MASONITE INTERNATIONAL CORP
Form 10-Q
November 07, 2018

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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

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# FORM 10-Q

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

**For the quarterly period ended September 30, 2018**

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: 001-11796**

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# Masonite International Corporation

(Exact name of registrant as specified in its charter)

| **British Columbia, Canada** | **98-0377314** |
| --- | --- |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**2771 Rutherford Road**
**Concord, Ontario L4K 2N6 Canada**
(Address of principal executive offices)
**(800) 895-2723**
(Registrant’s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

| Large accelerated filer | x | Accelerated filer | o |
| --- | --- | --- | --- |
| Non-accelerated filer | o | Smaller reporting company | o |
| Emerging growth company | o | | |

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

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

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

The registrant had outstanding 26,520,558 shares of Common Stock, no par value, as of November 2, 2018.

**MASONITE INTERNATIONAL CORPORATION**
**INDEX TO QUARTERLY REPORT ON FORM 10-Q**
**September 30, 2018**


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**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of the federal securities laws, including, without limitation, statements concerning the conditions in our industry, our operations, our economic performance and financial condition, including, in particular, statements relating to our business and growth strategy and product development efforts under "Management's Discussion and Analysis of Financial Condition and Results of Operations." Forward-looking statements include all statements that do not relate solely to historical or current facts and can be identified by the use of words such as "may," "might," "will," "should," "estimate," "project," "plan," "anticipate," "expect," "intend," "outlook," "believe" and other similar expressions. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their dates. These forward-looking statements are based on estimates and assumptions by our management that, although we believe to be reasonable, are inherently uncertain and subject to a number of risks and uncertainties. These risks and uncertainties include, without limitation, those identified under "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017, subsequent reports on Form 10-Q, and elsewhere in this Quarterly Report.

The following list represents some, but not necessarily all, of the factors that could cause actual results to differ from historical results or those anticipated or predicted by these forward-looking statements:

- our ability to successfully implement our business strategy;
- general economic, market and business conditions, including foreign exchange rate fluctuation and inflation;
- levels of residential new construction; residential repair, renovation and remodeling; and non-residential building construction activity;
- the United Kingdom's formal trigger of the two year process for its exit from the European Union, and related negotiations;
- competition;
- our ability to manage our operations including integrating our recent acquisitions and companies or assets we acquire in the future;
- our ability to generate sufficient cash flows to fund our capