrusion operation. See Strategic Divestitures below and Note 3 to the Consolidated Financial Statements in Item 8 of this report for further details.

Patrick had three reportable business segments in 2008 (based on continuing operations): Primary Manufactured Products, Distribution, and Other Component Manufactured Products. Financial information about Patrick s three segments is included in Note 16 to the Consolidated Financial Statements.

Competition

The MH and RV industries are highly competitive with low barriers to entry. This level of competition carries through to the suppliers to these industries. Across the Company s range of products and services, competition is based primarily on price, product features, quality, and service. We have several competitors in each class of our products. All of our competitors currently compete with us on a regional and local basis. In order for a competitor to compete with us on a national basis, we believe that a substantial capital commitment and investment and experienced personnel would be required. The other industrial markets in which we continue to expand are also highly competitive. In 2008, the declining sales volume and depressed economic conditions in all three of the primary markets we serve caused extreme pricing pressure on certain products as supply outweighed demand. As the RV and MH industries are projecting lower volume in 2009 compared to prior year levels, the Company expects competition in most of the products lines and industries we serve to remain intense in 2009 and potentially into 2010**.** Given this environment, the Company has identified several operating strategies to maintain or enhance earnings through productivity and fixed cost reduction initiatives, expansion into new product lines, and optimization of capacity utilization.

Strategy

Overview

We believe that we have developed quality-working relationships with our customers and suppliers, and have oriented our business to the needs of these customers. These customers include all of the larger MH and RV manufacturers and a number of large to medium-sized industrial customers. Our industrial customers generally are directly linked to the residential housing markets. Our MH and RV customers generally demand the lowest competitive prices, high quality standards, short lead times, and a high degree of flexibility from their suppliers. Our industrial customers generally are less price sensitive than our MH and RV customers, and more focused on quality customer service and quick response time. Consequently, we have focused our efforts on maintaining and improving the quality of our manufactured products, developing a nationwide manufacturing and distribution presence in response to our customers needs for flexibility and short lead times, and prioritizing the implementation of lean manufacturing principles and continuous improvement in all of our facilities including our corporate office. Additionally, because of the short lead times, which range from 24 hours to same day order receipt and delivery, we have intensified our focus on reducing our inventory levels with the help of some of our key suppliers with vendor managed inventory programs. These initiatives have been instrumental in improving our operating cash flow and liquidity. As we explore new markets and industries, we believe that these and other strategic initiatives provide us with a strong foundation for future growth. In 2008, approximately 45% of our sales were to the MH industry, 37% to the RV industry, and 18% to the industrial and other markets. In 2007, approximately 36% of our sales were to the MH industry, 39% to the RV industry, and 25% to the industrial and other markets.

Operating Strategies

Key operating strategies identified by management, include the following:
Strategic Acquisitions, Expansion and Restructuring

We supply a broad variety of building material products and, with our nationwide manufacturing and distribution capabilities, we believe that we are well positioned for the introduction of new products. We, from time to time, consider the acquisition of additional product lines, facilities, companies with a strategic fit, or other assets to complement or expand our existing businesses.

In May 2007, we purchased all of the outstanding stock of Adorn Holdings, Inc. (Adorn), an Elkhart, Indiana-based major manufacturer and supplier to the MH, RV, and industrial markets, for $78.8 million. This acquisition represented the largest acquisition in our history, virtually doubled our manufacturing revenues, and immediately strengthened our market position and presence in the major industries that we serve. Due to the size and complexity of the acquisition, and the potential for synergy realization through facility rationalization, headcount reduction, vendor consolidation, and the implementation of best practices, we intensely focused our efforts for the remainder of 2007 and through the first nine months of 2008 on the consolidation of Adorn into Patrick in order to maximize the planned efficiencies as soon as possible.

In May 2007, we initiated a restructuring plan (the Restructuring Plan) to integrate Adorn with our existing businesses. The completion of the Restructuring Plan in the third quarter of 2008 resulted in cumulative pretax charges totaling approximately $3.3 million. Expenses associated with the Restructuring Plan included the closure of duplicate facilities, severance related to the elimination of redundant jobs, and various asset write-downs related to the consolidation of product lines. We have realized, and expect to continue to realize, synergy savings from this acquisition on a go-forward basis.

While operating under the current depressed market and economic conditions, which we believe will continue through the end of 2009 and possibly into 2010, we expect to focus on fixed cost and debt reduction initiatives in order to reduce our leverage ratio, maintain operating cash flow, meet the covenants under our credit agreement and maximize efficiencies from the consolidation of Adorn into Patrick.

Strategic Divestitures

In an effort to strategically align our current operations with businesses within our core competencies and reduce overall fixed costs, we have explored and will continue to explore various alternatives for the divestiture of certain unprofitable, non-core operations. In 2008, we identified our American Hardwoods and aluminum extrusion operations as non-core operations. During the fourth quarter of 2008, we reclassified the carrying values of the assets of American Hardwoods and the aluminum extrusion operation to assets held for sale, which is included in current assets on the consolidated statements of financial position. The financial results of these operations have also been classified as discontinued operations in the consolidated financial statements and all prior period operating results have been reclassified to conform to the current year presentation. See Note 3 to the Consolidated Financial Statements for further details.

Sale of American Hardwoods, Inc. Operation

In January 2009, the Company sold certain assets and the business of the American Hardwoods operation, an industrial hardwood product distributor located in Phoenix, Arizona, and entered into a separate real estate purchase agreement with the buyer to sell the building that housed this operation, subject to certain conditions. At the time of the American Hardwoods purchase two years ago, we were focused on adding products that complemented Patrick s existing product lines while further diversifying our customer base and driving market penetration in growing economic regions. Since early 2008, the downturn in general economic conditions adversely affected the demand for building products in the Phoenix market and, ultimately, the sales volume from this operation. The decision to divest American Hardwoods and to seek to divest the aluminum extrusion operation (discussed below) was largely based on projected and potential operating losses under the current operating model and working capital requirements of these operations that forced us to assess the overall fit of these operations within the parameters of our strategic plan. Previously, the financial results of American Hardwoods had been included in the Distribution segment.

Sale of Aluminum Extrusion Operation

In the fourth quarter of 2008, the Company made the decision to divest certain assets of its aluminum extrusion operation located in Mishawaka, Indiana. Previously, the financial results of this operation comprised the entire Engineered Solutions business segment. Estimated pretax charges of approximately $5 million associated with the planned divesture are reflected in discontinued operations and consist of the write down to fair market value of trade receivables, inventories and fixed assets. These assets have been classified as held for sale.

Diversification into Other Markets

While we continually seek to improve our position as a leading supplier to the MH and RV industries and have substantially increased our presence in these markets through the acquisition of Adorn in 2007, we are also seeking to expand our product lines into other industrial, commercial and institutional markets. Many of our products, such as countertops, cabinet doors, laminated panels, and shelving, have applications in the kitchen cabinet, office furniture and fixture, and architectural markets. We have a dedicated sales force focused on increasing our industrial market penetration and on our diversification into more commercial and institutional markets.

Because order size from the industrial and commercial markets tends to be for larger numbers of units, we enjoy better production efficiencies for these orders. We believe that diversification into other industrial markets provides opportunities for improved operating margins with products that are complementary in nature to our current manufacturing processes. In addition, we believe that our nationwide manufacturing and distribution capabilities enable us to position ourselves for product expansion.

Utilization of Manufacturing Capacity

Efficiency utilization

Since we own a majority of our operating facilities, the acquisition and consolidation of Adorn into Patrick allowed us to increase capacity utilization at all of our consolidated manufacturing facilities. In 2008, we completed two plant expansion initiatives which were started in 2007 prior to the market declines, to allow for the increased volumes taken on at these operating facilities and to improve workflow and deliver efficiencies. Additionally, we are focused on cross-training all of our manufacturing work force in our manufacturing cells within each facility to maximize our efficiencies and increase the flexibility of our labor force. While we increased capacity utilization as a result of our facility consolidation, the decline in volume levels due to soft industry conditions in all of the major end markets we serve has left us with unused capacity. We have the ability to substantially increase volumes in almost all of our facilities without adding comparable incremental fixed costs. With the expected continued weak economic conditions, we are continually exploring opportunities for further facility consolidation.

Plant Consolidations / Closures and Division Changes

In 2008 and in the first quarter of 2009, we consolidated and closed certain manufacturing and distribution facilities in an effort to align operating costs with our revenue base and keep our overhead structure at a level consistent with operating needs, particularly given the overall soft economic conditions experienced in 2008 and further expected in 2009.

During the first quarter of 2008, the Company entered into a listing agreement to sell an idle manufacturing facility in Fontana, California, which was exited in 2007. In the second quarter of 2008, this facility was sold, resulting in a pretax gain on sale of approximately $4.2 million. The building that was sold formerly housed the Company s west coast molding division. In 2007, the Company consolidated this molding division into its Fontana custom vinyls and distribution facility. The consolidation was part of a multiphase integration effort following the acquisition of Adorn.

Additionally during the first quarter of 2008, the Company closed its Sun Adhesives division located in our Decatur, Alabama facility. Due to the ever-increasing demand for technical expertise and the economies of scale related to being able to consolidate its purchases, the Company was able to improve profitability and eliminate certain fixed costs by negotiating a new nationwide agreement with a leading supplier of bonding systems to supply adhesives to all of our manufacturing facilities.

During the fourth quarter of 2008, the Company entered into a listing agreement to sell its remaining manufacturing and distribution facility in Fontana, California. The Company will continue to assess the market conditions in California for its products and if appropriate will move to a leased facility in the event of a sale of this property. The Company has reclassified approximately $1.6 million of carrying value for this facility to assets held for sale in the consolidated financial statements at December 31, 2008 and expects that the property will be sold in 2009.

Additionally during the fourth quarter of 2008, the Company entered into a listing agreement to sell its custom vinyls manufacturing facility in Ocala, Florida. It is anticipated that the sale of this facility will not be completed until 2010 due to unfavorable real estate market conditions, and therefore the property s carrying value was not included in assets held for sale at December 31, 2008.

In December 2008, the Company announced its decision to close its leased distribution facility in Woodland, California and consolidate operations into the existing Fontana, California facility in order to offset a sizable reduction in sales volumes that stemmed from the planned closure of one of our major customers plants in the same location. The consolidation was completed in January 2009.

In January 2009 in conjunction with the sale of the American Hardwoods operation, the Company entered into a separate real estate purchase agreement with the buyer to sell the building that housed this operation. The agreement includes a purchase price of $2.5 million for the building and property and is subject to confirmatory due diligence by the buyer and is expected to be finalized by the end of the second quarter of 2009. The Company accordingly reclassified approximately $2.5 million of carrying value for this property to assets held for sale in the Company s consolidated financial statements at December 31, 2008.

Product Development and New Product Introductions/Discontinuations

With our versatile manufacturing and distribution capabilities, we are continually striving to increase our market presence in all of the markets that we serve and gain entrance into other potential markets. We remain committed to new product development and introduction initiatives. New product development is critical to growing our revenue base and keeping up with changing market conditions and addressing customer demand. We plan to continue to devote our time and attention to distribution products that fit within the strategic parameters of our current business model including appropriate margin and inventory turn levels. In 2008 and early 2009, we introduced several new products.

To further enhance our product offerings to marine and RV customers, we established new relationships with several vendors to distribute a complete line of audio/video source units, televisions and microwaves to the marine, RV and recreational product markets. This newly formed electronics division within our Distribution segment was launched in the first quarter of 2009.

In January 2009, we discontinued certain distribution product lines including our line of resilient flooring products and the hardwood products associated with the American Hardwoods operation.

Principal Products

Through our manufacturing divisions, we manufacture a variety of products including decorative vinyl and paper panels, wrapped moldings, stiles and battens, hardwood, foil and membrane pressed cabinet doors, drawer sides and bottoms, slotwall and slotwall components, components for electronic desks, countertops, and printed decorative vinyl and paper. In conjunction with our manufacturing capabilities, we also provide value added processes, including custom fabrication, edge-banding, drilling, and cut-to-size capabilities.

We distribute pre-finished wall and ceiling panels, drywall and drywall finishing products, floor covering products, particleboard, vinyl and cement siding, interior passage doors, roofing products, decorative tile, mirrors and glass, electronics, insulation, and other related products.

Manufactured laminated panels contributed 45%, 39%, and 33% of total sales for the years ended December 31, 2008, 2007, and 2006, respectively. Pre-finished wall panels and finishing products contributed 8%, 10%, and 20% of total sales for the years ended December 31, 2008, 2007, and 2006, respectively.

We have no material patents, licenses, franchises, or concessions and do not conduct significant research and development activities.

Manufacturing Processes and Operations

Our primary manufacturing facilities utilize various materials including gypsum, particleboard, plywood and fiberboard, which are bonded by adhesives or a heating process to a number of products, including vinyl, paper, foil and high-pressure laminate. Additionally, we offer high-pressure laminate laminated to substrates such as particleboard and lauan which has many uses, including counter tops and ambulance cabinetry. We manufacture laminate countertops and solid surface countertops, as well as slotwall and slotwall components for the store and office fixture markets. Laminated products are used in the production of wall, cabinet, shelving, counter and fixture products with a wide variety of finishes and textures.

We manufacture three distinct cabinet door product lines in both raised and flat panel designs, as well as square, cathedral and arched panels. One product line is manufactured from raw lumber using solid oak, maple and other hardwood materials. Another line of doors is made of laminated fiberboard, and a third line uses membrane press technology to produce doors and components with vinyls ranging from 2 mil to 14 mil in thickness. Several outside profiles are available on square, cathedral, and arched raised panel doors and the components include rosettes, arched window trim, blocks and windowsills, among others. Our doors are sold mainly to the MH and RV industries. We also market to the cabinet manufacturers and ready-to-assemble furniture manufacturers.

Our vinyl printing facility produces a wide variety of decorative vinyls which range from 4 mil to 5 mil in thickness and are shipped in rolls ranging from 350-700 yards in length. This facility produces material for both internal and external use.

Our aluminum extrusion operation, which is classified as held for sale on our December 31, 2008 consolidated statements of financial position, produces semi-fabricated and fabricated aluminum extrusions for structural and non-structural applications.

Markets

We are engaged in the manufacturing and distribution of building products and material for use primarily by the MH and RV industries, and in other industrial markets.

The current downturn in the residential housing market has had an adverse impact on our operations as the three primary industries in which we operate are experiencing overall declines that are expected to continue through 2009 and potentially into 2010. The manufactured housing industry continues to be negatively impacted by financing concerns and a lack of available financing sources, and the current credit situation in the residential housing market puts additional pressure on consumers, who are generally using financial institutions and conventional financing as a source for these purchases. Recreational vehicle purchases are generally consumer discretionary income purchases, and therefore any situation which causes concerns related to discretionary income has a negative impact on these markets. Approximately 70% of our industrial revenue base is associated with the U.S. residential housing market, and therefore there is a direct correlation between the demand for our products in this market and new residential housing production.

Manufactured Housing

The manufactured housing industry has historically served as a more affordable alternative to the traditional homebuyer. Because of the relative lower cost of construction as compared to site built homes, manufactured homes traditionally have been one of the principal means for first time homebuyers to overcome the obstacles of large down payments and higher monthly mortgage payments. Manufactured housing also presents an affordable alternative to site built homes for retirees and others desiring a lifestyle in which home ownership is less burdensome than in the case of site built homes. The increase in square footage of living space and updated modern designs in manufactured homes created by multi-sectional models has made them more attractive to a larger segment of homebuyers.

Manufactured homes are built in accordance with national, state and local building codes. Manufactured homes are factory built and transported to a site where they are installed, often permanently. Some manufactured homes have design limitations imposed by the constraints of efficient production and over-the-road transit. Delivery expense limits the effective competitive shipping range of the manufactured homes to approximately 400 to 600 miles.

Modular homes, which are a component of the manufactured housing industry, are factory built homes that are built in sections and transported to the site for installation. These homes are generally set on a foundation and are subject to land/home-financing terms and conditions. In recent years, these units have been gaining in popularity due to their aesthetic similarity to site-built homes and their relatively less expensive cost, as well as their less restrictive access to financing when compared to the chattel lending market.

The manufactured housing industry is cyclical and is affected by the availability of alternative housing, such as apartments, town houses, condominiums and site-built housing. In addition, interest rates, availability of financing, regional population, employment trends, and general regional economic conditions affect the sale of manufactured homes. The manufactured housing industry has been operating at the cyclical low point of the cycle over the past nine years where shipments steadily decreased on an annual basis from 1999 to 2004. The 2005 shipment statistics showed improvement which was aided by the increased demand for FEMA units as a result of the hurricane damage in the southeast in the third quarter of 2005. The 2006 levels unfortunately reverted back to the lowest levels in more than 45 years at approximately 117,000 units or 20% less than in 2005. 2007 and 2008 levels fell even further to finish at approximately 95,700 units and 81,900 units, respectively. From its most recent highs in 1998 to its current lows in 2008, shipments have declined approximately 78%. The Company currently projects unit shipments for full year 2009 to decline by approximately 20% when compared to 2008 levels.

We believe that the factors responsible for the most recent declines include lack of available financing and access to the asset-backed securities markets, high vacancy rates in apartments, high levels of repossessed inventories, over-built housing markets in certain regions of the country that resulted in fewer sales of new manufactured homes, as well as the generally depressed economic environment. Additionally, low conventional mortgage rates and less restrictive lending terms for residential site built housing have contributed to the decline as manufactured home loans and chattel mortgage loans generally carry a higher interest rate and less competitive terms. Beginning in mid-1999 and continuing through 2008, the MH industry has also had to contend with credit requirements that became more stringent and a reduction in availability of lenders for manufactured homes for both retail and dealers. While there is demand for permanent rebuilding in the hurricane damaged areas, credit conditions remain adverse especially in conjunction with the current credit crisis, and current overall economic conditions are not favorable in relation to the factors which will promote positive growth. The availability of financing and access to the asset-backed securities market is still restricted, and we believe that employment growth and standard quality-oriented lending practices in the conventional site-built housing markets are needed to enable more balanced demand, thus resulting in the potential for increased production and shipment levels in the MH industry.

The following chart reflects the historical shipment levels in the MH industry from 1991 through 2008 per the Manufactured Housing Institute:

Recreational Vehicles

The recreational vehicle industry has been characterized by cycles of growth and contraction in consumer demand reflecting prevailing general economic conditions which affect disposable income for leisure time activities. In the past, fluctuations in interest rates, consumer confidence, and concerns about the availability and price of gasoline, have had an adverse impact on RV sales. From 2002-2006, the industry experienced increased demand as a result of an increasing number of baby-boomers reaching retirement age, continued growth in disposable incomes, and low inflation and low interest rates. Increased gasoline prices over the past five years appear to have adversely impacted the sales of motorized units. 2007 marked the fourth largest shipment level in 30 years despite an approximate 10% shipment decline for all RV s compared to 2006. Shipment levels in 2008 declined approximately 33% versus 2007, reflecting tighter credit conditions, higher unemployment levels, slower growth in real incomes, higher average gasoline prices, and rapid declining consumer confidence, specifically in the latter half of the year.

According to the Recreational Vehicle Industry Association s (RVIA) chief economist, unit shipments are expected to decline in 2009 as well (with the lowest point in the first quarter of 2009), as credit restrictions, declining consumer confidence, and reduced disposable income levels are causing RV dealers to keep inventories low and RV buyers to delay purchases as their priorities have shifted away from spending and toward debt repayment and the restoration of their savings and retirement funds. Demographic and ownership trends point to favorable market growth in the long-term as the number of baby-boomers reaching retirement is steadily increasing, products such as sports-utility RV s are becoming attractive to younger buyers, and RV manufacturers are producing lightweight towables and smaller, fuel efficient motorhomes. In addition, federal economic credit and stimulus packages that contain provisions to stimulate RV lending and provide favorable tax treatment for new RV purchases, may help promote sales and aid in the RV industry s economic recovery.

Recreational vehicle classifications are based upon standards established by the RVIA. The principal types of recreational vehicles include conventional travel trailers, folding camping trailers, fifth wheel trailers, motor homes, and conversion vehicles. These recreational vehicles are distinct from mobile homes, which are manufactured houses designed for permanent and semi-permanent residential dwelling.

Conventional travel trailers and folding camping trailers are non-motorized vehicles designed to be towed by passenger automobiles, pick-up trucks, or vans. They provide comfortable, self-contained living facilities for short periods of time. Conventional travel trailers and folding camping trailers are towed by means of a frame hitch attached to the towing vehicle. Fifth wheel trailers, designed to be towed by pick-up trucks, are constructed with a raised forward section that is attached to the bed area of the pick-up truck. This allows for a bi-level floor plan and more living space than a conventional travel trailer.

A motor home is a self-powered vehicle built on a motor vehicle chassis. The interior typically includes a driver s area, kitchen, bathroom, dining, and sleeping areas. Motor homes are self-contained with their own lighting, heating, cooking, refrigeration, sewage holding, and water storage facilities. Although they are not designed for permanent or semi-permanent living, motor homes do provide comfortable living facilities for short periods of time.

Sales of recreational vehicle products have been cyclical. Shortages of motor vehicle fuels and significant increases in fuel prices have had a material adverse effect on the market for recreational vehicles in the past, and could adversely affect demand in the future. The recreational vehicle industry is also affected by the availability and terms of financing to dealers and retail purchasers. Substantial increases in interest rates and decreases in the general availability of credit have had a negative impact upon the industry in the past and may do so in the future. Recession and lack of consumer confidence generally result in a decrease in the sale of leisure time products such as recreational vehicles.

The period beginning in 1999 and continuing through 2007 resulted in eight out of the nine years with shipment levels over 300,000 units primarily due to the favorable demographic trend of the aging baby-boomer population, improved consumer confidence, depleted dealer inventories, lower interest rates, and a fear of flying after the September 11, 2001 terrorist attacks. The damage from the hurricanes in the southeast in the third quarter of 2005 resulted in increased demand for temporary housing and it is estimated that almost 39,000 incremental units were shipped to support the FEMA orders from September through December 2005. The FEMA shipments, while at a lower rate, continued into the first quarter of 2006. Shipment levels started to soften in the third and fourth quarters of 2006 and into 2007. 2007 shipments declined 10% from the 2006 levels, but still remained at historically high levels. In 2008, shipment levels declined approximately 33% to 237,000 units reflecting the tightest credit conditions in several decades, higher interest rates, declining consumer confidence, reduced disposable income levels and the generally depressed economic environment. While demographic trends point to positive conditions for this particular market sector in the foreseeable future, the RVIA s chief economist currently forecasts 2009 unit shipment levels declining by approximately 45% to 130,100 units, citing the overall uncertainty surrounding economic conditions, including the ongoing recession and tight credit restrictions.

The Company estimates that approximately 85% of its revenues related to the RV industry are derived from the towables sector of the market. The towable units are lighter and less expensive than standard gas or diesel powered units representing a more attractive solution for the cost-conscious buyer. From 2007 to 2008, motorized unit shipments declined approximately 49% and towable unit shipments declined approximately 30%. We believe that we are well-positioned with respect to our product mix within the RV industry to take advantage of any improved market conditions.

The following chart reflects the historical shipment levels in the RV industry from 1991 through 2008 per RVIA statistics:

Other Markets

Many of our core products, including paper/vinyl laminated panels, shelving, drawer-sides, and high-pressure laminated panels are routinely utilized in the kitchen cabinet, store fixture and commercial furnishings, and home and office furniture markets. These markets are generally categorized by a more performance than price driven customer base, and provide an opportunity for us to diversify our clientele while providing increased contribution to our core laminating and fabricating competencies. While the residential furniture markets have been severely impacted by import pressures, other segments have been less vulnerable, and therefore provide opportunities for increased sales penetration and market share gains.

Demand in the industrial markets in which the Company competes also fluctuates with economic cycles. Industrial demand tends to lag the housing cycle by six to twelve months, and will vary based on differences in regional economic prospects. As a result, we believe continued focus on industrial markets will reduce our reliance on the MH/RV markets and moderate the impact of their cyclical patterns on our operating results. We have the available capacity to increase industrial revenue and benefit from the diversity of multiple market segments, unique regional economies and varied customer strategies.

Marketing and Distribution

Our sales are to manufactured housing and recreational vehicle manufacturers and other industrial products manufacturers. We have approximately 800 customers. We have six customers, who together accounted for approximately 48% and 46% of our total sales in 2008 and 2007, respectively. We believe we have good relationships with our customers.

Sales to two different customers in the Primary Manufactured Products, Distribution and Other Component Manufactured Products segments accounted for approximately 13.1% and 11.5%, respectively, of consolidated net sales of the Company for the year ended December 31, 2008. No one customer accounted for 10% or more of consolidated net sales for the years ended December 31, 2007 or 2006.

Products for distribution are purchased in carload or truckload quantities, warehoused, and then sold and delivered by us. Approximately 33% and 38% of our distribution segment s products were shipped directly from the suppliers to our customers in 2008 and 2007, respectively. We typically experience a one to two week delay between issuing our purchase orders and the delivery of products to our warehouses or customers. As lead times have declined over the years, in some instances, certain customers have required same-day or next-day service. We generally keep backup supplies of various commodity products in our warehouses to ensure that we have product on hand at all times for our distribution customers. Our customers do not maintain long-term supply contracts, and therefore we must bear the risk of accurate advanced estimation of customer orders. We maintain an inventory to satisfy these orders. We have no significant backlog of orders.

We operate 10 warehouse and distribution centers and 14 manufacturing operations located in Alabama, Arizona, California, Florida, Georgia, Illinois, Indiana, Kansas, Minnesota, North Carolina, Oregon, Pennsylvania, Tennessee and Texas. Through the use of these facilities, we are able to minimize our in-transit delivery time and cost to the regional manufacturing plants of our customers.

Patrick does not engage in significant marketing efforts nor does it incur significant marketing or advertising expenditures other than the activities of its sales personnel and the maintenance of customer relationships through price, quality of its products, service and customer satisfaction.

Suppliers

During the year ended December 31, 2008, we purchased approximately 72% of our raw materials and distributed products from twenty different suppliers. The five largest suppliers accounted for approximately 45% of our purchases. Our current major material suppliers with contracts include United States Gypsum through December 31, 2010, and Masonite through December 31, 2009**.** We have terms and conditions with these and other suppliers that specify exclusivity in certain areas, pricing structures, rebate agreements and other parameters.

Materials are primarily commodity products, such as lauan, gypsum**,** particleboard, and other lumber products, which are available from many suppliers. We maintain a long-term supply agreement with one of our major suppliers of materials to the MH industry. Our sales in the short-term could be negatively impacted in the event any unforeseen negative circumstances were to affect our major supplier. We believe that we have a good relationship with this supplier and all of our other suppliers. Alternate sources of supply are available for all of our major material purchases.

Seasonality

Manufacturing operations in the MH and RV industries historically have been seasonal and are generally at the highest levels when the climate is moderate. Accordingly, the Company s sales and profits are generally highest in the second and third quarters. However, depressed economic conditions in both industries distorted the historical trends in 2008.

Employees

As of December 31, 2008, we had 924 employees, 708 of which were engaged directly in production, warehousing, and delivery operations; 59 in sales; and 157 in office and administrative activities. There is one manufacturing plant and one distribution center covered by collective bargaining agreements. Patrick continuously reviews benefits and other matters of interest to its employees and considers its relations with its employees to be good.

Executive Officers of the Company

The following table sets forth our executive officers as of February 1, 2009:

Name	**Position**
Todd M. Cleveland	President and Chief Executive Officer
Andy L. Nemeth	Executive Vice President of Finance, Chief Financial Officer, and Secretary-Treasurer
Darin R. Schaeffer	Vice President, Corporate Controller, and Principal Accounting Officer

Todd M. Cleveland (age 40) was appointed Chief Executive Officer as of February 1, 2009. Mr. Cleveland assumed the position of President and Chief Operating Officer of the Company in May 2008. Prior to that, Mr. Cleveland served as Executive Vice President of Operations and Sales and Chief Operating Officer from August 2007 to May 2008 following the acquisition of Adorn by Patrick in May 2007. Mr. Cleveland spent 17 years with Adorn serving as President and Chief Executive Officer since 2004; President and Chief Operating Officer from 1998 to 2004; Vice President of Operations and Chief Operating Officer from 1994 to 1998; Sales Manager from 1992 to 1994; and Purchasing Manager from 1990 to 1992. Mr. Cleveland has over 18 years of manufactured housing, recreational vehicle, and industrial experience in various operating capacities.

Andy L. Nemeth (age 39) was elected Executive Vice President of Finance, Chief Financial Officer, and Secretary-Treasurer as of May 2004. Prior to that, Mr. Nemeth was Vice President-Finance, Chief Financial Officer, and Secretary-Treasurer from 2003 to 2004, and Secretary-Treasurer from 2002 to 2003. Mr. Nemeth was a Division Controller from 1996 to 2002 and prior to that, he spent five years in public accounting with Coopers & Lybrand (now Pricewaterhouse Coopers). Mr. Nemeth has over 16 years of manufactured housing, recreational vehicle, and industrial experience in various financial capacities.

Darin R. Schaeffer (age 41) was elected Vice President, Corporate Controller, and Principal Accounting Officer as of March 26, 2008. From September 2007 to March 26, 2008, Mr. Schaeffer served as the Company s Corporate Controller. From 2005 to 2007, Mr. Schaeffer was a Corporate Controller for Utilimaster Corporation. Mr. Schaeffer also served in a variety of roles, including plant controller, for Robert Bosch Corporation from 1996 to 2005. Prior to that, Mr. Schaeffer spent seven years in public accounting.

As announced in January 2009, effective February 1, 2009, Todd M. Cleveland succeeded Paul E. Hassler as Patrick s Chief Executive Officer in accordance with the Company s executive succession plan. Mr. Cleveland continues in his role as President and Mr. Hassler continues to serve in his role as Chairman of the Board of Directors.

Website Access to Company Reports

We make available free of charge through our website, www.patrickind.com, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (SEC). The charters of our Audit, Compensation, and Corporate Governance/Nominations Committees, our Corporate Governance Guidelines, our Code of Ethics and Business Conduct, and our Code of Ethics Applicable to Senior Executives are also available on the About Us Corporate Governance portion of our website. Our internet website and the information contained therein or incorporated therein are not intended to be incorporated into this Annual Report on Form 10-K.

Additionally, the public may read or copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov.

ITEM 1A. RISK FACTORS

The Company s consolidated results of operations, financial position and cash flows can be adversely affected by various risks related to its business. These risks include, but are not limited to, the principal factors listed below and the other matters set forth in this Annual Report on Form 10-K. All of these risks should be carefully considered.

Our results of operations have been, and may continue to be, adversely impacted by a worldwide macroeconomic downturn.

In 2008, general worldwide economic conditions experienced a downturn due to the effects of the deterioration in the residential housing market, subprime lending crisis, general credit market crisis, collateral effects on the finance and banking industries, increased commodity costs, volatile energy costs, concerns about inflation, slower economic activity, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns (the Economic Crisis). These conditions have adversely affected demand in the three major end-markets we serve (the recreational vehicle, manufactured housing and industrial markets), resulting in decreased sales of our component products into these markets and could negatively affect our operations and result in lower sales, income, and cash flows.

In addition, it has become more difficult for our customers and us to accurately forecast and plan future business activities, and ultimately our profitability has been adversely affected. If our business conditions continue to deteriorate, we may be forced to close and/or consolidate certain of our operating facilities, sell assets, and/or reduce our workforce, which may result in our incurring restructuring charges. We cannot predict the duration of the Economic Crisis, the timing or strength of a subsequent economic recovery or the extent to which the Economic Crisis will continue to negatively impact our business, financial condition and results of operations.

The current downturn in the residential housing market has had an adverse impact on our operations, and is expected to continue throughout 2009.

The residential housing market has experienced overall declines and credit concerns that are expected to continue throughout 2009. Approximately 70% of our industrial revenue is directly or indirectly influenced by conditions in the residential housing market. The decline in demand for residential housing and the tightening of consumer credit have lowered demand for our industrial products and have had an adverse impact on our operations as a whole. In addition, the impact of the sub-prime mortgage crisis and housing downturn on consumer confidence, discretionary spending, and general economic conditions has decreased and may continue to decrease demand for our products sold to the manufactured housing and recreational vehicle industries.

We may incur significant charges or be adversely impacted by the closure of all or part of a manufacturing facility.

We periodically assess the cost structure of our manufacturing facilities to manufacture and sell our products in the most efficient manner. Based on our assessments, we may make capital investments to move, discontinue manufacturing capabilities, or close all or part of a manufacturing facility. These changes could result in significant future charges or disruptions in our operations, and we may not achieve the expected benefits from these investments which could result in an adverse impact on our operating results, cash flows and financial condition.

The financial condition of our customers and suppliers may deteriorate as a result of the current economic environment and competitive conditions in their markets.

The Economic Crisis may lead to increased levels of restructurings, bankruptcies, liquidations and other unfavorable events for our customers, suppliers and other service providers and financial institutions with whom we do business. Such events could, in turn, negatively affect our business either through loss of sales or inability to meet our commitments (or inability to meet them without excess expense) because of loss of suppliers or other providers. In addition, several of our major customers are undergoing unprecedented financial distress which may result in such customers undergoing major restructuring, reorganization or other significant changes. The occurrence of any such event could have further adverse consequences to our business including a decrease in demand for our products. If such customers become insolvent or file for bankruptcy, our ability to recover accounts receivables from that customer would be adversely affected and any payments we received in the preference period prior to a bankruptcy filing may be potentially recoverable by the bankruptcy trustee.

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Many of our customers participate in highly competitive markets, and their financial condition may deteriorate as a result. A decline in the financial condition of our customers could hinder the Company s ability to collect amounts owed by customers. In addition, such a decline could result in lower demand for the Company s products and services.

We have a number of large customers, the loss of any of which could have a material adverse impact on our operating results.

We have a number of customers which account for a significant percentage of our net sales. Specifically, two customers of the RV Segment accounted for a combined 25%, and another customer of the MH Segment accounted for 10% of consolidated net sales in 2008. The loss of any of these large customers could have a material adverse impact on our operating results.

We do not have long-term agreements with customers and cannot predict that we will maintain our current relationships with these customers or that we will continue to supply them at current levels. In addition, if any of our significant customers were to encounter financial difficulties, work stoppages or seek bankruptcy protection, our business could be adversely affected.

The manufactured housing and recreational vehicle industries are highly competitive, and some of our competitors may have greater resources than we do.

We operate in a highly competitive business environment and our sales could be negatively impacted by our inability to maintain or increase prices, changes in geographic or product mix, or the decision of our customers to purchase our competitors products instead of our products. We compete not only with other suppliers to the manufactured housing and recreational vehicle producers, but also with suppliers to traditional site-built homebuilders and suppliers of cabinetry and flooring. Sales could also be affected by pricing, purchasing, financing, advertising, operational, promotional, or other decisions made by purchasers of our products. Additionally, we cannot control the decisions made by suppliers of our distributed and manufactured products and therefore our ability to maintain our exclusive and non-exclusive distributor contracts and agreements may be adversely impacted.

As a result of highly competitive market conditions in the industries in which we participate, some of our competitors have been forced to seek bankruptcy protection. These competitors may emerge from bankruptcy protection with stronger balance sheets and a desire to gain market share by offering their products at a lower price than our products, which would have an adverse impact on our financial condition and results of operations and cash flows.

Seasonality and cyclical economic conditions affect the markets the Company serves.

The manufactured housing and recreational vehicle markets are cyclical and dependent upon various factors, including the general level of economic activity, consumer confidence, interest rates, access to financing, inventory and production levels, and the cost of fuel. Economic and demographic factors can cause substantial fluctuations in production, which in turn impact sales and operating results. Demand for recreational vehicles and manufactured housing generally declines during the winter season. Our sales levels and operating results could be negatively impacted by changes in any of these items.

The cyclical nature of the domestic housing market has caused our sales and operating results to fluctuate. These fluctuations may continue in the future, which could result in operating losses during downturns.

The U.S. housing industry is highly cyclical and is influenced by many national and regional economic and demographic factors, including:

- terms and availability of financing for homebuyers and retailers;
- consumer confidence;
- interest rates;
- population and employment trends;
- income levels;

housing demand; and

general economic conditions, including inflation, deflation and recessions.

The manufactured housing and recreational vehicle industries and the industrial markets are affected by the fluctuations in the residential housing market. As a result of the foregoing factors, our sales and operating results fluctuate, and we expect that they will continue to fluctuate in the future. Moreover, cyclical and seasonal downturns in the residential housing market may cause us to experience operating losses.

Fuel shortages, or higher prices for fuel, have had, and could continue to have, an adverse impact on our operations.

The products produced by the recreational vehicle industry typically require gasoline or diesel fuel for their operation, or the use of a vehicle requiring gasoline or diesel fuel for their operation. There can be no assurance that the supply of gasoline and diesel fuel will continue uninterrupted or that the price of or tax on fuel will not significantly increase in the future. Shortages of gasoline and diesel fuel have had a significant adverse effect on the demand for recreational vehicles in the past and would be expected to have a material adverse effect on demand in the future. Rapid significant increases in fuel prices, as we experienced in recent years, appear to affect the demand for recreational vehicles when gasoline prices reach unusually high levels and we believe the significant increase in fuel prices in 2007 and the first half of 2008 contributed to the decrease in demand for recreational vehicles. Such a reduction in overall demand for recreational vehicles could have a materially adverse impact on our revenues and profitability. Approximately 37% and 39% of our sales were to the recreational vehicle industry for 2008 and for 2007, respectively.

Dependence on Third-Party Suppliers and Manufacturers.

Generally, our raw materials, supplies and energy requirements are obtained from various sources and in the quantities desired. While alternative sources are available, our business is subject to the risk of price increases and periodic delays in the delivery. Fluctuations in the prices of these requirements may be driven by the supply/demand relationship for that commodity or governmental regulation. In addition, if any of our suppliers seek bankruptcy relief or otherwise cannot continue their business as anticipated, the availability or price of these requirements could be adversely affected.

Increased cost and limited availability of raw materials may have a material adverse effect on our business and results of operations.

Prices of certain materials, including gypsum, lauan, particleboard, MDF, and other commodity products, can be volatile and change dramatically with changes in supply and demand. Certain products are purchased from overseas and are dependent upon vessel shipping schedules and port availability. Further, certain of our commodity product suppliers sometimes operate at or near capacity, resulting in some products having the potential of being put on allocation. We generally have been able to maintain adequate supplies of materials and to pass higher material costs on to our customers in the form of surcharges and base price increases where needed. However, it is not certain that future price increases can be passed on to our customers without affecting demand or that limited availability of materials will not impact our production capabilities. The current credit crisis and its impact on the financial and housing markets may also impact our suppliers and affect the availability or pricing of materials. Our sales levels and operating results could be negatively impacted by changes in any of these items.

The ability to attract and retain qualified executive officers and key personnel may adversely affect our operations.

The loss of any of our executive officers or other key personnel could reduce our ability to manage our business and strategic plan in the short term and could cause our sales and operating results to decline.

Our ability to integrate acquired businesses may adversely affect operations.

As part of our business and strategic plan, we look for strategic acquisitions to provide shareholder value. In 2007, we acquired Adorn. This acquisition, and any future acquisitions, requires the effective integration of an existing business and its administrative, financial, sales and marketing, manufacturing and other functions to maximize synergies. Acquired businesses involve a number of risks that may affect our financial performance, including increased leverage, diversion of management resources, assumption of liabilities of the acquired businesses, and possible corporate culture conflicts. If we are unable to successfully integrate these acquisitions, we may not realize the benefits identified in our due diligence process, and our financial results may be negatively impacted. Additionally, significant unexpected liabilities could arise from these acquisitions.

Increased levels of indebtedness may harm our financial condition and results of operations.

On May 18, 2007, we entered into a senior secured credit agreement (as amended on March 19, 2008, the Credit Agreement), providing for a senior secured credit facility (the senior secured credit facility). Borrowings under our senior secured credit facility were used to finance the Adorn acquisition, to provide liquidity for the working capital needs of the combined companies, and to repay borrowings under our previous credit facility. On December 11, 2008, we amended our Credit Agreement (which amendment is more fully described below) (the Amended Credit Agreement) and, as a result, our senior secured credit facility was comprised of a revolving line of credit (subject to a borrowing base, up to a borrowing limit of $33.0 million) and a $38.5 million term loan and expires on January 3, 2011. On April 14, 2009, the Company entered into a Third Amendment and Waiver (the Third Amendment) (which amendment is more fully described below) and, as a result, our senior secured credit facility is comprised of a revolving line of credit (subject to a borrowing base, up to a borrowing limit of $29.0 million) and a term loan. The principal amount outstanding under the term loan, the interest rates for borrowings under the revolving line of credit and the term loan, and the expiration date of the Credit Agreement remained unchanged under the amended terms.

Our increased indebtedness as a result of the Adorn acquisition, as well as our greater need for working capital, may harm our financial condition and negatively impact our results of operations. The increase in our level of indebtedness could have consequences on our future operations, including (i) making it more difficult for us to meet our payments on other outstanding debt; (ii) an event of default, if we fail to comply with the financial and other restrictive covenants contained in our debt agreements, which could result in all of our debt becoming immediately due and payable; (iii) reducing the availability of our cash flow to fund working capital, capital expenditures, acquisitions and other general corporate purposes, and limiting our ability to obtain additional financing for these purposes; (iv) limiting our flexibility in planning for, or reacting to, and increasing our vulnerability to, changes in our business and the industry in which we operate; (v) placing us at a competitive disadvantage compared to our competitors that have less debt or are less leveraged; and (vi) creating concerns about our credit quality which could result in the loss of supplier contracts and/or customers.

The terms of the Third Amendment to the Credit Agreement contain various financial performance and other covenants with which we must remain in compliance. If we do not remain in compliance with these covenants, our amended Credit Agreement could be terminated and the amounts outstanding thereunder could become immediately due and payable.

We have a significant amount of debt outstanding that contains financial and non-financial covenants with which we must comply that place restrictions on our subsidiaries and us. At March 1, 2009 (February month end), the Company was in violation of its Consolidated earnings before interest, taxes, depreciation and amortization (EBITDA) financial covenant under the terms of the credit agreement that was amended in December 2008. On April 14, 2009, the Company entered into a Third Amendment to the Credit Agreement which included a waiver of any actual or potential Event of Default and amended and/or added certain definitions, terms and reporting requirements.

Without improvements from the conditions in the current Economic Crisis in 2009 there can be no assurance that we will maintain compliance with our 2009 financial covenants, which were modified in December 2008 and again in April 2009. These covenants are measured on a monthly basis and require that we attain minimum levels of Consolidated EBITDA as defined by our Credit Agreement. If we fail to comply with our covenants under the Third Amendment, the lenders could cause our debt to become due and payable prior to maturity or it could result in our having to refinance the related indebtedness under unfavorable terms. If our debt were accelerated, our assets might not be sufficient to repay our debt in full. If current unfavorable credit market conditions were to persist throughout 2009, there can be no assurance that we will be able to refinance any or all of this indebtedness.

For additional details and discussion concerning these financial covenants see Liquidity and Capital Resources in Item 7 of this Report and Note 8 to the Consolidated Financial Statements.

Industry conditions and our operating results have limited our sources of capital in the past. If we are unable to locate suitable sources of capital when needed, we may be unable to maintain or expand our business.

We depend on our cash balances, borrowings against our corporate-owned life insurance, our cash flows from operations and our Amended Credit Agreement to finance our operating requirements, capital expenditures and other needs. If the economic conditions that prevailed during the latter part of 2008 and the first quarter of 2009 continue or worsen, production of RVs and manufactured homes will likely decline even further, resulting in reduced demand for our products. A further decline in our operating results could negatively impact our liquidity. In addition, the downturn in the MH and RV industries, combined with our operating results and other changes, has limited our sources of financing in the past. If our cash balances, cash flows from operations, and availability under our Amended Credit Agreement are insufficient to finance our operations and alternative capital is not available, we may not be able to expand our business and make acquisitions, or we may need to curtail or limit our existing operations.

We have letters of credit representing collateral for our casualty insurance programs and for general operating purposes. The letters of credit are issued under our Amended Credit Agreement. For additional detail and information concerning the amounts of our letters of credit, see Note 8 to the Consolidated Financial Statements. The inability to retain our current letters of credit, to obtain alternative letter of credit sources or to retain our current Amended Credit Agreement to support these programs could require us to post cash collateral, reduce the amount of cash available for our operations or cause us to curtail or limit existing operations.

Increased levels of inventory may adversely affect our profitability.

Our customers generally do not maintain long-term supply contracts and, therefore, we must bear the risk of advanced estimation of customer orders. We maintain an inventory to support these customers needs. Changes in demand, market conditions and/or product specifications could result in material obsolescence and a lack of alternative markets for certain of our customer specific products and could negatively impact operating results.

We may be subject to additional charges for impairment of assets, including goodwill, other long-lived assets and deferred tax assets, due to potential declines in the fair value of those assets or a decline in expected profitability of the Company or individual reporting units of the Company.

A portion of our total assets as of December 31, 2008 was comprised of goodwill, amortizable intangible assets, and property, plant and equipment. Under generally accepted accounting principles, each of these assets is subject to periodic review and testing to determine whether the asset is recoverable or realizable. The events or changes that could require us to test our goodwill and intangible assets for impairment include a reduction in our stock price and market capitalization and changes in our estimated future cash flows, as well as changes in rates of growth in our industry or in any of our reporting units. In the fourth quarter of 2008, unfavorable economic conditions and trends in the industries in which we operate significantly contributed to declines in our market capitalization. In accordance with SFAS No. 142, we performed a test for impairment for each of these assets.

The result of the impairment test and an independent third party appraisal indicated that a majority of our goodwill and other intangible assets were impaired. As a result, non-cash pretax impairment charges were recorded in the fourth quarter of 2008 for $27.4 million related to goodwill and $29.3 million for other intangible assets. In addition, in accordance with SFAS No. 144, we performed a test for impairment of certain long-lived assets and determined that certain property, plant and equipment fixed assets were impaired. A non-cash pretax charge was recorded for $3.5 million in the fourth quarter of 2008.

In the future, if actual sales demand or market conditions change from those projected by management, additional asset write-downs may be required. Significant impairment charges, although not always affecting current cash flow, could have a material effect on our operating results and financial position.

A variety of factors could influence fluctuations in the market price for our common stock.

The market price of our common stock could fluctuate in the future in response to a number of factors, including those discussed below. The market price of our common stock has in the past fluctuated and is likely to continue to fluctuate. Some of the factors that may cause the price of our common stock to fluctuate include:

- variations in our and our competitors operating results;
- historically low trading volume;

high concentration of shares held by institutional investors and in particular our majority shareholder, Tontine Capital Partners, L.P. and affiliates (collectively, Tontine Capital);

- announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;
- the gain or loss of significant customers;
- additions or departure of key personnel;
- events affecting other companies that the market deems comparable to us;
- general conditions in industries in which we operate;
- general conditions in the United States and abroad;
- the presence or absence of short selling of our common stock;
- future sales of our common stock or debt securities;
- announcements by us or our competitors of technological improvements or new products; and
- the disclosure by Tontine Capital that it will begin to explore alternatives for the disposition of its equity interests in the Company.

Fluctuations in the stock market may have an adverse effect upon the price of our common stock.

The stock markets in general have experienced substantial price and trading fluctuations. These fluctuations have resulted in volatility in the market prices of securities that often has been unrelated or disproportionate to changes in operating performance. These broad market fluctuations may adversely affect the trading price of our common stock.

We may not be in compliance with NASDAQ s continued listing standards for the NASDAQ Global Market because (1) the average closing share price of Patrick s common stock for a consecutive 30-day trading period has fallen below $1.00 and (2) the market value of our publicly held shares is below $5,000,000.

Although the NASDAQ has suspended its listing requirements through April 19, 2009 and we have not received notice of non-compliance from NASDAQ, the listing of our common stock on the NASDAQ Global Market is at risk as a result of our average closing share price falling below $1.00 per share over a consecutive 30-day trading period. The Company would have a period of 180 days from the date it receives notice to cure this non-compliance, and could request a hearing to stay the delisting. Our listing on the NASDAQ Global Market is also at risk as a result of the failure to have an aggregate of $5,000,000 of public market value. For purposes of this calculation, shares of common stock held by officers, directors and beneficial owners of 10% or more of our common stock (such as Tontine Capital) are excluded. Following issuance of a deficiency notice, the Company would have 90 days to achieve compliance.

While we have a number of options to cure under consideration, there can be no assurance that we will be able to cure a deficiency in the time permitted. In addition, there can be no guarantee that the Company will remain in compliance with other continued listing requirements related to market capitalization and shareholder s equity.

In the current environment, there can be no assurance that we will not be in violation of other NASDAQ Global Market listing standards, which may not be curable.

In the event the Company s common stock is delisted from the NASDAQ stock exchange, there are additional risks such as the impact on the market liquidity of our common stock, the impact on our ability to raise capital or issue certain types of debt, and general issues regarding our perception in the marketplace.

Holders of our common stock are subject to the risk of dilution of their investment as the result of the issuance to our lenders of warrants to purchase common stock.

As part of the consideration for amending our Credit Agreement on December 11, 2008, we entered into a Warrant Agreement under which we issued to our lenders warrants to purchase an aggregate of 474,049 shares of common stock at an exercise price per share of $1 (the Warrants). The Warrants are immediately exercisable, subject to anti-dilution provisions and expire on December 11, 2018. The exercise of the Warrants would result in dilution to the holders of our common stock.

Ownership of a significant portion of our common stock is concentrated in the hands of a few holders.

On March 31, 2009, Tontine Capital owned 5,174,963 shares of our common stock or approximately 57.4% of our total common stock outstanding. In addition, we were aware of six other institutions that collectively own approximately 20% of our outstanding common stock as of December 31, 2008. In November 2008, Tontine Capital disclosed that it will begin to explore alternatives for the disposition of certain of its holdings, including its holdings of our common stock. We are not able to predict whether or when Tontine Capital or the other institutions will sell or otherwise dispose of substantial amounts of our common stock. Sales or other dispositions of our common stock by these institutions could adversely affect prevailing market prices for our common stock.

A majority of our common stock is held by Tontine Capital, which has the ability to control all matters requiring shareholder approval and whose interests may not be aligned with the interests of our other shareholders.

On March 31, 2009, Tontine Capital held approximately 57.4% of our outstanding common stock. As a result of its majority interest, Tontine Capital has the ability to control all matters requiring shareholder approval, including the election of our directors, the adoption of amendments to our Articles of Incorporation, the approval of mergers and sales of all or substantially all of our assets, decisions affecting our capital structure and other significant corporate transactions. In addition to its majority interest, pursuant to a Securities Purchase Agreement with Tontine Capital, dated April 10, 2007, if Tontine Capital (i) holds between 7.5% and 14.9% of our common stock then outstanding, Tontine Capital has the right to appoint one nominee to our board; or (ii) holds at least 15% of our common stock then outstanding, Tontine Capital has the right to appoint two nominees to our board. Tontine Capital s rights related to the appointment of directors were affirmed in a subsequent Securities Purchase Agreement with Tontine Capital, dated March 10, 2008. On July 21, 2008, a nominee of Tontine Capital was appointed to the board. As of March 31, 2009, Tontine Capital has not exercised its right to nominate a second director to the board.

The interests of Tontine Capital may not in all cases be aligned with the interests of our other shareholders. The influence of Tontine Capital may also have the effect of deterring hostile takeovers, delaying or preventing changes in control or changes in management, or limiting the ability of our shareholders to approve transactions that they may deem to be in their best interests. In addition, Tontine Capital and its affiliates are in the business of investing in companies and may, from time to time, invest in companies that compete directly or indirectly with us. Tontine Capital and its affiliates may also pursue acquisition opportunities that may be complementary to our business and, as a result, those acquisition opportunities may not be available to us.

Tontine Capital has indicated in a filing with the SEC that it will begin to explore alternatives for the disposition of its equity interests in the Company. This filing, and any future dispositions of stock by Tontine Capital, could adversely affect the market price of our common stock.

On November 10, 2008, Tontine Capital filed with the SEC an amendment to its previously filed Schedule 13D with respect to its ownership of common stock of the Company. Tontine Capital stated that it will begin to explore alternatives for the disposition of its equity interests in the Company, which alternatives may include: (a) dispositions of our common stock through open market sales, underwritten offerings and/or privately negotiated sales; (b) a sale of the Company; or (c) distributions by Tontine Capital of its shares to its investors. The public disclosure of such possible disposition may adversely affect the market price for our common stock due to the large number of shares involved. In addition, we are not able to predict whether or when Tontine Capital will dispose of its stock. Any such future disposition of stock by Tontine Capital may also adversely affect the market price of our common stock.

Certain provisions in our Articles of Incorporation and Amended and Restated By-laws may delay, defer or prevent a change in control that our shareholders each might consider to be in their best interest.

Our Articles of Incorporation and Amended and Restated By-laws contain provisions that are intended to deter coercive takeover practices and inadequate takeover bids by making them unacceptably expensive to the raider, and to encourage prospective acquirors to negotiate with our board of directors rather than to attempt a hostile takeover.

On March 21, 2006, our board adopted a Rights Agreement with National City Bank as our rights agent (the Rights Agreement). The Rights Agreement permits under certain circumstances each holder of common stock, other than potential acquirors, to purchase one one-hundredth of a share of a newly created series of our preferred stock at a purchase price of $30 or to acquire additional shares of our common stock at 50% of the current market price. The rights are not exercisable or transferable until a person or group acquires 20% or more of our outstanding common stock, except with respect to Tontine Capital and its affiliates and associates, which are exempt from the provisions of the Rights Agreement pursuant to an amendment signed on March 12, 2008.

Insurance Coverages and Terms and Conditions.

We negotiate our insurance contracts annually for property, casualty, workers compensation, general liability, health insurance, and directors and officers liability coverage. Due to conditions within these insurance markets and other factors beyond our control, future coverage limits, terms and conditions and the amount of the related premiums could have a negative impact on our operating results. While we continually measure the risk/reward of policy limits and coverage, the lack of coverage in certain circumstances could result in potential uninsured losses.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

As of December 31, 2008, the Company owned approximately 1.4 million square feet of manufacturing and distribution facilities and leased an additional 724,400 square feet as listed below:

Location	**Use**	**Area Sq. Ft.**	**Ownership or Lease Arrangement**
Elkhart, IN	Distribution(D)	107,000	Owned
Elkhart, IN	Manufacturing (P)	182,000	Owned
Elkhart, IN	Administrative Offices	35,000	Owned
Elkhart, IN	Manufacturing (O)	210,000	Leased to 2010
Elkhart, IN	Manufacturing (P)	198,000	Leased to 2018
Elkhart, IN	Design Center	4,000	Leased to 2009
Mishawaka, IN	Manufacturing (E)	223,000	Owned
Decatur, AL	Distribution (D)	40,000	Leased to 2009
Decatur, AL	Manufacturing (P)	94,000	Owned
Valdosta, GA	Distribution (D)	31,000	Owned
New London, NC	Mfg. & Dist. (P) (D)	163,000	Owned
Halstead, KS	Distribution (D)	36,000	Owned
Waco, TX	Mfg. & Dist. (P) (D)	106,000	Owned
Waco, TX	Manufacturing (P) (2)	42,000	Leased to 2009
Mt. Joy, PA	Manufacturing (P)	33,000	Owned
Mt. Joy, PA	Mfg. & Dist. (P) (D)	56,000	Owned
Ocala, FL	Manufacturing (P) (1)	56,000	Owned
Fontana, CA	Mfg. & Dist. (P) (D) (1)	110,000	Owned
Fontana, CA	Mfg. & Dist. (P) (D) (2)	71,000	Leased to 2009
Woodland, CA	Distribution (D) (2)	17,000	Leased to 2009
Phoenix, AZ	Manufacturing (P)	45,000	Leased to 2010
Phoenix, AZ	Distribution (D) (1)	44,000	Owned
Bensenville, IL	Manufacturing (O)	54,400	Leased to 2013
Madisonville, TN	Manufacturing (P)	43,000	Leased to 2010
Woodburn, OR	Mfg. & Dist. (P) (D)	153,000	Owned

(P) Primary Manufactured Products

(D) Distribution

(O) Other Component Manufactured Products

(E) Engineered Solutions refers to the aluminum extrusion operation that was placed into discontinued operations in 2008.

(1) Building for sale

Pursuant to the terms of the Company s credit agreement, all of its owned facilities are subject to a mortgage and security interest. During the fourth quarter of 2008, the Company reclassified approximately $4.1 million in total carrying value for the Fontana, California and Phoenix, Arizona properties to assets held for sale as we expect to sell each of these buildings within the next twelve months. In addition, the Company entered into a listing agreement to sell its custom vinyls manufacturing facility in Ocala, Florida. Since it is anticipated that the sale of this facility will not be completed until the first half of 2010 due to unfavorable real estate market conditions, the property s carrying value was not included in assets held for sale.

(2) Lease Expirations

We believe that the facilities we occupy as of December 31, 2008, excluding those designated for sale, are adequate for the purposes for which they are currently being used and are well maintained. We may, as part of our strategic operating plan, further consolidate and/or close certain owned facilities and, may not renew leases on property with near-term lease expirations. Use of our manufacturing facilities may vary with seasonal, economic and other business conditions.

As of December 31, 2008, we owned or leased 35 trucks, 43 tractors, 77 trailers, 159 forklifts, and 3 automobiles. All owned and leased facilities and equipment are in good condition and are well maintained.

ITEM 3. LEGAL PROCEEDINGS

We are subject to claims and suits in the ordinary course of business. In management s opinion, currently pending legal proceedings and claims against the Company will not, individually or in the aggregate, have a material adverse effect on our financial condition, results of operations, or cash flows.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock is listed on The NASDAQ Global Stock Market[SM] under the symbol PATK. The high and low trade prices per share of the Company s common stock as reported on NASDAQ for each quarterly period during 2008 and 2007 were as follows:

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
2008	**$ 9.870 - $ 6.770**	**$ 8.170 - $ 6.250**	**$ 9.030** - $ **6.050**	**$ 5.990 - $ 0.250**
2007	$ 12.500 - $ 9.000	$ 18.590 - $10.570	$ 18.300 - $ 11.320	$ 13.530 - $ 9.030

The quotations represent prices between dealers, do not include retail mark-ups, mark-downs, or commissions, and may not necessarily represent actual transactions.

Holders of Common Stock

As of March 13, 2009, we had approximately 400 shareholders of record and approximately 1,300 beneficial holders of our common stock.

Dividends

We declared a first time quarterly dividend of $0.04 per common share starting June 30, 1995 and continued it through the first quarter of 2003. The Board of Directors suspended the quarterly dividend in the second quarter of 2003 due to industry conditions and has not paid a dividend since that time. Any future determination to pay cash dividends will be made by the Board of Directors in light of the Company s earnings, financial position, capital requirements, restrictions under the Company s credit agreement, and such other factors as the Board of Directors deems relevant.

Purchases of Equity Securities by the Issuer or Affiliated Purchasers

During the fourth quarter of 2008, neither the Company, nor any affiliated purchaser, repurchased any of the Company s common stock.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in conjunction with the Company s Consolidated Financial Statements and Notes thereto included in Item 8 of this Report. In addition, this MD&A contains certain statements relating to future results which are forward-looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. See Information Regarding Forward-Looking Statements on page 3 of this Report.

This MD&A is divided into seven major sections. The outline for our MD&A is as follows:

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EXECUTIVE SUMMARY

Company Overview and Business Segments

Patrick Industries is a major manufacturer of component products and distributor of building products serving the manufactured housing (MH), recreational vehicle (RV), kitchen cabinet, home and office furniture, fixture and commercial furnishings, marine, and other industrial markets and operates coast-to-coast through locations in 14 states. Patrick's major manufactured products include decorative vinyl and paper panels, wrapped moldings, cabinet doors and components, slotwall and slotwall components, countertops, and printed vinyl. The Company also distributes drywall and drywall finishing products, interior passage doors, floor covering products, roofing products, vinyl and cement siding, ceramic tile, and other miscellaneous products. The Company has three reportable business segments: Primary Manufactured Products, Distribution and Other Component Manufactured Products, each of which contributed approximately 67%, 22% and 11%, respectively, to 2008 net sales.

In an effort to strategically align our current operations with businesses within our core competencies and reduce overall fixed costs, we explored various alternatives for the divestiture of certain unprofitable, non-core operations. In 2008, we identified American Hardwoods, Inc. (American Hardwoods) and our aluminum extrusion operation as non-core operations.

In January 2007, we purchased the assets of American Hardwoods, an industrial hardwood product distributor located in Phoenix, Arizona. In January 2009, the Company sold certain assets and the business of American Hardwoods for cash consideration of $2 million, and entered into a separate real estate purchase agreement with the buyer to sell the building that housed this operation, subject to certain conditions. Since early 2008, the downturn in general worldwide economic conditions adversely affected the demand for building products in the Phoenix market and, ultimately, the sales volume from this operation. Previously, the American Hardwoods financial results had been included in our Distribution segment.

In the fourth quarter of 2008, the Company made the decision to divest its aluminum extrusion operation located in Mishawaka, Indiana. Previously, the financial results of this operation had comprised the entire Engineered Solutions business segment. Estimated pretax charges of approximately $5 million associated with the planned divesture are reflected in discontinued operations.

The decision to divest American Hardwoods and the aluminum extrusion operation was largely based on projected and potential losses under the current operating model, along with working capital requirements, that forced us to assess the overall fit of these operations within the parameters of our strategic plan. During the fourth quarter of 2008, we reclassified the carrying values of American Hardwoods and the aluminum extrusion operation to assets held for sale, which is included in current assets. These operations have also been classified as discontinued operations in the consolidated financial statements and all prior period financial results have been reclassified to conform to the current year presentation. See Note 3 to the Consolidated Financial Statements for further details.

Overview of Markets and Related Industry Performance

The year 2008 marked a continuation of the deterioration in macroeconomic conditions, resulting in a constricted lending environment with restricted capacity and availability of capital in the residential housing, RV and MH industries, rapidly declining consumer confidence and discretionary spending, increasing commodity costs, volatile energy prices, and liquidity concerns, all of which had a negative impact on the Company s sales and a major impact

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on all three of the major markets the Company serves. The conditions in the residential housing market, which play a significant role in consumer confidence and discretionary spending as it relates to the products we sell, experienced significant declines from an extended period of prosperity due in part to weak credit standards in the residential housing market and excessive home prices resulting in an overall tightening of credit by the lenders, excess inventory levels of unsold homes in the marketplace resulting in less new construction, and a general skepticism by consumers resulting in less discretionary spending. The Company expects the depressed conditions in the RV, MH and residential housing markets to continue through 2009 and possibly into 2010 as certain customers of the Company are closing and consolidating facilities, reducing workforce, reducing inventory levels, and reducing costs. In addition, the Company s sales will continue to be negatively impacted as RV dealers are expected to continue to lower their inventory levels which will reduce the demand for new RVs and impact sales of our products.

According to industry sources, the RV industry, which represents approximately 37% of the Company s 2008 sales, experienced unit shipment declines in all four quarters of 2008 from the prior year, and a year over year decline of approximately 33% to finish at 237,000 units. The 2008 year represented the first year in the last seven consecutive years that shipment levels fell below the 300,000-unit level and the second decline in the last four years. Demographic projections for the RV industry remain positive from a long-term perspective as the hassles of air travel, an aging baby-boomer population with more disposable income, the relatively low cost of recreational vehicle vacations, and successful product development and enhancement campaigns all point to projected long-term growth for the industry. While demographic trends point to positive conditions for this particular market sector in the foreseeable future, the RVIA s chief economist currently forecasts 2009 unit shipment levels declining by approximately 45%, citing the overall uncertainty surrounding economic conditions, including the ongoing recession and tight credit restrictions.

The MH industry, which represents approximately 45% of our revenue base for 2008, continued to experience shipment declines and finished the year with shipments at approximately 81,900 units, levels not seen since 1961. This industry has been plagued by financing concerns including lack of funding sources, marketing and perception issues, excess capacity in apartment units, and low interest rates and weak credit standards on traditional site-built housing mortgages, which directly compete with the manufactured housing loans generally carrying a financing risk-based premium. The Company currently estimates MH shipments for full year 2009 to decline approximately 20% compared to 2008 levels. Factors that may favorably impact production levels in this industry include favorable changes in financing laws, permanent rebuilding in hurricane-damaged areas, rising interest rates, quality credit standards in the residential housing market, mild inflation and improved job growth.

The industrial and other markets sector, which represented approximately 18% of the Company s sales in 2008, has been negatively impacted by the steep decline in the residential housing market. New housing starts for 2008 were down approximately 33% from 2007 (as reported by the U.S. Department of Commerce). The Company estimates that approximately 70% of our revenue base in these industries is tied to the residential housing market and includes kitchen cabinet and cabinet components, which relate to not only new home construction, but also remodeling and upgrades as well. There is a direct correlation between the demand for our products in this market and new residential housing production. Demand for existing homes is forecast to begin a modest recovery late in 2009 with new home sales declining overall in 2009 but beginning to recover in 2010. Retail markets tend to follow housing by 12 months, therefore we are not expecting signs of a recovery in commercial construction and retail fixtures until 2011.

The weak conditions in the MH industry dramatically impacted the Company s Distribution Segment, which saw sales decline from the prior year by approximately 23% and operating profits decline approximately 58% in 2008, as approximately 91% of the Company s sales in this segment are associated with the MH Industry. Additionally, pricing on gypsum related commodity products that the Company sells into the MH industry was down approximately 21% year over year on manufactured products and approximately 15% on distribution products.

In addition, higher energy costs continue to affect the costs of raw materials. The Company continues to explore alternative sources of raw materials and components, both domestically and from overseas, and evaluate and implement sales price increases to customers where needed to offset the effect of cost increases. More recently, we have seen cost increases softening somewhat and expect that to continue until the general economy improves. While the Company has historically been able to obtain sales price increases to offset raw material cost increases, there can be no assurance that future cost increases can be passed on to customers.

Summary of 2008 Financial Results

Below is a summary of our 2008 financial results. Additional detailed discussions are provided elsewhere in this MD&A and in the Notes to the Consolidated Financial Statements.

Continuing operations:

Net sales declined $45.0 million or 12.2% in 2008 to $325.2 million compared to $370.2 million in 2007. Net sales were negatively impacted as RV and MH retailers and manufacturers reduced inventory levels in response to restricted credit conditions and increasing credit costs, a decline in consumer discretionary spending, and economic trends that continued to weaken in all three of the primary markets the Company serves.

Gross profit was $27.2 million or 8.4% of net sales in 2008, compared with gross profit of $44.1 million or 11.9% of net sales in 2007. Gross profit in 2008 includes charges of $3.5 million related to fixed asset impairments, $4.5 million for the write-down or disposal of slow moving inventory, and $0.8 million of restructuring charges related to the Adorn acquisition. Gross profit in 2007 includes $2.2 million of restructuring charges.

Total operating expenses were $97.5 million or 30.0% of net sales in 2008 and included non-cash impairment charges for goodwill and other intangible assets of approximately $56.7 million, a $1.9 million charge to increase the allowance for doubtful accounts, restructuring and other acquisition and financing related costs of approximately $1.8 million, acquisition-related amortization of $2.2 million, and offset by a $4.6 million gain on the sale of property and equipment. In 2007, total operating expenses were $46.5 million or 12.6% of net sales and included restructuring and other acquisition and financing related costs of approximately $6.6 million, and acquisition-related amortization of $1.3 million.

In 2008, we completed a restructuring plan that began in conjunction with the May 2007 acquisition of Adorn (the Restructuring Plan). As described above, the completion of the Restructuring Plan resulted in pretax charges totaling $1.0 million in 2008 and $2.4 million in 2007 and the elimination of approximately 240 jobs. These charges are reflected as separate line items under Costs of Goods Sold and Operating Expenses.

As of December 31, 2008, we provided a valuation allowance against deferred tax assets net of deferred tax liabilities expected to reverse resulting in a non-cash charge of approximately $18.0 million in the fourth quarter of 2008.

The loss from continuing operations was approximately $66.7 million or $8.32 per diluted share in 2008, compared to a net loss of $6.1 million or $1.07 per diluted share for 2007. The major factors impacting the net loss for both periods are described above.

Discontinued Operations:

These results include the operations for American Hardwoods since its acquisition on January 29, 2007 and for the aluminum extrusion operation for full years in 2007 and 2008. The after-tax loss from discontinued operations in 2008 was $4.9 million or $0.61 diluted net income per share which was comprised of a $0.7 million loss on operations and $3.2 million related to estimated planned divestiture costs related to the aluminum extrusion operation, and a $0.3 million loss on operations and a $0.7 million loss on sale related to American Hardwoods. For 2007, after-tax income from discontinued operations was $0.2 million or $0.04 diluted net income per share. See Note 3 to the Consolidated Financial Statements for further information.

2008 Challenges and Initiatives

In 2008, our underlying goal was to keep the Company focused on its strategic operating plan, which included an emphasis on earnings before interest, taxes, depreciation, and amortization (EBITDA), cash flow, debt reduction, improved inventory turns, and focused market share growth despite declining revenue. As we expect the depressed conditions in the RV, MH and residential housing markets to continue through 2009, we continue to review our operations on a regular basis to balance appropriate risks and opportunities to maximize efficiencies and to support

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the Company s long-term strategic growth goals and preserve our ability to grow when the markets eventually recover.

In fiscal year 2008, we completed the consolidation of Patrick and Adorn pursuant to the deliverables and timeline established at the May 2007 acquisition date. In addition, we proactively explored, initiated and completed a number of necessary cost reduction and efficiency improvement initiatives designed to keep operating costs aligned with our revenue base and keep our overhead structure at a level consistent with our operating needs given current economic conditions. Some of these initiatives are as follows:

- Explored alternatives for certain unprofitable, non-core businesses in 2008, namely American Hardwoods and the aluminum extrusion operation;
- Closed/consolidated facilities to improve operating efficiencies in our plants through increased capacity utilization;
- Managed inventory costs by reducing supplier lead times and minimum order requirements, and by increasing inventory turns; and
- Reduced workforce and production capacities to accommodate anticipated customer demand and maintain efficiencies.

Further, the Company s capital utilization and preservation actions during 2008 included:

- Amended our senior secured credit agreement to increase our operating and financial flexibility and fund working capital needs through the end of 2010. In addition, in April 2009 we entered into a Third Amendment and Waiver (the Third Amendment) to the Company s Credit Agreement which included a waiver of any actual or potential Event of Default and amended and/or added certain definitions, terms and reporting requirements. See Note 8 to the Consolidated Financial Statements for further details.
- Reduced our senior term loan by approximately $21.8 million and reduced total long-term debt under the facility by approximately $38.0 million. Management s debt reduction focus has resulted in overall long-term debt reduction under the facility of approximately $16.6 million over and above its normal debt service requirements in 2008.
- Completed a rights offering of common stock to our shareholders, and a private placement of common stock with Tontine Capital Partners, L.P. and Tontine Capital Overseas Master Fund, L.P. (collectively with their affiliates, Tontine Capital) to provide additional equity capital, repay our subordinated debt and repay other debt.

In addition, we eliminated certain product lines not fitting within the parameters of our working capital targets and enhanced other product and service offerings through new product development and expansion into new product lines including the establishment of a new electronics distribution division.

Fiscal Year 2009 Outlook

We anticipate further closures/consolidations of customers and suppliers during 2009, which may result in continued pricing erosion in certain of our major commodity product categories and potential closings/consolidations of our own facilities in situations where additional cost savings may be achieved. We anticipate that the recession and low consumer confidence will continue for at least the next nine to twelve months as consumers remain cautious when deciding whether or not to purchase discretionary items such as RVs.

We believe we are well positioned to increase revenues in all of the markets that we serve upon improvement in the overall economic environment. We believe that we have good working relationships with all of our customers, especially the customers who have access to other financing sources who we believe have the best chance for both survival and success during these extremely difficult times. As we move into 2009, the Company s key focus areas include EBITDA, cash flow, and debt reduction. While market conditions are expected to remain depressed for 2009, additional key focus areas include:

- fixed and variable overhead cost reduction;
- gain additional market share;
- further improve operating efficiencies in all manufacturing operations and our corporate functions;
- aggressively manage inventory and costs and add select key commodity suppliers; and

maximize sales in weaker markets by reviewing and adjusting product offerings where needed to ensure they are appropriately positioned in both price and features.

In conjunction with our strategic plan, we have invested significantly in capital over the past five years to facilitate increased efficiencies, add capacity and value added capabilities, and appropriately maintain our facilities and equipment, especially for times like these where access to capital is restricted. Our capital plan for 2008 included capital expenditures of approximately $4.2 million. For 2009, our capital expenditures are estimated to be approximately $2.0 million, and are limited to $2.25 million for any fiscal year per our Amended Credit Agreement.

To generate profitable growth, we will continue to make targeted capital investments to support new business and leverage our operating platform, and work to more fully integrate sales efforts to broaden customer relationships and meet customer demands. Management believes productivity improvement and cost reduction are critical to Patrick s competitiveness while at the same time enhancing the value the Company delivers to its customers. The management team remains focused on matching costs with revenues and will continue to size the operating structure and platform according to the revenue base.

KEY RECENT EVENTS

Credit Agreement Amendments

At September 28, 2008, we were in violation of the leverage and fixed charge covenants of our senior secured credit agreement dated May 18, 2007 (the Credit Agreement). On December 11, 2008, we entered into a Second Amendment and Waiver to our Credit Agreement, pursuant to which, among other things, (i) the lenders waived any Event of Default (as defined in the Credit Agreement) resulting from our failure to comply with these covenants and (ii) these covenants were replaced with financial covenants more suited to current and expected operating conditions. The terms of our Amended Credit Agreement contained financial and non-financial covenants that placed restrictions on our subsidiaries and us. In addition, the amendment included both the addition and modification of certain definitions, terms and reporting requirements and amended the termination date of the Credit Agreement to expire on January 3, 2011.

As part of the lenders consideration for the Amendment, on December 11, 2008, we entered into a Warrant Agreement under which the Company issued warrants to the lenders to purchase an aggregate of 474,049 shares of common stock, subject to adjustment, at an exercise price per share of $1 (the Warrants). The Warrants are subject to anti-dilution provisions and expire on December 11, 2018.

In connection with the Warrants and the Warrant Agreement, on December 11, 2008, the Company amended its existing Registration Rights Agreement with Tontine Capital Partners, L.P. and Tontine Capital Overseas Master Fund, L.P. to include the shares of common stock that may be issued upon the exercise of the Warrants by the lenders.

At March 1, 2009 (February month end), we were in violation of the Consolidated EBITDA financial covenant under the terms of the credit agreement that was amended in December 2008. On April 14, 2009, the Company entered into a Third Amendment to the Company s Credit Agreement, pursuant to which, among other things, the lenders waived any actual or potential Event of Default (as defined in the Credit Agreement) resulting from our failure to comply with the Consolidated EBITDA covenants for the fiscal months ended March 1, 2009 and March 29, 2009. In addition, the Third Amendment amended and/or added certain definitions, terms and reporting requirements including a modification of the one-month and two-month Consolidated EBITDA covenants. Borrowings under the revolving line of credit are subject to a borrowing base, up to a borrowing limit. The maximum borrowing limit amount was reduced from $33.0 million (as defined in the second amendment to the Credit Agreement) to $29.0 million. The principal amount outstanding under the term loan, the interest rates for borrowings under the revolving line of credit and the term loan, and the expiration date of the Credit Agreement remained unchanged under the amended terms. For additional details and discussion concerning these financial covenants see Liquidity and Capital Resources in Item 7 of this Report and Note 8 to the Consolidated Financial Statements.

Impairments

Goodwill and Other Intangible Assets Impairments

The Company s goodwill and indefinite-lived intangible assets are subject to an annual (or under certain circumstances more frequent) impairment test based on their estimated fair value. The impairment calculation compares the implied fair value of reporting unit goodwill and intangible assets with the carrying amount. If the carrying amount of goodwill exceeds its implied fair value, an impairment loss is recognized in an amount equal to that excess. 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, similar to other long-lived assets. As a result of our annual impairment tests in the fourth quarter of 2008, we recorded a total pretax impairment loss of $56.7 million of which $27.4 million was related to goodwill, $7.0 million to indefinite-lived intangible assets (trademarks), and $22.3 million to finite-lived intangible assets (customer relationships and non-compete agreements). There was no impairment recognized for either goodwill or other intangible assets for the years ended December 31, 2007 and 2006. See Note 7 to the Consolidated Financial Statements.

Other Long-Lived Assets Impairments

When events or conditions warrant, the Company evaluates the recoverability of other long-lived assets (such as property and equipment) and considers whether these assets are impaired. The Company assesses the recoverability of these assets based upon several factors, including management's intention with respect to the assets and their projected future undiscounted cash flows. If projected undiscounted cash flows are less than the carrying amount of the assets, the Company adjusts the carrying amounts of such assets to their estimated fair value. For the year ended December 31, 2008, changes in the Company s business climate, including a significant downturn in the Company s operations, led to an assessment of the recoverability of the Company s long-lived assets, which resulted in an impairment charge of $3.5 million related to property, plant and equipment which is included in cost of goods sold on the consolidated statements of operations. The Company did not recognize any impairment charges for the years ended December 31, 2007 and 2006. See Note 6 to the Consolidated Financial Statements.

Divestiture of Non-Core Operations

In January 2009, we announced that we sold certain assets and the business of our American Hardwoods operation. Proceeds were $2.0 million from the sale. In addition, we entered into a separate real estate purchase agreement with the buyer to sell the building that housed this operation for $2.5 million, subject to certain conditions. The sale of the building is expected to be completed in the second quarter of 2009. In the fourth quarter of 2008, the Company recorded a pretax loss of $1.0 million on the sale of American Hardwoods, which includes the expected sale of the building. In addition, in the fourth quarter of 2008, the Company decided to divest its aluminum extrusion operation located in Mishawaka, Indiana. Estimated pretax charges associated with the planned divestiture of this operation are approximately $5 million. These operations have been classified as discontinued operations in the consolidated financial statements and all prior periods have been reclassified to conform to this presentation. See Note 3 to the Consolidated Financial Statements.

CEO Succession

As previously announced, effective February 1, 2009, Todd M. Cleveland succeeded Paul E. Hassler as Patrick s Chief Executive Officer in accordance with the Company s executive succession plan. Mr. Cleveland continues in his role as President and Mr. Hassler continues to serve in his role as Chairman of the Board of Directors.

Restructuring Initiatives

In an effort to integrate our acquisition of Adorn with our existing businesses, we announced our Restructuring Plan in the second quarter of 2007 which included the closure of duplicate facilities, severance related to the elimination of redundant jobs, and various asset write-downs related to the consolidation of product lines. Asset write-downs include machinery and equipment, inventory, tooling, and other write-downs directly related to discontinued product lines. The completion of the Restructuring Plan in the third quarter of 2008 resulted in cumulative pretax charges totaling $3.3 million in 2007 and 2008 and resulted in the elimination of approximately 240 jobs.

Majority Shareholder to Explore Disposition of Equity Interests in the Company

On November 10, 2008, Tontine Capital, which owns approximately 57% of our common stock, filed with the SEC an amendment to its previously filed Schedule 13D with respect to its ownership of common stock of the Company. Tontine Capital stated that it will begin to explore alternatives for the disposition of its equity interests in the Company, which alternatives may include: (a) dispositions of our common stock through open market sales, underwritten offerings and/or privately negotiated sales; (b) a sale of the Company; or (c) distributions by Tontine Capital of its shares to its investors. Tontine Capital stated that the timing, manner and aggregate amount of any such dispositions will be dependent on many factors, including, without limitation, market conditions, available prices and Tontine Capital s ability to conduct sales in compliance with federal and state securities laws.

CONSOLIDATED OPERATING RESULTS

General

The following consolidated and business segment discussions of operating results pertain to continuing operations. The results of operations related to the acquisition of Adorn (acquired on May 18, 2007) are included since its acquisition date.

Year Ended December 31, 2008 Compared to 2007

The following table sets forth the percentage relationship to net sales of certain items in the Company s consolidated statements of operations for the years ended December 31, 2008, 2007 and 2006.

	Year Ended December 31,		
(thousands)	**2008**	2007	2006
Net sales	**100.0%**	100.0%	100.0%
Cost of goods sold	**91.4**	87.5	87.4
Restructuring charges	**0.2**	0.6	-
Gross profit	**8.4**	11.9	12.6
Warehouse and delivery expenses	**5.1**	5.1	4.6
Selling, general, and administrative	**8.3**	7.2	6.5
Goodwill impairment	**8.4**	-	-
Intangible assets impairments	**9.0**	-	-
Restructuring charges	**0.1**	0.1	-
Amortization of intangible assets	**0.5**	0.3	-
Gain on sale of fixed assets	**(1.4)**	(0.1)	-
Operating income (loss)	**(21.6)**	(0.7)	1.5
Interest expense, net	**2.0**	1.8	0.5
Income taxes (credit)	**(3.1)**	(0.9)	0.4
Income (loss) from continuing operations	**(20.5)**	(1.6)	0.6

Net Sales. Net sales decreased $45.0 million or 12.2%, to $325.2 million in 2008 from $370.2 million in 2007. Net sales were negatively impacted as RV and MH retailers and manufacturers reduced inventory levels in response to restricted credit conditions and increasing credit costs, a decline in consumer discretionary spending, and economic trends that continued to weaken in all three of the primary markets the Company serves. Gypsum products, which are sold out of both manufacturing and distribution divisions, experienced pricing erosion during the year and resulted in overall manufacturing and distribution revenue declines. From a market perspective, the MH industry, which represents approximately 45% of our 2008 sales, experienced unit shipment declines of approximately 14% from the prior year. The RV industry, which represents 37% of our 2008 sales, experienced unit shipment declines of approximately 33% from year-to-year. The industrial and other markets represent approximately 18% of our sales in 2008. The residential housing market, which represents approximately 70% of the Company s industrial revenue base, continued to be impacted by depressed conditions as new housing starts for 2008 were down 33% from 2007 (as reported by the U.S. Department of Commerce).

Cost of Goods Sold. Cost of goods sold declined $26.9 million or 8.3% to $297.1 million in 2008 from $324.0 million in 2007. The decline is principally due to the impact of lower sales volumes. A $3.5 million impairment to fixed assets related to machinery, furniture and equipment and the write-down or disposal of $3.8 million of slow-moving inventory due to obsolescence and commodity market price declines in the fourth quarter of 2008 partially offset the decline. As a percentage of net sales, cost of goods sold increased to 91.4% from 87.5% as a result of certain manufacturing overhead costs such as depreciation, building charges, and property taxes remaining relatively constant despite lower sales, as well as the charges mentioned above. Higher steel and other raw materials costs have declined from peak levels, due to the global economic downturn. We still have higher priced raw materials in our inventory which we will use through early 2009 based on current sales levels. Current prices of some of the key raw materials remain well above prior year levels and could have an adverse impact on our quarterly results. Improved production efficiencies, facility consolidations, and lower workers compensation costs partially offset the decline.

In addition, on March 30, 2008, in conjunction with the performance of its physical inventory at a Patrick manufacturing facility, the Company discovered that certain procedures were not being followed in accordance with the Company s established policies. The Company conducted an internal investigation and discovered that certain members of the management team at that particular facility had engaged in collusive acts to circumvent various controls in order to misappropriate Company assets and concealed the misappropriation by underreporting scrap at the facility. As a result of the investigation and a second physical inventory, the Company recorded an adjustment to reduce inventory and increase cost of goods sold at this particular facility by approximately $0.7 million during the quarter ended March 30, 2008. The Company further performed a detailed analysis of its internal controls associated with the inventory and control thereof, and determined that appropriate controls were in place and working effectively, and that the level of collusion was significant enough to be able to circumvent the controls. The impact of the $0.7 million inventory adjustment did not have a material impact on the Company s liquidity or Credit Facility at March 30, 2008, or in any other prior periods.

Restructuring Charges. In 2008, total restructuring charges were $1.0 million or 0.3% of net sales, of which $0.8 million was included as a separate line item under cost of goods sold. The charges were recorded in conjunction with the final phase of the Restructuring Plan. Comparatively, total restructuring charges in 2007 were approximately $2.4 million or 0.7% of net sales, of which $2.2 million was included as a separate line item under costs of goods sold. These activities were related to the first phase of the Restructuring Plan. The Restructuring Plan included total estimated workforce reductions of approximately 240 employees, facility closures, and various asset write-downs.

Restructuring charges included as a separate line item under operating expenses were $0.2 million in 2008 for severance costs related to consolidation activities and for severance and benefits for a former officer who notified the Company of his intention to resign from the Company as of June 27, 2008. The Company entered into a separation agreement which included severance payments. In 2007, restructuring charges included as a separate line item under operating expenses were $0.2 million for severance packages and other contractual closing costs to be incurred in conjunction with various consolidation activities related to the acquisition integration plans. In 2009, the Company expects to identify further cost reduction opportunities which may result in additional restructuring charges.

Gross Profit. Gross profit decreased $16.9 million or 38.2%, to $27.2 million in 2008 from $44.1 million in 2007. As a percent of net sales, gross profit decreased to 8.4% in 2008 from 11.9% in 2007. The decrease in the percentage of net sales is attributable to certain fixed overhead costs remaining relatively constant despite lower sales volumes, and a shift to lower margin products that was partially offset by direct labor efficiencies of approximately 0.4% of net sales. As discussed above, restructuring charges decreased $1.4 million to $0.8 million from $2.2 million in 2007. Additionally, estimated purchasing synergies resulting from the Adorn acquisition were offset by an adjustment in the first quarter of 2008 to increase cost of goods sold and reduce inventory by approximately $0.7 million related to the misappropriation of Company assets and the underreporting of scrap at one of the Company s manufacturing facilities (as discussed above), and by the $3.5 million impairment to fixed assets and the $3.8 million write-down or disposal of slow-moving inventory adjustments made in the fourth quarter of 2008. Throughout 2008, the Company proactively adjusted its strategic operating plan based on rapidly declining market conditions and softening sales levels that began in the first quarter of 2008. Increases in fixed overhead costs including depreciation expense, rent and utilities of approximately $1.0 million or 0.3% of net sales, were largely offset by improvements in other overhead costs including workers compensation and group and liability insurance of approximately $0.9 million.

Warehouse and Delivery Expenses. Warehouse and delivery expenses decreased $2.4 million or 12.4%, to $16.5 million in 2008 from $18.9 million in 2007. As a percentage of net sales, warehouse and delivery expenses were 5.1% for both 2008 and 2007. Efficiency improvements realized from the consolidation of Adorn related to delivery costs were partially offset by increased fuel costs, including surcharges, and common carrier charges, as customers are requiring similar numbers of deliveries but of smaller quantities, thus resulting in higher delivery cost per unit.

Selling, General, and Administrative (SG&A) Expenses. SG&A expenses in 2008 were basically flat with 2007, with an increase of $147,000 or 0.6%. As a percentage of net sales, SG&A expenses increased to 8.3% in 2008 from 7.2% in 2007. A full year of depreciation expense related to the Adorn acquisition compared to 7 ½ months of depreciation expense in 2007 and an increase in capital expenditures primarily contributed to a $1.0 million increase in depreciation expense in 2008 compared to the prior year. SG&A expenses were partially offset by a reduction in expenses related to our ongoing efforts to align operating costs with revenue and maximize efficiencies gained through headcount reduction synergies achieved from the Adorn acquisition.

SG&A expenses in 2008 included the impact of $0.3 million in costs associated with certain vesting of employee retirement obligations incurred as a result of the change of control provisions associated with the completion of the previously announced rights offering, $0.5 million related to attaining certain milestone objectives in conjunction with the Adorn consolidation plan, and $0.2 million of restructuring charges. In 2008, we eliminated certain administrative salaried positions in an effort to continue to align our operating costs with revenues as discussed above. SG&A expenses also included a $1.9 million increase to the allowance for doubtful accounts in 2008 that was driven principally by certain customers of the Company that have closed or filed bankruptcy.

In 2007, SG&A included $0.9 million in stock compensation, and $1.0 million in deferred compensation vesting and severance expenses, all directly related to the Adorn acquisition and the consolidation of Adorn into Patrick. Additionally, the Company recognized approximately $1.1 million in incentive compensation expense related to the achievement of certain debt reduction targets established during 2007 as a result of the Company entering into a new credit facility upon consummation of the Adorn acquisition, and approximately $1.2 million of expenses related to certain severance and litigation settlement costs, and the write-off of costs related to an overseas expansion initiative, and $0.2 million of restructuring charges.

Goodwill Impairments. The acquisition of Adorn in May 2007 resulted in the recording of $29.5 million of goodwill within the Primary Manufactured Products segment and in the Other Component Manufactured Products segments on the date of the acquisition, and represented the excess between the purchase price and the net assets acquired. During our annual goodwill impairment analysis in the fourth quarter of 2008, we determined that the carrying value of goodwill exceeded its implied fair value, which resulted in a goodwill impairment charge of $27.4 million. No goodwill impairment charges were recorded in 2007.

Intangible Assets Impairments. The acquisition of Adorn in May 2007 resulted in the recording of certain intangible assets includes customer relationships, trademarks and non-compete agreements within the Primary Manufactured Products segment and in the Other Component Manufactured Products segments on the date of the acquisition. During our impairment analysis in the fourth quarter of 2008, we determined that the carrying value of these intangible assets exceeded their implied fair value, which resulted in an impairment charge of $29.3 million. No impairment charges were recorded in 2007.

Amortization of Intangible Assets. In conjunction with the Adorn acquisition in May 2007, the Company recognized $39.5 million in certain intangible assets which were being amortized over periods ranging from 5 to 19 years. The Company recorded amortization expense on these intangibles of $1.7 million in 2008 compared to $1.0 million in 2007. The impairment of $22.3 million of amortizable intangible assets will reduce annual amortization expense by approximately $1.3 million in 2009 and beyond.

Gain on Sale of Fixed Assets. A pretax gain of $4.2 million from the June 2008 sale of our idle Fontana, California facility was included in 2008 results. The building that was sold formerly housed the Company's west coast molding division. In 2007, the Company consolidated this molding division into its Fontana Custom Vinyls facility. The consolidation was part of the Company's multiphase integration effort following the acquisition of Adorn. In addition, 2008 results include $0.4 million in gains on the sale of excess equipment acquired in the Adorn acquisition and in the normal course of business.

Operating Loss. The operating loss was $70.2 million in 2008 compared to a loss of $2.5 million in 2007. The increase in the operating loss from period to period is primarily attributable to the impairment charges related to goodwill and other intangible assets and fixed assets, the charges related to inventory write-downs or dispositions, the increase in the allowance for doubtful accounts, restructuring charges and the decline in net sales as discussed above. The year-end 2007 operating loss included approximately $2.4 million in restructuring charges related to the Adorn acquisition as well as approximately $4.2 million of other acquisition-related or integration related expenses and certain settlement and litigation costs as discussed above.

Income Taxes (Credit) Continuing Operations. As of December 31, 2008, we provided a valuation allowance against our deferred tax assets net of deferred tax liabilities expected to reverse, resulting in a non-cash charge of approximately $18.0 million in the fourth quarter of 2008. The effective tax rate on continuing operations was 36.4% (exclusive of the valuation allowance) for 2008. In 2007, the effective tax rate was 32.5%.

Discontinued Operations, Net of Tax. These results include the operations for American Hardwoods since its acquisition on January 29, 2007 and for the aluminum extrusion operation for full years in 2007 and 2008. The after-tax loss from discontinued operations in 2008 was $4.9 million or $0.61 diluted net income per share which was comprised of a $0.7 million loss on operations and $3.2 million related to estimated planned divestiture costs related to the aluminum extrusion operation, and a $0.3 million loss on operations and a $0.7 million loss on sale related to American Hardwoods. For 2007, after-tax income from discontinued operations was $0.2 million or $0.04 diluted net income per share. See Note 3 to the Consolidated Financial Statements for further details.

Net Income (Loss). The Company reported a net loss of approximately $71.5 million or $8.93 per share for 2008 compared to a net loss of approximately $5.8 million or $1.03 per diluted share for 2007. The incremental decline in net income reflects the impact of the items previously discussed.

Average Diluted Shares Outstanding. Average diluted shares outstanding increased 41.7% in 2008 compared to 2007. The increase principally reflects the completion on March 12, 2008 of the private placement of 1,125,000 shares of common stock, and the sale of 1,850,000 shares in connection with the June 26, 2008 rights offering.

Year Ended December 31, 2007 Compared to 2006

Net Sales. Net sales increased $67.3 million or 22.2%, to $370.2 million in 2007 from $302.9 million in 2006. The increase was primarily attributable to the Adorn acquisition in 2007 which the Company estimates contributed approximately $135.0 million to revenues in 2007. Revenue increases from the acquisition were partially offset by softening market conditions in all three of the major sectors we serve and pricing declines on certain commodity products that we sell. Gypsum products, which are sold out of both manufactured and distribution divisions, experienced pricing erosion during the year and resulted in overall manufacturing and distribution revenue declines of approximately $11.0 million. From a market perspective, the manufactured housing industry, which represents approximately 36% of our 2007 revenues, experienced unit shipment declines of approximately 19% from the prior year. The recreational vehicle industry, which represents 39% of our revenues, experienced unit shipment declines of approximately 10% from year-to-year. The industrial market sector, representing approximately 25% of our revenues, is primarily linked to the residential housing market which experienced declines in new housing starts of approximately 25% from year-to-year.

Cost of Goods Sold. Cost of goods sold increased $59.3 million or 22.4% to $324.0 million in 2007 from $264.7 million in 2006. The increase was principally due to the impact of higher sales volumes due to the Adorn acquisition. As a percentage of net sales, cost of goods sold increased to 87.5% from 87.4%. See the Gross Profit discussion below for further details related to the impact of pricing on certain major commodity products.

Restructuring Charges. During the year ended December 31, 2007, we initiated restructuring actions relating to the closing and consolidation of Patrick operating units associated with the integration of the Adorn acquisition, including the closure of duplicate facilities, elimination of redundant jobs, consolidation of product lines, and improved capacity utilization. As of December 31, 2007, workforce reductions of approximately 130 employees had been completed as well as facility closures and various asset write-downs. Total restructuring charges incurred during 2007 related to the Adorn acquisition were approximately $2.4 million. Of these restructuring charges, $2.2 million were included in a separate line item in cost of goods sold, while selling and administrative restructuring charges of approximately $0.2 million were recorded in a separate line item in operating expenses.

Gross Profit. Gross profit increased $5.9 million or 15.4%, to $44.1 million in 2007 from $38.2 million in 2006. As a percent of net sales, gross profit decreased to 11.9% in 2007 from 12.6% in 2006. Gross profit in 2007 included the impact of restructuring charges of approximately $2.2 million or 0.6% of net sales. The overall increase in gross profit dollars is due to the acquisition of Adorn in 2007 which the Company estimated contributed approximately $15.0 million to gross profit dollars in 2007. Additionally, gross profit dollars in 2007 included the impact of approximately $1.4 million in purchasing synergies gained from the acquisition of Adorn since May 18, 2007 and the related consolidation of the Company s vendor base and supply chain management leverage. Gross profit dollars increased due to the sales increase, but were offset by pricing declines on prices charged to customers on certain major commodity products. The Company estimates pricing declines of approximately $10.7 million on gypsum and gypsum related products. Additional contributors to the gross profit decline were soft overall industry conditions resulting in excess capacity, increased average per employee group insurance costs from year-to-year of approximately 21% or $0.9 million, and certain fixed costs including utilities, depreciation, and building rent increasing from year-to-year, representing approximately $3.2 million of incremental impact or 0.9% of net sales.

Warehouse and Delivery Expenses. Warehouse and delivery expenses increased $4.8 million or 34.1%, to $18.9 million in 2007 from $14.1 million in 2006. As a percentage of net sales, warehouse and delivery expenses increased to 5.1% in 2007 from 4.6% in 2006. The increase in warehouse and delivery expenses in dollars and as a percentage of net sales was due to the acquisition of Adorn in 2007, which the Company estimates contributed approximately $5.0 million in incremental warehouse and delivery costs.

SG&A Expenses. SG&A expenses increased $7.1 million or 36.1% to $26.7 million in 2007 from $19.6 million in 2006. As a percentage of net sales, SG&A expenses increased to 7.2% in 2007 from 6.5% in 2006. The increase in SG&A expenses was due primarily to the acquisition of Adorn in May 2007, which the Company estimated contributed approximately $5.0 million. The 2007 expenses further included the incremental impact of approximately $0.9 million in stock compensation, and $1.0 million in deferred compensation vesting and severance expenses, all directly related to the Adorn acquisition and the consolidation of Adorn into Patrick. Additionally, the Company recognized approximately $1.1 million in incentive compensation expense related to the achievement of certain debt reduction targets established during 2007 as a result of the Company entering into a new credit facility upon consummation of the Adorn acquisition, and approximately $1.2 million in incremental expenses related to certain severance and litigation settlement costs and the write-off of costs related to an overseas expansion initiative.

Amortization of Intangible Assets. In conjunction with the Adorn acquisition, the Company recognized approximately $39.5 million in certain intangible assets being amortized over periods ranging from 5 to 19 years. Accordingly, the Company recorded amortization expense of $1.0 million for the seven-month period since the acquisition date in May 2007.

Operating Income (Loss). The Company reported an operating loss of approximately $2.5 million in 2007. In 2006, the Company reported operating income of approximately $4.5 million. The operating loss in 2007 included the impact of approximately $2.4 million in restructuring charges, approximately $3.0 million in other acquisition-related or integration-related expenses as described above, and $1.0 million in severance and litigation settlement costs and the write-off a potential overseas expansion initiative.

Interest Expense, Net. Interest expense, net, increased $4.9 million to $6.5 million in 2007 from $1.6 million in 2006. The increase is due to increased debt levels incurred in order to finance the acquisitions of Adorn and American Hardwoods. In May 2007 in connection with the Adorn acquisition, the Company entered into a credit agreement providing for a credit facility totaling $110 million. The facility was provided by an eight-bank syndication led by JP Morgan Securities, Inc. and JP Morgan Chase Bank, N.A., and includes a $75 million term loan and a $35 million revolving line of credit. The Company further issued 9.5% senior subordinated notes to Tontine Capital, which were paid off in the first half of 2008 through the Company s private placement of common stock with Tontine Capital and the rights offering of common stock to its shareholders. The interest rate on the senior subordinated notes increased to 13.5% in May 2008. Since May 18, 2007, the Company has paid down approximately $21.2 million on the overall facility, including more than $17 million over and above normal debt service requirements. The Company s debt service increased from period to period as total debt levels increased approximately $63.6 million from December 2006.

Discontinued Operations, Net of Tax. After-tax income from discontinued operations in 2007 was $0.2 million or $0.04 diluted net income per share which primarily reflected $0.2 million of income on operations related to American Hardwoods. For 2006, after-tax income from discontinued operations primarily reflected income from operations related to the aluminum extrusion operation of $1.0 million or $0.53 diluted net income per share. For 2007, these results include the operations of American Hardwoods since its acquisition on January 29, 2007 and for the aluminum extrusion operation for the full year. See Note 3 to the Consolidated Financial Statements.

Net Income (Loss). The Company reported a net loss of approximately $5.8 million or $1.03 per share, for 2007 compared to net income of approximately $2.6 million or $0.53 per diluted share for 2006. The decrease in net income reflects the impact of the items previously discussed.

BUSINESS SEGMENTS
General

We classify our businesses into three reportable business segments based on the Company s method of internal reporting, which segregates its business by product category and production/distribution process. The Company regularly evaluates the performance of each segment and allocates resources to them based on a variety of indicators including sales, cost of goods sold, and operating income.

The Company s reportable business segments based on continuing operations are as follows:

Primary Manufactured Products utilizes various materials, including gypsum, particleboard, plywood, and fiberboard, which are bonded by adhesives or a heating process to a number of products, including vinyl, paper, foil, and high pressure laminate. These products are utilized to produce furniture, shelving, wall, counter, and cabinet products with a wide variety of finishes and textures.
Distribution distributes drywall and ceiling panels, drywall finishing products, hardboard and various sidings, roofing products, various flooring products, passage doors, insulation, and other products. Previously, this segment had included our American Hardwoods operation that was sold in January 2009 and was reclassified to discontinued operations for all periods presented.
Other Component Manufactured Products includes an adhesive division (closed in first quarter 2008), a cabinet door division, and a vinyl printing division.

Results relating to the planned divestiture of the aluminum extrusion operation, which comprised the entire Engineered Solutions segment, have been reclassified to discontinued operations for all periods presented.

The table below presents information about the sales, gross profit and operating income (loss) from continuing operations of those segments. A reconciliation to consolidated totals is presented in Note 16 to the Consolidated Financial Statements.

	Years Ended December 31		
(thousands)	**2008**	2007 (1)	2006
Sales			
Primary Manufactured Products	**$ 223,875**	$ 247,889	$ 176,562
Distribution	**71,416**	92,947	118,491
Other Component Manufactured Products	**42,955**	42,323	16,201
Gross Profit			
Primary Manufactured Products	**13,111**	22,887	17,742
Distribution	**9,390**	11,762	14,677
Other Component Manufactured Products	**2,862**	3,522	1,453
Operating Income (Loss)			
Primary Manufactured Products	**(10,706)**	6,965	6,977
Distribution	**1,527**	3,606	5,567
Other Component Manufactured Products	**(47,001)**	135	51

(1) Includes 7 ½ months activity pertaining to the Adorn acquisition.

Year Ended December 31, 2008 Compared to 2007

Primary Manufactured Products

Sales. Total sales decreased $24.0 million or 9.7%, to $223.9 million in 2008 from $247.9 million in 2007. This segment accounted for approximately 67% of the Company s consolidated net sales in 2008. As discussed earlier, decreased unit shipment levels in the MH and RV industries and declines in the industrial market which were exacerbated by the current credit crisis in 2008, largely impacted the year s results on a year-over-year basis. From a pricing perspective, overall price increases in certain commodity products were offset by pricing declines in certain other major commodity products from period to period.

Gross profit. Gross profit decreased $9.8 million or 42.7%, to $13.1 million in 2008 from $22.9 million in 2007. As a percentage of sales, gross profit decreased to 5.9% in 2008 compared to 9.2% in the prior year. The decrease in the percentage of sales is attributable to certain fixed overhead costs remaining relatively constant despite lower sales volumes, and a shift in product mix to lower margin products. Gross profit for 2008 and 2007 includes the impact of restructuring charges of $0.5 million and $1.2 million, respectively. In addition, gross profit in 2008 includes a $3.5 million fixed asset impairment charge, $3.8 million charge to reflect the write down or disposal of inventory due to obsolescence and commodity market price declines, and a $0.7 million adjustment to inventory and cost of goods sold related to the misappropriation of Company assets and underreporting of scrap at one of the Company s manufacturing facilities.

Operating income. For 2008, the operating loss was $10.7 million compared to operating income of $7.0 million in 2007. The decline in operating income in 2008 reflected the decline in gross profit (which included the fixed asset impairment and inventory adjustments discussed above) as well as charges reflecting the impairment of intangible assets. Based on the results of the Company s annual impairment analysis in the fourth quarter of 2008, it was determined that the entire carrying value of the goodwill and other intangible assets attributable to this segment was impaired. As a result, a goodwill impairment charge of $9.2 million and an impairment charge for other intangible assets of $0.5 million were recorded in the fourth quarter of 2008. No impairment charges were recorded in 2007. These impairment charges and the decline in gross profit were partially offset by lower restructuring charges and lower SG&A expenses (including a reduction in administrative costs resulting from staffing reductions and reduced charges for vesting of retirement obligations).

Distribution

Sales. Sales decreased $21.5 million or 23.2%, to $71.4 million in 2008 from $92.9 million in 2007. This segment accounted for approximately 22% of the Company s consolidated net sales in 2008. The decline in sales is attributable to the approximate 14% decline in unit shipments in the manufactured housing industry, which is the primary market sector this segment serves. Additionally, pricing declines on prices charged to customers on certain major commodity products negatively impacted revenues in this segment by an estimated $3.0 million. The decrease in sales is attributable to pricing declines on gypsum related products of approximately 15%. These declines were partially offset by increased new product sales of approximately $3 million.

Gross profit. Gross profit decreased $2.4 million or 20.2%, to $9.4 million in 2008 from $11.8 million in 2007. As a percentage of sales, gross profit increased to 13.2% in 2008 from 12.7% in 2007. The decrease in gross profit dollars for 2008 is due to the decline in sales primarily resulting from decreased shipment levels in the manufactured housing industry. The increase in percent of sales is attributable to the Company being able to maintain margins in light of pricing declines and due to increased sales of the Company s flooring product line, which carries higher gross margins.

Operating income. Operating income decreased $2.1 million or 57.7% to $1.5 million in 2008 from $3.6 million in 2007 due primarily to the decrease in gross profit dollars described above.

Other Component Manufactured Products

Sales. Sales increased $0.7 million or 1.5%, to $43.0 million in 2008 from $42.3 million in 2007. This segment accounted for approximately 11% of the Company s consolidated net sales in 2008. The increase in sales reflects the full year impact of the addition of a cabinet door facility and vinyl printing facility as the result of the May 2007 Adorn acquisition. The acquisition of Adorn contributed sales of $42.2 million and $32.9 million for 2008 and 2007, respectively. These increased sales were primary offset by the closing and consolidation of one of the Company s hardwood cabinet door operations in late 2007.

Gross profit. Gross profit decreased $0.6 million or 18.8%, to $2.9 million in 2008 from $3.5 million in 2007. As a percentage of sales, gross profit decreased to 6.7% in 2008 from 8.3% in 2007. Gross profit includes the impact of approximately $0.2 million in restructuring charges in 2008 related to the closing and consolidation of two Patrick divisions. Restructuring charges of $1.0 million in 2007 related to the closing and consolidation of the Company s cabinet door division as a result of the Adorn acquisitionThe decrease in gross profit dollars is due to the decline in net sales as discussed above. The decrease in the percentage of sales is attributable to certain fixed overhead costs remaining relatively constant despite lower sales volumes, and a shift in product mix to lower margin products in the cabinet door division.

Operating income. The operating loss in 2008 was $47.0 million compared to a profit of $135,000 in 2007. This operating loss was primarily due to charges reflecting the impairment of intangible assets. Based on the results of the Company s impairment analysis in the fourth quarter of 2008, it was determined that approximately $18.2 million of the carrying value of goodwill and $28.8 million of the carrying value of other intangible assets attributable to this segment was impaired. As a result, total impairment charges of $47.0 million were recorded in the fourth quarter of 2008. No impairment charges were recorded in 2007.

Year Ended December 31, 2007 Compared to 2006

Primary Manufactured Products

Sales. Sales increased $71.3 million or 40.4%, to $247.9 million in 2007 from $176.6 million in 2006. This segment accounted for approximately 66% of the Company s consolidated net sales in 2007. The increase is attributable to the Adorn acquisition in May 2007. The increased sales from the acquisition were offset by sales volume declines in this segment due to depressed market conditions in the MH and RV, and industrial market sectors in 2007. From a pricing perspective, overall price increases of approximately $12 million in certain commodity products were offset by approximately $5 million in pricing declines in certain other major commodity products from period to period.

Gross Profit. Gross profit increased $5.2 million or 29.0%, to $22.9 million in 2007 from $17.7 million in 2006, primarily as a result of the Adorn acquisition. As a percentage of sales, gross profit decreased to 9.2% in 2007 from 10.0% in 2006. Gross profit in 2007 includes the impact of approximately $1.2 million in restructuring charges, or 0.5% of net sales in this segment, recorded in cost of goods sold, directly related to the consolidation of Adorn into Patrick and the closing and consolidation of certain Patrick business units and facilities.

Operating Income. Operating income remained consistent with 2006 at $7.0 million in 2007. Operating income in 2007 includes the impact of approximately $1.3 million in restructuring charges in this segment, of which $1.2 million were included in cost of goods sold, and $0.1 million were included in SG&A expenses.

Distribution

Sales. Sales decreased $25.6 million or 21.6%, to $92.9 million in 2007 from $118.5 million in 2006. This segment accounted for approximately 25% of the Company s consolidated net sales in 2007. The decline in sales in this segment is attributable to the approximate 19% decline in unit shipments in the manufactured housing industry, which is the primary market sector this segment serves. Additionally, pricing declines on prices charged to customers on certain major commodity products negatively impacted revenues in this segment by an estimated $5 million. These declines were partially offset by increased new product sales of approximately $3 million.

Gross Profit. Gross profit decreased $2.9 million or 19.9%, to $11.8 million in 2007 from $14.7 million in 2006. As a percentage of sales, gross profit increased to 12.7% in 2007 from 12.4% in 2006. The decline in gross profit dollars is attributable to the decreased sales volume, and the increase in percent of sales is due to the increased new product sales which carry higher margins.

Operating Income. Operating income decreased $2.0 million or 35.2%, to $3.6 million in 2007 from $5.6 million in 2006. As a percentage of sales, operating income decreased to 3.9% in 2007 from 4.7% in 2006. The decline in operating income is primarily attributable to the decrease in gross profit dollars.

Other Component Manufactured Products

Sales. Sales increased $26.1 million or 161.2%, to $42.3 million in 2007 from $16.2 million in 2006. This segment accounted for approximately 9% of the Company s consolidated net sales in 2007. The increase in sales is attributable to the Adorn acquisition which included two additional business units in this segment accounting for approximately $33 million in additional sales from May 18, 2007 to December 31, 2007. Exclusive of the Adorn acquisition, sales decreased primarily as a result of weakness in both the manufactured housing and recreational vehicle industries in 2007. In the third quarter of 2007 in conjunction with the acquisition of Adorn and its cabinet door facility in Elkhart, Indiana, the Company closed and consolidated its Patrick hardwood cabinet door operation in Oregon into this division. The Company estimates it lost approximately $5 million in annualized sales volume as a result of this consolidation due primarily to logistics and contribution levels. Additionally, the Company closed its machine manufacturing division in the fourth quarter of 2006 resulting in a decline in annual sales volume of approximately $2 million from year-to-year.

Gross Profit. Gross profit increased $2.1 million or 142.4%, to $3.5 million in 2007 from $1.4 million in 2006. As a percentage of sales, gross profit decreased to 8.3% in 2007 from 9.0% in 2006. Gross profit includes approximately $1.0 million or 2.3% of sales, in restructuring charges related to the closing and consolidation of the Company s cabinet door division as a result of the Adorn acquisition. Excluding the restructuring charges, gross profit increased due to the incremental volume and profitability from the Adorn acquisition and its state of the art cabinet door facility and vinyl printing facility in the second quarter of 2007.

Operating Income. Operating income increased $84,000 to $135,000 in 2007 from $51,000 in 2006. As a percentage of sales, operating income remained consistent as a percent of sales from period to period. Operating income in 2007 includes the effect of approximately $1.0 million in restructuring charges or 2.3% of net sales, and the impact of $0.1 million in amortization expenses related to intangible assets acquired in the Adorn acquisition. Excluding the restructuring charges and amortization expenses related to the Adorn acquisition, operating income increased due to the additional contribution related to the activity from the Adorn operating units. The Company s Patrick hardwood cabinet door division incurred operating losses of approximately $1.0 million in 2007. A decision was made to close this unprofitable division in the third quarter of 2007 and consolidate a portion of its business into Adorn s profitable state-of-the-art cabinet door facility in Elkhart, Indiana.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows

Cash Flows From Operating Activities

Cash flows from operations represent the net income we earned or the net loss sustained in the reported periods adjusted for non-cash charges and changes in operating assets and liabilities. Our primary sources of liquidity have been cash flows from operating activities and borrowings from third parties. Our principal uses of cash have been to support seasonal working capital demands, meet debt service requirements and support our capital expenditure plans.

Net cash provided by operating activities decreased $20.9 million to $1.7 million in 2008 compared to $22.6 million in 2007. The year-over year change in operating cash flow is primarily the result of lower net income in 2008 that was largely impacted by the deterioration of macroeconomic conditions that negatively impacted sales volumes in the RV, MH and residential housing markets and industries. Trade receivables decreased $3.8 million in 2008 primarily due to the decline in sales and to our efforts to maintain appropriate credit policies as we strive to keep our trade receivables at acceptable levels given the tight retail credit standards and the level of consolidations/closures of our RV and MH customers. Cash provided by operating activities also included a decrease in inventory levels of $16.5 million primarily resulting from the Company s continued focus on improving inventory turns and reducing levels to create supply/demand consistency. In 2008, the Company remained focused on reducing inventory levels and managing inventory costs by reducing supplier lead times and minimum order requirements, and pursuing other vendor managed inventory programs.

Net cash provided by operating activities in 2007 increased $23.7 million to $22.6 million from $1.1 million in 2006. In 2007, trade receivables decreased $16.1 million reflecting normal cyclical trends and plant shutdowns at the end of the year and due to the timing of the Adorn purchase which was traditionally a high point in the year from a sales and receivables perspective. Inventory decreased $17.3 million and accounts payable and accrued expenses decreased $11.4 million in 2007 primarily reflecting normal seasonal declines in inventory levels which comprise a significant portion of the accounts payable balance at any given time. In addition, the Company improved its inventory turns by entering into a vendor managed inventory program in June 2007.

Cash Flows From Investing Activities

Investing activities generated cash of $1.9 million in 2008 compared to a net cash outflow of $86.8 million in 2007. We received cash of $6.6 million primarily from the sale of our idle facility in Fontana, California in 2008. Cash flows used by investing activities included $4.2 million for capital expenditures in 2008 versus $2.4 million in the prior year that were in conjunction with our strategic and capital plans. For 2009, our capital expenditures are estimated to be approximately $2.0 million and are limited to $2.25 million for any fiscal year per our Amended Credit Agreement. Cash outflows in 2007 also included the acquisition of American Hardwoods for $7.1 million and Adorn Holdings for $78.7 million. In 2006, investing activities used cash of $7.0 million primarily attributable to the Company s significant capital expenditures and capital expenditure plan over the past four years.

Cash Flows From Financing Activities

Our net financing needs were $1.1 million in 2008 compared to a net inflow of $64.0 million in 2007. In 2008, net borrowings under our revolver of $16.7 million, proceeds of $7.9 million from the private placement of common stock and $13.0 million from our rights offering substantially offset principal repayments on long-term debt of $38.5 million. In 2007, net cash provided by financing activities included borrowings under debt agreements of $101.8 million (principally to fund the Adorn and American Hardwoods acquisitions), and $10.9 million of proceeds from the private placement of common stock. Net short-term borrowing payments of $8.5 million and principal payments on long-term debt of $38.1 million partially reduced the cash inflows.

In 2006, financing activities generated cash of $7.4 million primarily reflecting short-term borrowings of $10.0 million. Principal payments on long-term debt of $2.6 million partially reduced the cash inflows.

Capital Resources

Prior to May 18, 2007, the Company maintained a secured bank revolving credit agreement which provided loan availability of $15.0 million and maturity in the year 2009. Interest on this facility was at Prime or the Eurodollar rate plus a percentage based on the Company s cash flow. The Company paid a commitment fee of between 0.25% and 0.375% of the unused portion of the revolving line based on the Company s cash flow. The agreement was secured by all of the Company s assets.

In January 2007, the Company secured a term note for $7.5 million in conjunction with the American Hardwoods, Inc. acquisition. Interest on this note was at Prime or the Eurodollar rate plus a percentage based on our cash flow. This note provided for a five-year maturity in January 2012 and a ten-year amortization schedule with monthly principal and interest payments due at the end of each month which began in February 2007.

In April 2007, in conjunction with the addition of the new paint line facility and equipment, the Company issued $4.5 million in industrial revenue bonds. These bonds were purchased by JPMorgan Chase and are subject to the terms of a loan agreement with JPMorgan Chase. The bonds bear interest at a variable tax-exempt bond rate with principal and interest payments due monthly over five years and covenants consistent with the Company s revolving credit agreement. The loan agreement is subject to a five-year amortization period with a balloon payment in April 2012.

In May 2007, the Company completed the acquisition of Adorn Holdings, Inc. The acquisition was funded through both debt and equity financing, which was structured to provide additional liquidity to facilitate the combined companies future growth plans and working capital needs. In connection with the Adorn acquisition, the Company entered into an eight-bank syndication agreement led by JPMorgan Securities Inc. and JPMorgan Chase Bank, N.A. for a $110 million senior secured credit facility (the Credit Facility) comprised of revolving credit availability of $35 million and a term loan of $75 million. The Credit Facility provided for a five-year maturity and replaced the Company s previous credit agreement and related term loans. The Company kept the outstanding industrial revenue bonds in place in conjunction with this new Credit Facility and these bonds are therefore part of the consolidated debt package. The Credit Facility bears interest at Prime or the Eurodollar rate plus the Company s credit spread which is based on cash flow leverage. The term-debt and revolving credit loans may be prepaid at any time without penalty. Interest payments are due monthly with quarterly principal payments that began in September 2007. In order to reduce its vulnerability to variable interest rates, this package includes an interest rate swap agreement with interest fixed at a rate of 4.78% for approximately $12.9 million of term-debt at May 18, 2007. In July 2007, the Company entered into a second interest rate swap agreement on approximately $10.0 million of term-debt to fix interest at a rate of 5.60%. The unused portion of the revolving Credit Facility is subject to a commitment fee of between 0.25% and 0.50% annually. The Company incurred approximately $2.2 million in financing costs as part of this transaction. Pursuant to the Credit Agreement, the Company was required to maintain certain financial ratios including a leverage ratio, a debt service coverage ratio, and other financial ratios, all of which were effective beginning in the third quarter of 2007. Obligations under the Credit Facility are secured by essentially all of the tangible and intangible assets of the Company.

In June 2007, the Company entered into an agreement with one of its suppliers to sell a portion of its inventory back in return for a vendor managed inventory program. In conjunction with this agreement, the Company received approximately $9.4 million in proceeds which were used to pay down its term loan.

Additional financing for the Adorn acquisition was provided by Tontine Capital. Concurrently with the closing of the Adorn acquisition, Tontine Capital, a significant shareholder of Patrick, purchased 980,000 shares of Patrick common stock in a private placement at a purchase price of $11.25 per share for total proceeds of approximately $11.0 million, less related costs. Tontine Capital also provided additional interim debt financing of approximately $14.0 million in the form of senior subordinated promissory notes with an initial interest rate of 9.50% which was payable in cash or in-kind. Interest on these notes increased to 13.50% on May 19, 2008. On March 10, 2008, the Company entered into a Securities Purchase Agreement providing for the sale in a private placement of an additional 1,125,000 shares of its common stock to Tontine Capital at $7.00 per share, for an aggregate purchase price of $7.9 million. The sale was completed on March 12, 2008. Proceeds from the sale of common stock were used to prepay approximately $7.7 million of the approximate $14.8 million in principal then outstanding under the senior subordinated promissory notes and to pay related accrued interest.

On March 10, 2008, the Company entered into a Standby Purchase Agreement (the 2008 Standby Purchase Agreement) with Tontine Capital in connection with the Company s rights offering of 1,850,000 shares of common stock to its shareholders. Under the rights offering, shareholders received one right to purchase 0.2580693 of a share of common stock for each share of common stock held as of the May 27, 2008 record date at a purchase price of $7.00 per share. On June 26, 2008, the Company consummated the transactions set forth in the 2008 Standby Purchase Agreement with Tontine Capital in connection with the completion of its previously announced rights offering. Pursuant to the terms of the 2008 Standby Purchase Agreement, Tontine Capital purchased in a private placement its pro rata portion of the 1,850,000 shares of the Company s common stock offered in the rights offering and all shares of common stock that were unsubscribed for by the Company s shareholders at the close of the rights offering, for an aggregate purchase by Tontine Capital of 1,706,874 shares of common stock and for a total purchase price of approximately $11.9 million. Including the proceeds of Tontine Capital s purchase, the Company raised a total of approximately $13.0 million of additional equity capital in the rights offering of common stock to its shareholders. The Company used the proceeds from the rights offering to prepay approximately $7.1 million of remaining principal under the senior subordinated promissory notes and to pay approximately $0.3 million of related accrued interest, and used the remaining proceeds to reduce borrowings under its Credit Facility on the first day of the fiscal third quarter of 2008.

In connection with the 2008 private placement and the 2007 Standby Purchase Agreement, the Company amended its Rights Agreement (the Rights Agreement), dated as of March 21, 2006, as amended on May 18, 2007, with National City Bank, as Rights Agent, to permit the acquisition by Tontine Capital of the shares offered in the 2008 private placement and in the rights offering.

On March 30, 2008, in conjunction with the performance of its physical inventory at a Patrick manufacturing facility, the Company discovered that certain procedures were not being followed in accordance with the Company s established policies. The Company conducted an internal investigation and discovered that certain members of the management team at that particular facility had engaged in collusive acts to circumvent various controls in order to misappropriate Company assets and concealed the misappropriation by underreporting scrap at the facility. As a result of the investigation and a second physical inventory, the Company recorded an adjustment to reduce inventory and increase cost of goods sold at this particular facility by approximately $0.7 million during the quarter ended March 30, 2008. The impact of the $0.7 million inventory adjustment did not have a material impact on the Company s liquidity or Credit Facility at March 30, 2008, or in any other prior periods.

During 2008, the Company paid down $37.8 million in principal on its long-term debt. The debt repayments were funded by a combination of operating cash flow, the net proceeds from the previously announced sale of the idle California facility, and the Company s rights offering to its shareholders.

The Credit Facility is subject to certain restrictive covenants that, among other things, required the Company to maintain certain financial ratios. In addition, the related agreement imposes restrictions on capital additions, additional debt, merger transactions, and the disposition of significant assets. At December 31, 2007, the Company was in violation of one of its financial covenants. The Company operated under a waiver of this violation until March 19, 2008, at which time the credit agreement was amended. The amendments to the credit agreement modified certain financial covenants, terms and reporting requirements, and include the following provisions:

(a) For purposes of covenant calculations certain non-cash and/or non-recurring charges are added back to Consolidated EBITDA (as defined) as approved by the Lenders.

(b) For purposes of calculating the Leverage Ratio (as defined) as of any date prior to the first anniversary of the Effective Date (as defined), Consolidated EBITDA (as defined) shall be adjusted to include the consolidated financial results of Adorn for the period prior to the Effective Date (as defined).

(c) For purposes of determining compliance with the leverage ratio covenant, the Maximum Leverage Ratio (as defined) for the quarterly computation dates for the remainder of the term of the Credit Facility was redefined.

Consistent with the proactive approach the management team has been taking to manage the business during this market downturn, the Company reported in its second quarter 2008 Form 10-Q that it was anticipating a third quarter violation of its leverage and fixed charge covenants under the terms of the Credit Agreement as a result of the deterioration in all three of the major markets it serves. The Company subsequently reported in its third quarter 2008 Form 10-Q that it was in violation of those covenants at September 28, 2008 under the terms of the Credit Facility. As these covenant violations were not cured as of the filing of our Form 10-Q for the third quarter ended September 28, 2008, the remaining $45.5 million of long-term debt was reclassified to current liabilities until such time as an amended and/or new credit facility could be established.

On December 11, 2008, the Company entered into a Second Amendment and Waiver (the Amendment) to its senior secured credit agreement dated May 18, 2007 (the Credit Agreement). The Amendment included both the addition and modification of certain definitions, terms and reporting requirements and amended the termination date of the Credit Agreement to expire on January 3, 2011.

Under the terms of the Amendment, the lenders waived any Event of Default (as defined in the Credit Agreement) that resulted from the Company s failure to comply with the Maximum Leverage Ratio and Minimum Fixed Charge Coverage Ratio covenants for the Computation Period ended September 28, 2008. The financial covenants were amended to eliminate certain covenants in lieu of covenants more suited to current and expected operating conditions. Specifically, the Consolidated Net Worth, Minimum Fixed Charge Coverage Ratio and Maximum Leverage Ratio covenants were eliminated, in lieu of new one-month and two-month minimum Consolidated EBITDA requirements and a $2.25 million capital expenditures limitation for any fiscal year.

Effective with the Amendment to the Credit Agreement on December 11, 2008, the Company s credit facility consisted of a term loan and a revolving line of credit. Borrowings under the revolving line of credit were subject to a borrowing base, up to a borrowing limit of $33.0 million. The principal amount outstanding under the term loan of approximately $38.5 million at September 30, 2008 remained unchanged under the amended terms. Pricing under the revolving line of credit and the term loan was adjusted to be more consistent with current market rates for similar credits. The interest rates for borrowings under the revolving line of credit were the Alternate Base Rate (the ABR) plus 3.50%, or the London Interbank Offer Rate (LIBOR) plus 4.50%. For term loans, interest rates were the ABR plus 6.50%, or LIBOR plus 7.50%. The Company had the option to pay a portion of the interest in kind on the term loan. The fee payable by the Company on unused but committed portions of the revolving loan facility was amended to 0.50%. The Company incurred approximately $0.7 million in financing costs as part of this transaction.

Effective with the Amendment to the Credit Agreement on December 11, 2008, the interest rates on the obligation were adjusted and the Company determined that its two swap agreements were ineffective as hedges against changes in interest rates and were de-designated. The Company is amortizing losses on the swaps included in other comprehensive income as of the de-designation date into net income (loss) over the life of the swaps utilizing the straight-line method which approximates the effective interest method. All future changes in the swap value will be recorded within earnings on the statements of operations. For the year ended December 31, 2008, a loss of $46,000 was recognized in earnings for the portion of the changes in fair value of the ineffective swaps.

As part of the lenders consideration for the Amendment, on December 11, 2008, the Company entered into a Warrant Agreement under which the Company issued warrants to the lenders to purchase an aggregate of 474,049 shares of common stock, subject to adjustment, at an exercise price per share of $1 (the Warrants). The Warrants are immediately exercisable, subject to anti-dilution provisions and expire on December 11, 2018.

In connection with the Warrants and the Warrant Agreement, on December 11, 2008, the Company entered into a Second Amended and Restated Registration Rights Agreement (the Registration Rights Agreement) with the lenders and Tontine Capital Partners, L.P. and Tontine Capital Overseas Master Fund, L.P. The Registration Rights Agreement

provides that the Company shall file a registration statement on Form S-3 registering the shares of common stock that may be issued upon the exercise of the Warrants, as well as a registration statement on Form S-3 registering the shares of common stock held by Tontine Capital, and also provides the holders of the Warrants and Tontine Capital

certain demand registration rights and piggy-back registration rights in the event the Company files a registration statement with the Securities and Exchange Commission, subject to certain exceptions.

At March 1, 2009 (February month end), the Company was in violation of its Consolidated EBITDA financial covenant under the terms of the credit agreement that was amended in December 2008. On April 14, 2009, the Company entered into a Third Amendment to the Company s Credit Agreement dated May 18, 2007. The Third Amendment to the Credit Agreement amended and/or added certain definitions, terms and reporting requirements and included the following provisions:

(a) The lenders waived any actual or potential Event of Default (as defined in the Credit Agreement) resulting from the Company s failure to comply with the one-month and two-month Consolidated EBITDA covenants for the fiscal months ended March 1, 2009 and March 29, 2009.
(b) The financial covenants were modified to establish new one-month and two-month minimum Consolidated EBITDA requirements that will be effective beginning with the fiscal month ended June 28, 2009 and July 26, 2009, respectively. Until that date, there is no applicable minimum Consolidated EBITDA requirement.
(c) The definition of Consolidated EBITDA was amended to exclude the effects of losses and gains due to discontinued operations and restructuring charges, subject to approval of the administrative agent.
(d) The revolving commitments were reduced by $5.0 million to a maximum of $30.0 million.
(e) The monthly borrowing limits under the revolving commitments were reset in conjunction with projected monthly cash flows.
(f) The Company will provide an appraisal by a lender approved firm of each parcel of real estate owned by the Company and its subsidiaries within 60 days of the effectiveness of the Third Amendment.
(g) The receipt of net cash proceeds related to any asset disposition, other than proceeds attributable to inventory and receivables, will be used to pay down principal on the term loan.

Effective with the Third Amendment, the Company s credit facility consists of a term loan and a revolving line of credit. Borrowings under the revolving commitments are subject to a borrowing base, up to a borrowing limit. The maximum borrowing limit amount was reduced from $33.0 million (as defined in the second amendment to the Credit Agreement) to $29.0 million. The principal amount outstanding under the term loan at March 29, 2009 remained unchanged under the amended terms. The interest rates for borrowings under the revolving line of credit and the term loan, and the expiration date of the Credit Agreement also remained unchanged. The Company s ability to access these borrowings is subject to compliance with the terms and conditions of the credit facility including the financial covenants.

Summary of Liquidity and Capital Resources

Our primary capital requirements are to meet seasonal working capital demands, meet debt service requirements, and support our capital expenditure plans. We also have a substantial asset collateral base, which we believe if sold in the normal course, is more than sufficient to cover our outstanding senior debt, and the market value of our major tangible properties exceeds the book value. We obtain additional liquidity through selling our products and collecting receivables. We use the funds collected to pay creditors and employees and to fund working capital needs. The Company has another source of cash through the cash surrender value of life insurance policies. As of December 31, 2008, the gross cash surrender value of life insurance is approximately $3.0 million. The Company can borrow an estimated additional amount of $2.0 million against the net cash surrender value at December 31, 2008. We believe that cash generated from operations and borrowings under our current Credit Facility and life insurance policies will be sufficient to fund our working capital requirements and capital expenditure programs as currently contemplated. Our current Credit Facility allows us to borrow funds based on certain percentages of accounts receivable (80% of eligible accounts) and inventories (50% of eligible inventory), less outstanding letters of credit.

We are subject to market risk primarily in relation to our cash and short-term investments. The interest rate we may earn on the cash we invest in short-term investments is subject to market fluctuations. We utilize a mix of investment maturities based on our anticipated cash needs and evaluation of existing interest rates and market conditions. While we attempt to minimize market risk and maximize return, changes in market conditions may significantly affect the

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income we earn on our cash and cash equivalents and short-term investments. In addition, a portion of our debt obligations under our Credit Facility are currently subject to variable rates of interest based on LIBOR.

Cash, cash equivalents, and borrowings available under our Credit Facility are expected to be sufficient to finance the known and/or foreseeable liquidity and capital needs of the Company for at least the next 12 months. Our working capital requirements vary from period to period depending on manufacturing volumes related to the RV and MH industries, the timing of deliveries and the payment cycles of our customers. The level of cash availability is projected to be in excess of cash needed to operate our businesses for the next year. In the event that our operating cash flow is inadequate and one or more of our capital resources were to become unavailable, we would seek to revise our operating strategies accordingly.

We believe that maintaining compliance with the revised minimum one and two-month Consolidated EBITDA covenants, as modified in the Third Amendment, is probable based on the Company s 2009 operating plan, notwithstanding significant changes in market conditions. Management has also identified other actions within their control that could be implemented, if necessary, to help the Company meet these requirements. However, there can be no assurance that these actions will be successful.

If we fail to comply with the covenants under our amended Credit Agreement, there can be no assurance that a majority of the lenders that are party to our Credit Agreement will consent to a further amendment of the Credit Agreement. In this event, the lenders could cause the related indebtedness to become due and payable prior to maturity or it could result in the Company having to refinance this indebtedness under unfavorable terms. If our debt were accelerated, our assets might not be sufficient to repay our debt in full. Further, if current unfavorable credit market conditions were to persist throughout 2009, there can be no assurance that we will be able to refinance any or all of this indebtedness.

While we will explore asset sales, divestitures and other types of capital raising alternatives in order to reduce indebtedness under the Credit Agreement prior to expiration of the Amendment, there can be no assurance that such activities will be successful or generate cash resources adequate to retire or sufficiently reduce this indebtedness.

Contractual Obligations

The following table summarizes our contractual cash obligations at December 31, 2008, and the future periods during which we expect to settle these obligations. We have provided additional details about some of these obligations in our Notes to the Consolidated Financial Statements.

(thousands)	Payments due by period				
Contractual Obligations	2009	2010-2011	2012-2013	Thereafter	Total
Revolving line of credit	$ 18,200	$ -	$ -	$ -	$ 18,200
Long-term debt (1)	14,741	24,967	2,400	-	42,108
Interest payments on debt (2)	3,361	1,614	63	-	5,038
Purchase obligation (3)	5,102	-	-	-	5,102
Deferred compensation payments	341	922	814	3,910	5,987
Building Leases	2,376	2,927	2,323	4,349	11,975
Operating Leases	1,319	1,730	506	329	3,884
Total contractual cash obligations	$ 45,440	$ 32,160	$ 6,106	$ 8,588	$ 92,294

(1) The estimated long-term debt payment of $14.7 million in 2009 includes $6.6 million of payments based on normal debt service requirements. In addition, it is anticipated that the Company will use the net proceeds from the planned sales of three buildings classified as available for sale to prepay approximately $8.1 million in principal on the Company s term loan.

(2) Scheduled interest payments on debt are calculated as follows: (a) revolving line of credit 6.75% interest rate in effect at December 31, 2008; (b) term loan 5.93% interest rate in effect as of January 2, 2009; (c) industrial revenue bonds average interest rate of 5.38% in 2008; and (d) Oregon and North Carolina revenue bonds average weekly interest rate in 2008 of 3.87% and 3.59%, respectively.

(3) The purchase obligation primarily relates to an inventory purchase commitment to be settled within one year.

We also have commercial commitments as described below (in thousands):

Other Commercial Commitments	Total Amount Committed	Outstanding at 12/31/08	Date of Expiration
Revolving Credit Agreement (1)	$ 35,000	**$ 18,200**	January 3, 2011
Letters of Credit	$ 15,000	**$ 3,584**	January 3, 2011

(1) Effective with the Third Amendment to the Credit Agreement, the total amount committed under the revolving credit agreement was reduced to $30 million.

Off-Balance Sheet Arrangements

Other than the commercial commitments set forth above, we have no off-balance sheet arrangements.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The SEC has defined a company s most critical accounting policies as those that are most important to the portrayal of its financial condition and results of operations, and which require the company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Although management believes that its estimates and assumptions are reasonable, they are based upon information available when they are made. Actual results may differ significantly from these estimates under different assumptions or conditions. Other significant accounting policies are described in Note 1 to the Consolidated Financial Statements. The Company has identified the following critical accounting policies and judgments:

Trade Receivables. We are engaged in the manufacturing and distribution of building products and material for use primarily by the manufactured housing and recreational vehicle industries and other industrial markets. Trade receivables consist primarily of amounts due to us from our normal business activities. In assessing the carrying value of its trade receivables, the Company estimates the recoverability by making assumptions based on our historical write-off and collection experience and specific risks identified in the accounts receivable portfolio. A change in the Company s assumptions would result in the Company recovering an amount of its accounts receivable that differs from the carrying value. Additional changes to the allowance could be necessary in the future if a customer s creditworthiness deteriorates, or if actual defaults are higher than the Company s historical experience. Any difference could result in an increase or decrease in the allowance for doubtful accounts. Based on the Company s estimates and assumptions, an allowance for doubtful accounts of $2.0 million and $153,000 was established at December 31, 2008 and 2007, respectively. The increase in the allowance at December 31, 2008 primarily reflects certain customers of the Company that have closed or filed bankruptcy. There were no material changes made to the accounting estimates for 2007 and 2006.

Inventories. Estimated inventory allowances for slow-moving and obsolete inventories are based on current assessments of future demands, market conditions and related management initiatives. Based on the Company s estimates and assumptions, an allowance for inventory obsolescence of $2.0 million and $1.1 million was established at December 31, 2008 and 2007, respectively. If market conditions or customer requirements change and are less favorable than those projected by management, inventory allowances are adjusted accordingly. There was no material change made to the accounting estimate in 2006.

Impairment of Long-Lived Assets. The Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted future cash flows estimated to be generated by those assets are less than the carrying amount of those items. Events that may indicate that certain long-lived assets might be impaired might include a significant downturn in the economy or the manufactured housing or recreational vehicle industries, and/or a loss of a major customer or several customers. Our cash flow estimates are based on historical results adjusted to reflect our best estimate of future market and operating conditions and forecasts. The net carrying value of assets not recoverable is reduced to fair value. Our

estimates of fair value represent our best estimate based on industry trends and reference to market rates and transactions. A change in the Company s business climate in 2008, including a significant downturn in the Company s operations, led to a required assessment of the recoverability of the Company s long-lived assets, which subsequently resulted in an impairment charge of $3.5 million related to machinery, furniture and equipment. No events or changes in circumstances occurred that required the Company to assess the recoverability of its property and equipment for the years ended December 31, 2007 and 2006, and therefore the Company has not recognized any impairment charges for those years. See Note 6 to the Consolidated Financial Statements for further details regarding the impairment charge in 2008.

All of the Company s goodwill and long-lived asset impairment assessments are based on established fair value techniques, including discounted cash flow analysis. These analyses require management to estimate both future cash flows and an appropriate discount rate to reflect the risk inherent in the current business model. The assumptions supporting valuation models, including discount rates, are determined using the best estimates as of the date of the impairment review. These estimates are subject to significant uncertainty, and differences in actual future results may require further impairment charges, which may be significant.

Impairment of Goodwill and Other Acquired Intangible Assets. The Company has made acquisitions in the past that included goodwill and other intangible assets. 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 its estimated fair value. There are many assumptions and estimates underlying the determination of an impairment loss. Another estimate using different, but still reasonable, assumptions could produce a significantly different result. Therefore, impairment losses could be recorded in the future. We perform the required impairment test of goodwill and indefinite-lived intangible assets annually, or more frequently if conditions warrant. For purposes of the goodwill impairment test, the reporting units of the Company are utilized, after considering the requirements of Statement of Financial Accounting Standards (SFAS) No. 142 *Goodwill and Other Intangible Assets (as amended)* and the relevant provisions of SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* , and related interpretive literature. The impairment tests performed by the Company are based on estimates of the fair value of the Company s reporting units. The fair value is calculated using a discounted cash flow analysis. A change in the Company s business climate in future periods, including a significant downturn in the Company s operations, and/or a significant decrease in the market value of the Company s discounted cash flows could result in an impairment charge.

Note 7 to the Consolidated Financial Statements sets out the impact of $56.7 million of charges taken in the fourth quarter of 2008 to recognize the impairment of goodwill and other intangible assets and the factors which led to changes in estimates and assumptions. Significant assumptions used in our step one discounted cash flow analysis for the reporting units included a five-year compound average growth rate (CAGR) of 0.7%, weighted average cost of capital of 14.5%, and a terminal value growth rate of 2.5%.

Deferred Income Taxes. The carrying value of the Company s deferred tax assets assumes that the Company will be able to generate sufficient taxable income in future years to utilize these deferred tax assets. If these assumptions change, the Company may be required to record valuation allowances against its gross deferred tax assets, which would cause the Company to record additional income tax expense in the Company s consolidated statements of operations. Management evaluates the potential the Company will be able to realize its gross deferred tax assets and assesses the need for valuation allowances on a quarterly basis. The Company recorded a valuation allowance in the fourth quarter of 2008. See Note 10 to the Consolidated Financial Statements.

OTHER

Sale of Property

In 2008, the Company sold an idle manufacturing facility in Fontana, California, which was exited in 2007, resulting in a pretax gain on sale of approximately $4.2 million. The building that was sold formerly housed the Company s west coast molding division. In 2007, the Company consolidated this molding division into its Fontana custom vinyls facility. The consolidation was part of a multiphase integration effort following the acquisition of Adorn.

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Purchase of Property

Not Applicable.

Inflation

The prices of key raw materials, consisting primarily of lauan, gypsum, particleboard, and aluminum are influenced by demand and other factors specific to these commodities, such as the price of oil, rather than being directly affected by inflationary pressures. Prices of certain commodities have historically been volatile. During periods of rising commodity prices, we have generally been able to pass the increased costs to our customers in the form of surcharges and price increases. We do not believe that inflation had a material effect on results of operations for the periods presented.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information required by this item is set forth in Item 15(a)(1) of Part IV on page 49 of this Annual Report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Under the supervision and with the participation of our senior management, including our Chief Executive Officer and Chief Financial Officer, the Company conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15(d)-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of the end of the period covered by this annual report (the Evaluation Date). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded as of the Evaluation Date that our disclosure controls and procedures were effective such that the information relating to the Company, including consolidated subsidiaries, required to be disclosed in our Securities and Exchange Commission (SEC) reports (i) is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to the Company s management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management s Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control - Integrated Framework, we concluded that our internal controls over financial reporting were effective as of December 31, 2008. This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report**.**

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Directors of the Company

The information required by this item with respect to directors is set forth in our Proxy Statement for the Annual Meeting of Shareholders to be held on May 21, 2009, under the captions Election of Directors and Section 16(a) Beneficial Ownership Reporting Compliance, which information is hereby incorporated herein by reference.

Executive Officers of the Registrant

The information required by this item is set forth under the caption Executive Officers of the Registrant in Part I of this Annual Report.

Audit Committee

Information on our Audit Committee is contained under the caption Audit Committee in our Proxy Statement for the Annual Meeting of Shareholders to be held on May 21, 2009 and is incorporated herein by reference.

The Company has determined that Terrence D. Brennan, Keith V. Kankel, Larry D. Renbarger and Walter E. Wells all qualify as audit committee financial experts as defined in Item 407(d)(5)(ii) of Regulation S-K, and that these directors are independent as the term is used in 407(a)(1) of Regulation S-K.

Code of Ethics and Business Conduct

We have adopted a Code of Ethics and Business Conduct Policy applicable to all employees. Additionally, we have adopted a Code of Ethics Applicable to Senior Executives including, but not limited to, the Chief Executive Officer and Chief Financial Officer of the Company. Our Code of Ethics and Business Conduct, and our Code of Ethics Applicable to Senior Executives are available on the Company s web site at www.patrickind.com under Corporate Governance . We intend to post on our web site any amendments to, or waivers from, our Corporate Governance Guidelines and our Code of Ethics Policy Applicable to Senior Executives. We will provide shareholders with a copy of these policies without charge upon written request directed to the Company s Corporate Secretary at the Company s address.

Corporate Governance

Information on our corporate governance practice is contained under the caption Corporate Governance in our Proxy Statement for the Annual Meeting of Shareholders to be held on May 21, 2009 and incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is set forth in the Company s Proxy Statement for the Annual Meeting of Shareholders to be held on May 21, 2009, under the captions Compensation of Executive Officers and Directors, Compensation Committee Interlocks and Director Participation, and Compensation Committee Report, and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is set forth in our Proxy Statement for the Annual Meeting of Shareholders to be held on May 21, 2009, under the captions Equity Compensation Plan Information and Security Ownership of Certain Beneficial Owners and Management, and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item is set forth in our Proxy Statement for the Annual Meeting of Shareholders to be held on May 21, 2009, under the captions Certain Transactions and Director Independence, and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is set forth in our Proxy Statement for the Annual Meeting of Shareholders to be held on May 21, 2009, under the heading Accounting Information, and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) The financial statements listed in the accompanying Index to the Financial Statements on page F-1 of the separate financial section of this Report are incorporated herein by reference.

(3) The exhibits required to be filed as part of this annual report on Form 10-K are listed under (c) below.

(c) Exhibits

Exhibit Number	Exhibits
3.1	Articles of Incorporation of Patrick Industries, Inc. (filed as Exhibits 3.1 and 3.2 to the Company s Form 10-Q filed on May 14, 1996, Exhibit 3.2 to Form S-3 filed on December 28, 2007, and Exhibit 3.1 to Form 8-K filed on June 27, 2008 and incorporated herein by reference).
3.2	Amended and Restated By-laws (filed as Exhibit 3.2 to the Company s Form 8-K on June 27, 2008 and Exhibit 3.1 to Form 8-K filed on January 21, 2009 and incorporated herein by reference).
4.1	Rights Agreement, dated March 21, 2006, between Patrick Industries, Inc. and National City Bank, as Rights Agent (filed as Exhibit 10.1 to the Company s Form 8-K filed on March 23, 2006 and incorporated herein by reference).
4.2	Amendment No. 1 to Rights Agreement, dated May 18, 2007, between Patrick Industries, Inc. and National City Bank, as Rights Agent (filed as Exhibit 10.5 to the Company s Form 8-K filed on May 24, 2007 and incorporated herein by reference).
4.3	Amendment No. 2 to Rights Agreement, dated March 12, 2008, between Patrick Industries, Inc. and National City Bank, as Rights Agent (filed as Exhibit 10.3 to the Company s Form 8-K filed on March 13, 2008 and incorporated herein by reference).
4.4	Second Amended and Restated Registration Rights Agreement, dated as of December 11, 2008, by and among Patrick Industries, Inc., Tontine Capital Partners, L.P., Tontine Capital Overseas Master Fund, L.P. and the lenders party thereto (filed as Exhibit 10.3 to the Company s Form 8-K filed on December 15, 2008 and incorporated by reference).
10.1	Loan Agreement dated as of December 1, 1994 between the State of Oregon Economic Development Commission, along with the Pledge and Security Agreement relating thereto (filed as Exhibit 10(b) to the Company s Form 10-K for the fiscal year ended December 31, 1994 and incorporated herein by reference).

10.2*	Patrick Industries, Inc. 1987 Stock Option Program, as amended (filed as Exhibit 10(e) to the Company s Form 10-K for the fiscal year ended December 31, 1994 and incorporated herein by reference).
10.3	Amendment to extend Patrick Industries, Inc. 1987 Stock Option Program to May 14, 2014 (filed as Exhibit 10(h)(1) to the Company s Form 10-K for the fiscal year ended December 31, 2004 and incorporated herein by reference).
10.4*	Patrick Industries, Inc. 401(k) Employee Savings Plan (filed as Exhibit 10(a) to the Company s Form 10-K for the fiscal year ended December 31, 1993 and incorporated herein by reference).
10.5*	Form of Employment Agreements with Executive Officers (filed as Exhibit 10(e) to the Company s Form 10-K/A-1 amending its report on Form 10-K for the fiscal year ended December 31, 1992 and incorporated herein by reference).
10.6*	Form of Deferred Compensation Agreements with Executive Officers (filed as Exhibit 10(f) to the Company s Form 10-K/A-1 amending its report on Form 10-K for the fiscal year ended December 31, 1992 and incorporated herein by reference).
10.7	Commercial Lease dated December 1, 2004 between Teachers Insurance and Annuity Association of America (TIAA) as lessor, and the Company, as lessee (filed as Exhibit 10(v) to the Company s Form 10-K for the fiscal year ended December 31, 2004 and incorporated herein by reference).
10.8	Patrick Industries, Inc. Form of Stock Option (filed as Exhibit 10(x) to the Company s Form 10-K for the fiscal year ended December 31, 2004 and incorporated herein by reference).
10.9	Patrick Industries, Inc. form of Directors Annual Restricted Stock Grant (filed as Exhibit 10(y) to the Company s Form 10-K for the fiscal year ended December 31, 2004 and incorporated herein by reference).
10.10	Credit Agreement, dated May 18, 2007, among Patrick Industries, Inc., JPMorgan Chase Bank, N.A.; Fifth Third Bank; Bank of America, N.A./LaSalle Bank National Association; Key Bank, National Association; RBS Citizens, National Association/Charter One Bank; Associated Bank; National City Bank; and 1st Source Bank (collectively, the Lenders and JPMorgan Chase Bank, N.A., as administrative agent) (filed as Exhibit 10.1 to the Company s Form 8-K filed on May 24, 2007 and incorporated herein by reference).
10.11	First Amendment and Waiver, dated March 19, 2008, among Patrick Industries, Inc., the Lenders and JPMorgan Chase Bank, N.A. (filed as Exhibit 10.1 to the Company s Form 8-K filed on March 26, 2008 and incorporated herein by reference).
10.12	Second Amendment and Waiver, dated December 11, 2008, among Patrick Industries, Inc., the Lenders and JPMorgan Chase Bank, N.A. (filed as Exhibit 10.1 to the Company s Form 8-K filed on December 15, 2008 and incorporated herein by reference).
10.13	Warrant Agreement, dated December 11, 2008, among Patrick Industries, Inc., and the holders of the Warrants (filed as Exhibit 10.2 to the Company s Form 8-K filed on December 15, 2008 and incorporated herein by reference).
10.14	Third Amendment and Waiver, dated April 14, 2009, among Patrick Industries, Inc., the Lenders and JPMorgan Chase Bank, N.A. (filed as Exhibit 10.1 to the Company s Form 8-K filed on April 15, 2009 and incorporated herein by reference).

10.15	Securities Purchase Agreement, dated March 10, 2008, by and among Tontine Capital Partners, L.P., Tontine Capital Overseas Master Fund L.P., and Patrick Industries, Inc. (filed as Exhibit 10.1 to Form 8-K filed on December 15, 2008 and incorporated herein by reference.
12**	Statement of Computation of Operating Ratios.
16.1	Letter from McGladrey & Pullen, LLP to the SEC dated April 6, 2007 (filed as Exhibit 16.1 to Form 8-K filed on April 6, 2007 and incorporated herein by reference).
21**	Subsidiaries of the Registrant.
23.1**	Consent of Ernst & Young LLP.
23.2**	Consent of McGladrey & Pullen LLP.
31.1**	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Executive Officer.
31.2**	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Financial Officer.
32**	Certification pursuant to 18 U.S.C. Section 1350.

*Management contract or compensatory plan or arrangement.

**Filed herewith.

All other financial statement schedules are omitted because they are not applicable or the required information is immaterial or is shown in the Notes to the Consolidated Financial Statements**.**

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

PATRICK INDUSTRIES, INC

Date: April 14, 2009

By: /s/ Todd M. Cleveland

Todd M. Cleveland

President and Chief Executive Officer

Pursuant to the Requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

Signature	**Title**	**Date**	
/s/ Paul E. Hassler	Chairman of the Board	April 14, 2009	
Paul E. Hassler			
/s/ Todd M. Cleveland	President and Chief Executive Officer	April 14, 2009	
Todd M. Cleveland	(Principal Executive Officer) Accrued vacation	5,815	5,684
Payroll accruals	4,533		4,032
Total	$	18,808	$ 26,502

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4. Net Income per Share

The following table sets forth the computation of the Company’s basic and diluted net income per share for the three and six months ended January 31, 2013 and 2012:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2013	2012	2013	2012 [2]
	(in thousands, except share and per share amounts)			
Numerator:				
Net income	$5,501	$3,691	$5,948	$8,503
Non-cumulative dividends to preferred stockholders	—	(751)	—	(1,574)
Undistributed earnings allocated to preferred stockholders	—	(1,642)	—	(4,122)
Net income, basic	5,501	1,298	5,948	2,807
Adjustments to net income for dilutive options and restricted stock options	—	241	—	593
Net income, diluted	$5,501	$1,539	$5,948	$3,400
Net income per share:				
Basic	$0.10	$0.07	$0.11	$0.17
Diluted	$0.09	$0.06	$0.10	$0.15
Denominator:				
Weighted average shares used in computing net income per share:				
Basic	55,868,308	18,433,369	55,341,176	16,499,660
Weighted average effect of diluted stock options	3,668,115	3,565,468	3,958,906	3,597,819
Weighted average effect of dilutive restricted stock units	2,170,034	3,559,165	2,152,163	3,248,528
Weighted average effect of dilutive stock warrants (1)	—	52,199	—	41,576
Diluted	61,706,457	25,610,201	61,452,245	23,387,583

(1) Series C convertible preferred stock warrants were automatically converted to equivalent common stock warrants upon the Company’s IPO on January 24, 2012 and were converted or cancelled as of April 30, 2012.

(2) Amounts shown for basic earnings per share during the six month period ended January 31, 2012 are revised for a correction in the net income allocation calculation under the two-class method.

The following outstanding shares of common stock equivalents were excluded from the computation of diluted net income per share for the periods presented because including them would have been antidilutive:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2013	2012	2013	2012
Stock options to purchase common stock	338,712	788,238	269,040	649,263
Restricted stock units	—	—	12,417	—

5. Commitments and Contingencies

There has been no material change in the Company's contractual obligations and commitments other than in the ordinary course of business since the Company's fiscal year ended July 31, 2012. See the Annual Report on Form 10-K for the fiscal year ended July 31, 2012 for additional information regarding our contractual obligations.

Leases

The Company leases certain facilities and equipment under operating leases. On December 5, 2011, the Company entered into a seven-year lease for a facility to serve as its corporate headquarters, located in Foster City, California, for approximately

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97,674 square feet of space which commenced on August 1, 2012. In connection with this lease, the Company opened a letter of credit with Silicon Valley Bank for $1.2 million.
Lease expense for all worldwide facilities and equipment, which is being recognized on a straight-line basis over terms of the various leases, was $1.2 million and $2.4 million during the three and six months ended January 31, 2013, respectively, and $1.0 million and $1.9 million for the three and six months ended January 31, 2012, respectively. This expense was reduced by sublease income of $0.3 million and $0.6 million for the three and six months ended January 31, 2012, respectively.

Letters of Credit
In addition to the unsecured letter of credit noted above, the Company had an unsecured letter of credit agreement related to a customer arrangement for Polish Zloty 10.0 million (approximately $3.2 million as of January 31, 2013) to secure contractual commitments and prepayments. No amounts were outstanding under our unsecured letters of credit as of January 31, 2013 or July 31, 2012.

The Company had no outstanding secured letters of credit as of January 31, 2013. As of July 31, 2012, the Company had three outstanding letters of credit required by certain customers to secure contractual commitments and prepayments. These letters of credit were fully secured by cash balances, which we classified as restricted cash in our consolidated balance sheets as of July 31, 2012.
Legal Proceedings
In December 2007, Accenture Global Services GmbH and Accenture LLP (collectively, “Accenture”) filed a lawsuit against the Company in the U.S. District Court for the District of Delaware, (the "Delaware Court") titled Accenture Global Services GmbH and Accenture LLP v. Guidewire Software, Inc., Case No 07-826-SLR. Accenture alleged infringement of U.S. Patent No. 7,013,284, ("the '284 patent"), among others, by the Company’s products; trade-secret misappropriation; and tortious interference with business relations. Accenture sought damages and an injunction. The Company denied Accenture’s claims, and it asserted counterclaims seeking a declaration that the Company's products do not infringe either patent, that the patents are invalid and that the '284 patent is unenforceable. The Company also asserted counterclaims against Accenture for breach of contract and trade secret misappropriation. In March 2011, the USPTO granted a third re-examination against the '284 patent, after having rejected all claims in the '284 patent on two prior re-examinations.
On May 31, 2011, the Delaware Court granted the Company’s motion for summary judgment finding that Accenture’s '284 patent is invalid. In July 2011, Accenture filed an appeal to the Federal Circuit Court of Appeals (the "Appeals Court") of the Delaware Court’s judgment of invalidity of the '284 patent. We believe that the Delaware Court was correct in finding the '284 patent invalid and we intend to vigorously defend the Delaware Court's judgment in the appeal. On August 6, 2012, the oral argument of this appeal was held by the Appeals Court and their ruling is pending. However, at this time, the Company is unable to predict the likelihood of success of Accenture's appeal.

In October 2011, the Company agreed with Accenture to resolve all outstanding patent litigation concerning their respective insurance claims management software. In connection with the settlement, the Company has paid $10.0 million to Accenture with a potential additional payment based on the final outcome of Accenture’s pending appeal regarding the validity of its ‘284 patent. If Accenture is successful in its appeal, the Company has agreed to pay them an additional $20.0 million. At any time prior to an initial determination by the appeals court, the Company may instead pay Accenture $15.0 million to discharge this potential obligation. If Accenture is not successful in its appeal, no further payments would be due in connection with the settlement. As part of the settlement, the Company also agreed to a royalty free cross license of all then-current patents and patent applications. The Company expensed the $10.0 million litigation provision in fiscal year 2011.
In addition to the matters described above, from time to time, the Company is involved in various other legal proceedings and receives claims from time to time, arising from the normal course of business activities. The Company has accrued for estimated losses in the accompanying condensed consolidated financial statements for matters with respect to which we believe the likelihood of an adverse outcome is probable and the amount of the loss

is reasonably estimable.

Indemnification

The Company sells software licenses and services to its customers under contracts (“Software License”). Each Software License contains the terms of the contractual arrangement with the customer and generally includes certain provisions for defending the customer against any claims that the Company’s software infringes upon a patent, copyright, trademark, or other proprietary right of a third party. The Software License also indemnifies the customer against losses, expenses, and liabilities

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from damages that may be assessed against the customer in the event the Company's software is found to infringe upon such third party rights.

The Company has not had to reimburse any of its customers for losses related to indemnification provisions and no material claims against the Company are outstanding as of January 31, 2013 and July 31, 2012. For several reasons, including the lack of prior indemnification claims and the lack of a monetary liability limit for certain infringement cases under the Software License, the Company cannot estimate the amount of potential future payments, if any, related to indemnification provisions.

The Company has also agreed to indemnify its directors and executive officers for costs associated with any fees, expenses, judgments, fines and settlement amounts incurred by any of these persons in any action or proceeding to which any of these persons is, or is threatened to be, made a party by reason of the person's service as a director or officer, including any action by the Company, arising out of that person's services as the Company's director or officer or that person's services provided to any other company or enterprise at the Company's request. The Company maintains director and officer insurance coverage that may enable the Company to recover a portion of any future amounts paid.

6. Stockholders' Equity and Stock-based Compensation

Stock-based Compensation Expenses

Stock-based compensation expenses related to all employee and non-employee stock-based awards was as follows:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2013	2012	2013 [1]	2012 [1]
Stock-based compensation expenses:	(in thousands)			
Cost of maintenance revenues	$340	$113	$601	$185
Cost of services revenues	3,439	1,055	6,055	1,741
Research and development	2,446	1,258	4,488	2,103
Sales and marketing	1,942	527	3,593	1,024
General and administrative	2,207	3,339	5,421	4,551
Total stock-based compensation expenses	$10,374	$6,292	$20,158	$9,604

[1] Expenses shown include $1.0 million of expense recognized in 2013 related to the modification of RSUs upon accelerated vesting terms for the retirement of one of the Company's officers, as well as $1.2 million of expense recognized in 2012 related to the satisfaction of performance-based criteria upon successful close of the Company's IPO.

As of January 31, 2013, total unrecognized compensation cost, adjusted for estimated forfeitures, was as follows:

	As of January 31, 2013	
	Unrecognized Expense	Average Expected Recognition Period
	(in thousands)	(in years)
Restricted stock units	$40,541	1.4
Stock options	4,050	1.2
	$44,591	

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RSUs

RSU activity under the Company's equity incentive plans for the period presented is as follows:

	RSUs Outstanding	
	Number of RSUs Outstanding	Weighted Average Grant Date Fair Value
Balance as of July 31, 2012	3,992,177	$8.00
Granted	1,454,569	31.67
Released	(835,322)	8.48
Cancelled	(116,641)	16.46
Balance as of January 31, 2013	4,494,783	$15.35

The fair value of RSUs released during the three and six months ended January 31, 2013 was $14.5 million and $25.5 million, respectively.

Stock Options

The options exercisable as of January 31, 2013 include options that are exercisable prior to vesting. The total intrinsic value of options exercised was approximately $20.2 million and $8.2 million for the three months ended January 31, 2013 and 2012, respectively, and $53.1 million and $9.9 million for the six months ended January 31, 2013 and 2012, respectively.

	Stock Options Outstanding			
	Number of Stock Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value [1] (in thousands)
Balance as of July 31, 2012	6,486,641	$3.74	6.1	$142,321
Granted	339,912	31.86		
Exercised	(1,949,448)	2.88		
Cancelled	(35,694)	9.27		
Balance as of January 31, 2013	4,841,411	$6.02	6.1	$131,224
Vested and expected to vest as of January 31, 2013	4,754,015	$5.84	6.1	$129,734
Exercisable as of January 31, 2013	4,451,540	$4.25	5.8	$128,523

(1) Aggregate intrinsic value represents the difference between the Company's closing stock price of $33.12 and $25.66 on January 31, 2013 and July 31, 2012, respectively, against the exercise price of outstanding, in-the-money options.

Valuation of Awards

The per share fair value of each stock option was determined on the date of grant using the Black-Scholes option pricing model and the following assumptions:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2013	2012	2013	2012
Expected life (in years)	5.5	6.0 - 6.1	5.1 - 6.0	5.9 - 6.1
Risk-free interest rate	0.7%	1.2%	0.6% - 0.8%	1.1% - 1.2%
Expected volatility	47.7%	45.0% - 45.2%	45.1% - 48.7%	44.5% - 45.2%
Expected dividend yield	—%	—%	—%	—%

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Common Stock Reserved for Issuance

As of January 31, 2013 and July 31, 2012, the Company was authorized to issue 500,000,000 shares of common stock with a par value of $0.0001 per share. As of January 31, 2013 and July 31, 2012, the Company had reserved shares of common stock, on an as-if-converted basis, for issuance as follows:

	January 31, 2013	July 31, 2012
Exercise of stock options to purchase common stock	4,841,411	6,486,641
Vesting of restricted stock units	4,494,783	3,992,177
Issuances of shares available under stock plans	9,107,725	7,655,332
Total common stock reserved for issuance	18,443,919	18,134,150

Equity Incentive Plans

In February 2007, the Company's board of directors ("Board") adopted and the stockholders approved the 2006 Stock Plan ("2006 Plan") as an amendment and restatement of the stockholder-approved 2002 Stock Option/Stock Issuance Plan, as amended, providing for the issuance of incentive and nonstatutory options to employees and nonemployees of the Company and under which 14,074,904 shares had been reserved for issuance as of January 31, 2013.

In July 2009, the Board adopted and the stockholders approved the 2009 Stock Plan ("French Plan"). Under the French Plan, 31,000 shares had been reserved for issuance as of January 31, 2013. The number of shares exercised and issued under the French Plan reduced the corresponding number of shares available under the 2006 Plan.

In June 2010, the Board adopted and the stockholders approved the 2010 Restricted Stock Unit Plan ("2010 Plan"). As of January 31, 2013, the Company had reserved 4,265,637 shares of common stock for issuance under the 2010 Plan.

On September 14, 2011, the Board, upon the recommendation of the Compensation Committee of the Board ("Committee"), adopted the 2011 Stock Plan ("2011 Plan"), which was subsequently approved by the Company's stockholders in January 2012. The 2011 Plan provides flexibility to the Committee to use various equity-based incentive awards as compensation tools to motivate the Company's workforce. The Company had initially reserved 7,500,000 shares of its common stock for the issuance of awards under the 2011 Plan. In addition, the number of shares remaining available for grant under the 2006 Plan and 2010 Plan immediately prior to the closing of the IPO were added to the shares available under the 2011 Plan. The number of shares remaining available for grant under the French Plan expired upon the IPO. The 2011 Plan provides that the number of shares reserved and available for issuance under the plan will automatically increase each January 1, beginning on January 1, 2013, by up to 5% of the outstanding number of shares of the Company's common stock on the immediately preceding December 31. This number is subject to adjustment in the event of a stock split, stock dividend or other defined changes in the Company's capitalization. With the adoption of the 2011 Plan upon the completion of the Company's IPO, both option and RSU grants now reduce the 2011 Plan reserve. As of January 31, 2013, the Company had reserved 11,248,544 shares of common stock for issuance under the 2011 Plan.

The shares the Company issues under the 2011 Plan will be authorized but unissued shares or shares that are reacquired. The shares of common stock underlying any awards under the 2011 Plan, 2010 Plan and 2006 Plan that are forfeited, canceled, held back upon exercise or settlement of an award to satisfy the exercise price or tax withholding, reacquired by the Company prior to vesting, satisfied without any issuance of stock or are otherwise terminated (other than by exercise) are added back to the shares of common stock available for issuance under the 2011 Plan. The shares of common stock underlying any outstanding awards under the French Plan that are forfeited, canceled or otherwise not issued will expire and not be available for future issuance.

No awards may be granted under the 2011 Plan after the date that is 10 years from the effectiveness of the plan. No awards under the 2011 Plan were granted prior to the Company's IPO. Following the closing of the IPO, no additional awards will be made under the 2006 Plan, French Plan and 2010 Plan.

7. Income Taxes

The benefit from income taxes for the three and six months ended January 31, 2013 was $0.3 million and $0.5 million, respectively. The provision for income taxes for the three and six months ended January 31, 2012 was $1.4 million and $4.5 million, respectively. The changes are primarily due to the reinstatement of federal research and development credits of $1.6 million, the benefit from incentive stock option (ISO) tax deduction, and the decrease in year-to-date income before tax. The effective tax rate of (5.1)% and (10.0)% for the three and six months ended January 31, 2013 differs from the statutory U.S.

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federal income tax rate of 35% mainly due to the reasons discussed above, as well as permanent differences for stock based compensation, the impact of state income taxes, and the tax rate differences between the United States and foreign countries and foreign tax credits.

The Company provides U.S. income taxes on the earnings of foreign subsidiaries, unless the subsidiaries' earnings are considered indefinitely reinvested outside the United States. As of January 31, 2013, U.S. income taxes were not provided for on the cumulative total of $10.7 million undistributed earnings from certain foreign subsidiaries. As of January 31, 2013, the unrecognized deferred tax liability for these earnings was approximately $0.9 million.

During the six months ended January 31, 2013, unrecognized tax benefits increased $1.6 million from the beginning of the period. Accordingly, as of January 31, 2013, the Company had unrecognized tax benefits of $2.7 million that, if recognized, would affect the Company's effective tax rate.

8. Segment Information

The Company operates in one segment. The Company's chief operating decision maker (the "CODM"), its Chief Executive Officer, manages the Company's operations on a consolidated basis for purposes of allocating resources. When evaluating the Company's financial performance, the CODM reviews separate revenues information for the Company's license, maintenance and professional services offerings, while all other financial information is reviewed on a consolidated basis. All of the Company's principal operations and decision-making functions are located in the United States.

The following table sets forth revenues by country based on the billing address of the customer:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2013	2012	2013	2012
	(in thousands)			
United States	$36,823	$30,882	$72,210	$63,281
Canada	10,984	8,359	21,065	12,975
Australia	3,433	3,451	7,472	10,117
United Kingdom	6,708	3,605	12,079	6,836
Other	14,240	8,800	22,663	14,268
Total revenues	$72,188	$55,097	$135,489	$107,477

No other country accounted for more than 10% of revenues during the three and six months ended January 31, 2013 and 2012.

The following table sets forth the Company's property and equipment, net by geographic region:

	January 31, 2013	July 31, 2012
	(in thousands)	
North America	$11,274	$11,522
Europe	322	388
Asia Pacific	12	14
Total net property and equipment	$11,608	$11,924

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

The following discussion and analysis should be read in conjunction with our condensed consolidated financial statements and the notes thereto included elsewhere in this document and the Risk Factors included in Item 1A of Part II of this Quarterly Report on Form 10-Q. All information presented herein is based on our fiscal calendar. Unless otherwise stated, references in this report to particular years or quarters refer to our fiscal years ended in July and the associated quarters of those fiscal years. We do not undertake, and specifically disclaim, any obligation to update any forward-looking statements to reflect the occurrence of events or circumstances after the date of such statements except as required by law.

Overview

We are a leading provider of core system software to the global property and casualty ("P&C") insurance and reinsurance industry. Our solutions serve as the transactional systems-of-record for, and enable the key functions of, a P&C insurance carrier's business: underwriting and policy administration, claims management and billing. Since our inception, our mission has been to empower P&C insurance carriers to transform and improve their businesses by replacing their legacy core systems with our software platform.

We derive our revenues from licensing our software applications, providing maintenance support and providing professional services to the extent requested by our customers. Our license revenues are primarily generated through annual license fees that recur during the term of our multi-year contracts. These multi-year contracts have an average term of approximately five years and are renewed on an annual or multi-year basis. In certain cases, when required by a customer, we license our software on a perpetual basis. In addition, certain of our multi-year term licenses provide the customer with the option to purchase a perpetual license at the end of the initial contract term. We generally price our licenses based on the amount of direct written premiums ("DWP") that will be managed by our solutions. We typically invoice our customers annually in advance or, in certain cases, quarterly for both recurring term license and maintenance fees, and we invoice our perpetual license customers either in full at contract signing or on an installment basis and invoice related maintenance fees annually, in advance. Our focus is to encourage recurring term license arrangements instead of perpetual license arrangements, and we have historically experienced seasonal variations in our revenues as a result of increased customer orders in our second and fourth fiscal quarters and subsequent annual fees.

To extend our technology leadership position in our market, we intend to continue to focus on product innovation through research and development and aggressively pursue new customers and up-sell additional products within our existing customer base. This will require us to make continued investment in our research and development and sales and marketing functions to capitalize on opportunities for growth. We expect research and development, sales and marketing and general and administrative expenses to continue to increase in absolute dollars for the foreseeable future to support this strategy. Research and development and sales and marketing expenses are also expected to increase as a percentage of revenues in future periods as we focus on expanding our technological leadership.

We face a number of risks in the execution of our strategy, including reliance on sales to a relatively small number of large customers, variances in the mix amongst our components of revenues, possibly resulting in lower gross margin from services revenues as compared to license and maintenance revenues, and the overall impact of weakening economic conditions on the insurance industry. We believe that our focus on continued product innovation and customer wins and renewals will support the expansion of our license sales and reduce the impact from weakened economic conditions. We sell our core system software primarily through our direct sales force. Our sales cycle for new customers is typically 12 to 24 months and may take longer.

Opportunities, Challenges, & Risks

Since August 2010, our license revenues from new orders and subsequent annual payments have generally been recognized when payment is due from our customers. Historically, and to a lesser extent during fiscal years 2013, 2012 and 2011, our license revenues from existing orders have been recognized under three methods: under the residual method upon the earlier of payment being due and payable or cash being received from our customers, under the percentage-of-completion method as we complete customer implementations of our software, or under the zero gross margin method as we complete customer implementations of our software. During the three months ended January 31, 2013 and 2012, our license revenues accounted for 42% and 47% of our total revenues, respectively, and our recurring term license revenues accounted for 96% and 77% of our total license revenues, respectively. During the six months ended January 31, 2013 and 2012, our license revenues accounted for 38% and 43% of our total revenues, respectively, and our recurring term license revenues accounted for 97% and 69% of our total license revenues, respectively.

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Our maintenance revenues are generally recognized over the committed maintenance term. Our maintenance fees are invoiced annually, typically priced as a fixed percentage of the associated license fees and generate lower gross margins than our license revenues. Our maintenance revenues accounted for 13% and 12% of our total revenues during the three months ended January 31, 2013 and 2012, respectively, and 14% and 13% of our total revenues during the six months ended January 31, 2013 and 2012, respectively.

We generally charge services fees on a time and materials basis and revenues are typically recognized upon delivery of our services. We derive our services revenues primarily from implementation services performed for our customers, revenues related to reimbursable travel expenses and training fees. Our services revenues generate lower gross margins than our license and maintenance revenues and accounted for 45% and 41% of our total revenues during the three months ended January 31, 2013 and 2012, respectively. Our services revenues accounted for 48% and 44% of our total revenues during the six months ended January 31, 2013 and 2012, respectively.

We enter into multi-year renewable contracts to license our software and provide technical support and unspecified upgrades to our software as they become available. Regardless of contract length, we typically invoice our customers for annual and, in certain cases, quarterly amounts at the contract signing and at each anniversary date. Our deferred revenues consist only of amounts that have been invoiced, but not yet recognized as revenues. As a result, deferred revenues and change in deferred revenues are incomplete measures of the strength of our business and are not necessarily indicative of our future performance. Further, we expect to recognize our current deferred services revenue into income but do not expect significant deferrals of services revenue in future periods. Deferred license and service revenues related to projects under contract accounting as of January 31, 2013 were $4.2 million and $3.4 million, respectively, while deferred license and service revenues as of July 31, 2012 were $10.2 million and $5.6 million, respectively. Such deferral is in accordance with our Revenue Recognition policy as described in Note 1 to the consolidated financial statements.

In October 2012, we announced the introduction of Guidewire Live™, a network connecting Guidewire customers to one another, curated external content, and expert tools. Guidewire Live delivers relevant context to P & C insurance professionals based on who they are and the problems they are trying to solve. Guidewire Live is deployed as a cloud-based, instant-on solution that can be used by Guidewire customers within days, without the need for an implementation project. Guidewire Live enables insurers to compare their operational performance versus their peers. While we have incurred expenses to develop and market Guidewire Live, initial revenue expectations for fiscal 2013 are modest.

We have historically experienced seasonal variations in our revenues as a result of increased customer orders in our second and fourth fiscal quarters and subsequent annual fees. We generally see increased orders in our second fiscal quarter, which is the quarter-ended January 31, due to customer buying patterns. We also see increased orders in our fourth fiscal quarter due to efforts by our sales team to achieve annual incentives. As a result, a significantly higher percentage of our annual license fees are invoiced and recognized as revenues during those quarters at contract inception or in the subsequent quarter when the annual license payment is due and in subsequent years upon the anniversary of the contract date. We generally expect these seasonal trends to continue in the future, which may cause quarterly fluctuations in our results of operations and certain financial metrics. Our perpetual license revenues are not consistent from quarter to quarter. We expect that perpetual license revenues recognized in fiscal 2013 will be significantly lower than those recognized in prior periods, due to continued adoption of recurring term licenses, and our continued emphasis away from perpetual licenses.

Our quarterly growth in revenues may not match up to new orders we receive in a given quarter. This mismatch is primarily due to the following reasons:

- for the initial year of a multi-year term license, we generally recognize revenues when payment is due and payment may not be due until a subsequent fiscal quarter;
- we may enter into license agreements with specified terms for product upgrades or functionality, which may require us to delay revenue recognition until the period in which the upgrade or functionality is delivered;
- we may separately negotiate renewals of contracts which may have differing terms and conditions from the original contract; and
- we may enter into license agreements with other contractual terms that may affect the timing of revenue recognition.

For example, we received new orders for both term and perpetual licenses in the fourth quarter of fiscal year 2011 that committed future product functionality that was delivered in the first quarter of fiscal year 2012. As a result, our license revenues in the first quarter of fiscal year 2012 were $7.2 million higher than they would have been had the functionality been delivered in the fourth fiscal quarter of fiscal year 2011.

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In addition, our revenue may fluctuate if our customers make an early payment of their annual fees. For example, during the three months ended January 31, 2012, we recognized $2.5 million of revenue upon early payment of annual fees from one customer, which would have been otherwise recognized during the three months ended April 30, 2012. Product implementations, the primary driver of our services revenues, typically last 6 to 24 months and may take longer. No customer accounted for 10% or more of our revenues for the three and six months ended January 31, 2013 or 2012. Our ten largest customers accounted for 38% and 42% of our total revenues for the three months ended January 31, 2013 and 2012, respectively, and 35% and 42% of our total revenues for the six months ended January 31, 2013 and 2012, respectively. We count as customers distinct buying entities, which may include multiple national or regional subsidiaries of large, global P&C insurance carriers.

We generated revenues of $72.2 million and $55.1 million in the three months ended January 31, 2013 and 2012, respectively, and revenues of $135.5 million and $107.5 million in the six months ended January 31, 2013 and 2012, respectively. We generate the majority of our revenues in the United States and Canada. Our revenues from outside the United States and Canada as a percentage of total revenues were 34% and 29% in the three months ended January 31, 2013 and 2012, respectively, and 31% and 29% in the six months ended January 31, 2013 and 2012, respectively. We generated net income of $5.5 million and $3.7 million in the three months ended January 31, 2013 and 2012, respectively, and $5.9 million and $8.5 million in the six months ended January 31, 2013 and 2012, respectively.

Key Business Metrics

We use certain key metrics to evaluate and manage our business, including rolling four-quarter recurring revenues from term licenses and total maintenance. In addition, we present select GAAP and non-GAAP financial metrics that we use internally to manage the business and that we believe are useful for investors. These metrics include Adjusted EBITDA and operating cash flow.

Four-Quarter Recurring Revenues

We measure four-quarter recurring revenues by adding the total term license revenues and total maintenance revenues recognized in the preceding four quarters ended in the stated period and excluding perpetual license revenues, revenues from perpetual buyout rights and services revenues. This metric allows us to better understand the trends in our recurring revenues because it typically reduces the variations in any particular quarter caused by seasonality, the effects of the annual invoicing of our term licenses and certain effects of contractual provisions that may accelerate or delay revenue recognition in some cases. Our four-quarter recurring revenues for each of the eight periods presented were:

	Four quarters ended							
	1/31/2013	10/31/2012	7/31/2012	4/30/2012	1/31/2012	10/31/2011	7/31/2011	4/30/2011
	(in thousands)							
Term license revenues	$92,792	$83,114	$74,869	$70,165	$70,871	$64,174	$60,541	$54,797
Total maintenance revenues	34,207	31,802	29,538	27,581	25,412	23,818	21,321	20,188
Total four-quarter recurring revenues	$126,999	$114,916	$104,407	$97,746	$96,283	$87,992	$81,862	$74,985

Adjusted EBITDA

We define Adjusted EBITDA as net income plus provision for (benefit from) income taxes, other (income) expense, net, interest income, net, depreciation and amortization and stock-based compensation. We believe Adjusted EBITDA provides investors and other users of our financial information consistency and comparability with our past financial performance and facilitates period-to-period comparisons of operations. Adjusted EBITDA was $16.4 million and $12.3 million for the three months ended January 31, 2013 and 2012, respectively, and $27.2 million and $24.5 million for the six months ended January 31, 2013 and 2012, respectively.

We believe Adjusted EBITDA, a non-GAAP measure, is useful, in addition to other financial measures presented in accordance with GAAP, in evaluating our operating performance compared to that of other companies in our industry, as this metric generally eliminates the effects of certain items that may vary for different companies for reasons unrelated to overall operating performance. We believe that:

- Adjusted EBITDA provides investors and other users of our financial information consistency and comparability with our past financial performance, facilitates period-to-period comparisons of operations and facilitates

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comparisons with other companies, many of which use similar non-GAAP financial measures to supplement their GAAP results; and

- it is useful to exclude non-cash charges, such as depreciation and amortization, stock-based compensation and one-time charges because the amount of such expenses in any specific period may not directly correlate to the underlying performance of our business operations and these expenses can vary significantly between periods.

We use Adjusted EBITDA in conjunction with traditional GAAP measures as part of our overall assessment of our performance, including the preparation of our annual operating budget and quarterly forecasts, to evaluate the effectiveness of our business strategies and to communicate with our board of directors regarding our financial performance.

Adjusted EBITDA should not be considered as a substitute for other measures of financial performance reported in accordance with GAAP. There are limitations to using non-GAAP financial measures, including that other companies may calculate these measures differently than we do. We compensate for the inherent limitations associated with using Adjusted EBITDA through disclosure of these limitations, presentation of our financial statements in accordance with GAAP and reconciliation of Adjusted EBITDA to the most directly comparable GAAP measure, net income.

The following table provides a reconciliation of net income to Adjusted EBITDA:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2013	2012	2013	2012
	(in thousands)			
Reconciliation of Adjusted EBITDA:				
Net income	$5,501	$3,691	$5,948	$8,503
Non-GAAP adjustments:				
Provision for (benefit from) income taxes	(265)	1,420	(543)	4,464
Other (income) expense, net	(23)	319	(164)	635
Interest income, net	(132)	(73)	(222)	(113)
Depreciation and amortization	945	685	2,045	1,364
Total stock-based compensation	10,374	6,292	20,158	9,604
Adjusted EBITDA	$16,400	$12,334	$27,222	$24,457

Operating Cash Flows

We monitor our cash flows from operating activities, or operating cash flows, as a key measure of our overall business performance, enabling us to analyze our financial performance without the effects of certain non-cash items such as depreciation and amortization and stock-based compensation expenses. Additionally, operating cash flows takes into account the impact of changes in deferred revenues, which reflects the receipt of cash payment for products before they are recognized as revenues. Our operating cash flows are significantly impacted by changes in deferred revenues, timing of bonus payments and collections of accounts receivable. They were also impacted by the payment of a litigation settlement during the three months ended October 31, 2011. As a result, our operating cash flows fluctuate significantly on a quarterly basis. Operating cash flows were inflows of $3.1 million and outflows of $12.3 million for the six months ended January 31, 2013 and 2012, respectively. For a further discussion of our operating cash flows, see "Liquidity and Capital Resources—Cash Flows from Operating Activities."

Results of Operations

The following tables set forth our results of operations for the periods presented (in thousands, except per share data, and as a percentage of our total revenues) for those periods. The data have been derived from the unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report on Form 10-Q which, in the opinion of our management, reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position and results of operations for the interim periods presented. The operating results for any period should not be considered indicative of results for any future period. This information should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K filed with the SEC on September 25, 2012.

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	Three Months Ended January 31, 2013	2012	Six Months Ended January 31, 2013	2012
Revenues :	(in thousands)			
License	$30,752	$25,729	$51,564	$46,544
Maintenance	9,210	6,805	18,580	13,911
Services	32,226	22,563	65,345	47,022
Total revenues	72,188	55,097	135,489	107,477
Cost of revenues:				
License	130	234	297	533
Maintenance	1,787	1,197	3,351	2,463
Services	29,471	19,310	55,297	37,235
Total cost of revenues	31,388	20,741	58,945	40,231
Gross profit :				
License	30,622	25,495	51,267	46,011
Maintenance	7,423	5,608	15,229	11,448
Services	2,755	3,253	10,048	9,787
Total gross profit	40,800	34,356	76,544	67,246
Operating expenses:				
Research and development	15,885	12,162	30,649	23,121
Sales and marketing	12,389	9,198	24,765	16,559
General and administrative	7,445	7,639	16,111	14,077
Total operating expenses	35,719	28,999	71,525	53,757
Income from operations	5,081	5,357	5,019	13,489
Interest income, net	132	73	222	113
Other income (expense), net	23	(319)	164	(635)
Income before provision for (benefit from) income taxes	5,236	5,111	5,405	12,967
Provision for (benefit from) income taxes	(265)	1,420	(543)	4,464
Net income	$5,501	$3,691	$5,948	$8,503

	Three Months Ended January 31, 2013	2012	Six Months Ended January 31, 2013	2012
Revenues :				
License	42%	47%	38%	43%
Maintenance	13%	12%	14%	13%
Services	45%	41%	48%	44%
Total revenues	100%	100%	100%	100%
Total cost of revenues	44%	38%	43%	37%
Total gross profit	56%	62%	57%	63%
Operating expenses:				
Research and development	22%	22%	23%	22%
Sales and marketing	17%	17%	18%	15%
General and administrative	10%	14%	12%	13%
Total operating expenses	49%	53%	53%	50%
Income from operations	7%	9%	4%	13%
Interest income, net	—%	—%	—%	—%
Other income (expense), net	—%	—%	—%	(1)%
Income before provision for (benefit from) income taxes	7%	9%	4%	12%
Provision for (benefit from) income taxes	(1)%	2%	—%	4%

Net income	8 %	7 %	4 %	8 %

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Comparison of the Three and Six Months Ended January 31, 2013 and 2012
Revenues
Please refer to Note 1 of Notes to Condensed Consolidated Financial Statements for a description of our accounting policy related to revenue recognition.

	Three Months Ended January 31,					
	2013		2012			
	Amount	% of total revenues	Amount	% of total revenues	Change ($)	(%)
	(in thousands, except percentages)					
Revenues:						
License	$30,752	42 %	$25,729	47 %	$5,023	20 %
Maintenance	9,210	13 %	6,805	12 %	2,405	35 %
Services	32,226	45 %	22,563	41 %	9,663	43 %
Total revenues	$72,188	100 %	$55,097	100 %	$17,091	31 %

	Six Months Ended January 31,					
	2013		2012			
	Amount	% of total revenues	Amount	% of total revenues	Change ($)	(%)
	(in thousands, except percentages)					
Revenues:						
License	$51,564	38 %	$46,544	43 %	$5,020	11 %
Maintenance	18,580	14 %	13,911	13 %	4,669	34 %
Services	65,345	48 %	47,022	44 %	18,323	39 %
Total revenues	$135,489	100 %	$107,477	100 %	$28,012	26 %

License Revenues
The $5.0 million increase in license revenues during each of the three and six months ended January 31, 2013 was primarily driven by increasing term licensing of our core products: PolicyCenter, ClaimCenter and BillingCenter, and increased sales and marketing efforts in Europe and North America, partially offset by a decrease in perpetual license revenues in the current periods.

	Three Months Ended January 31,					
	2013		2012			
	Amount	% of license revenues	Amount	% of license revenues	Change ($)	(%)
	(in thousands, except percentages)					
License revenues:						
Term	$29,501	96 %	$19,823	77 %	$9,678	49 %
Perpetual	1,251	4 %	5,906	23 %	(4,655)	(79)%
Total license revenues	$30,752	100 %	$25,729	100 %	$5,023	20 %

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	Six Months Ended January 31,					
	2013		2012			
	Amount	% of license revenues	Amount	% of license revenues	Change ($)	(%)
	(in thousands, except percentages)					
License revenues:						
Term	$50,104	97 %	$32,182	69 %	$17,922	56 %
Perpetual	1,460	3 %	14,362	31 %	(12,902)	(90)%
Total license revenues	$51,564	100 %	$46,544	100 %	$5,020	11 %

The $9.7 million increase in term license revenues during the three month period was primarily driven by $9.2 million of revenues recognized from new orders during the three months ended January 31, 2013 and $1.3 million of revenues recognized upon attainment of the required revenue recognition criteria related to prior year orders during the three months ended January 31, 2013. In addition, there were $1.7 million of revenues recognized due to early payment and $1.2 million of revenues recognized pursuant to new orders in the prior comparable period for which revenues were recognized in the second half of prior fiscal year. These increases were partially offset by a decrease of $2.5 million of revenues recognized for one customer who paid on time in the current period rather than in advance of the due date in the comparable period and a decrease of $1.0 million of revenues recognized due to completion of project implementation in prior periods.

The $4.7 million decrease in perpetual license revenues during the three month period was primarily driven by new customers' increasingly signing term license agreements in the current quarter.

The $17.9 million increase in term license revenues during the six month period was primarily driven by $13.6 million of revenues recognized from new orders during the six months ended January 31, 2013 and $5.8 million of revenues recognized upon attainment of the required revenue recognition criteria related to prior year orders during the six months ended January 31, 2013. In addition, there were $3.5 million of revenues recognized due to timing of payment. These increases are partially offset by a decrease of $2.4 million of revenues recognized due to completion of project implementations in prior periods and a decrease of $2.5 million of revenue recognized for one customer due to early payment in the comparable prior period.

The $12.9 million decrease in perpetual license revenues during the six month period was primarily driven by new customers' increasingly signing term license agreements in the current period.

Maintenance Revenues

The $2.4 million increase in maintenance revenues during the three month period was primarily driven by $2.1 million of additional revenues recognized due to new and existing orders since the three months ended January 31, 2012 and $0.4 million of revenue recognized upon attainment of the required revenue recognition criteria related to prior year orders during the three months ended January 31, 2013.

The $4.7 million increase in maintenance revenues during the six month period was primarily driven by $3.5 million of additional revenues recognized from new and existing orders, and $1.1 million of revenues recognized upon attainment of the required revenue recognition criteria related to prior year orders during the period.

Services Revenues

The $9.7 million increase in service revenues during the three month period was primarily driven by an additional $8.0 million of revenues related to implementation of our software. Included in this is $3.3 million of revenues recognized upon receipt of acceptance of service-related deliverables, and $1.1 million of revenues recognized upon completion of implementation projects continued from prior fiscal years. An additional $1.3 million in revenues were recognized related to training and reimbursable travel costs.

The $18.3 million increase in service revenues during the six month period was primarily driven by an additional $15.4 million of revenues related to implementation of our software. Included in this increase is $1.7 million of revenues recognized when reliable estimates were obtained for one customer during the six months ended January 31, 2013, $3.3 million of revenues recognized upon receipt of acceptance of service-related deliverables and $2.3 million of revenues recognized upon

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completion of implementation projects continued from prior fiscal years. In addition, $1.7 million of revenues were recognized related to training and $1.2 million in revenues were recognized related to reimbursable travel expenses.

Deferred Revenues

	As of January 31, 2013	July 31, 2012	Change	
	Amount	Amount	($)	(%)
	(in thousands, except percentages)			
Deferred revenues:				
Deferred license revenues	$18,948	$25,766	$(6,818)	(26)%
Deferred maintenance revenues	20,833	21,536	(703)	(3)%
Deferred services revenues	5,276	8,214	(2,938)	(36)%
Total deferred revenues	$45,057	$55,516	$(10,459)	(19)%

The $6.8 million decrease in deferred license revenues compared to the prior year end was primarily driven by $5.8 million of revenues recognized from existing orders entered into in prior fiscal years where we attained the required revenue recognition criteria, of which $3.2 million was due to obtainment of reliable estimates during the six months ended January 31, 2013. In addition, $3.4 million of revenues were recognized during the six months ended January 31, 2013 related to implementation projects completed in prior fiscal years and for which revenue is recognized over the related maintenance term due to lack of VSOE. This decrease was partially offset by $2.4 million of deferred license billings for new and existing orders during the six months ended January 31, 2013.

The $0.7 million decrease in deferred maintenance revenues compared to the prior year end was primarily driven by $1.1 million of revenues recognized upon attainment of revenue recognition criteria during the six months ended January 31, 2013. This decrease was partially offset by $0.5 million of revenues recognized from existing orders in excess of new billings during the period.

The $2.9 million decrease in deferred services revenues compared to the prior year end was primarily driven by $1.7 million of revenue recognized upon obtainment of reliable estimates for one customer during the six months ended January 31, 2013 and $2.3 million of revenue recognized related to an implementation project completed in prior fiscal years and for which revenue is recognized over the related maintenance term due to lack of VSOE. This decrease was partially offset by $1.7 million of service revenue deferred during the six months ended January 31, 2013 pending receipt of acceptance of service-related deliverables.

Our deferred revenues consist only of amounts that have been invoiced, but not yet recognized as revenues. As a result, deferred revenues and change in deferred revenues are incomplete measures of the strength of our business and are not necessarily indicative of our future performance.

Cost of Revenues and Gross Profit

	Three Months Ended January 31,			
	2013	2012	Change	
	Amount	Amount	($)	(%)
	(in thousands, except percentages)			
Cost of revenues:				
License	$130	$234	$(104)	(44)%
Maintenance	1,787	1,197	590	49%
Services	29,471	19,310	10,161	53%
Total cost of revenues	$31,388	$20,741	$10,647	51%
Includes stock-based compensation of:				
Cost of maintenance revenues:	$340	$113	$227	
Cost of services revenues:	3,439	1,055	2,384	

Total	$3,779	$1,168	$2,611

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	Six Months Ended January 31,			
	2013	2012	Change	
	Amount	Amount	($)	(%)
	(in thousands, except percentages)			
Cost of revenues:				
License	$297	$533	$(236)	(44)%
Maintenance	3,351	2,463	888	36%
Services	55,297	37,235	18,062	49%
Total cost of revenues	$58,945	$40,231	$	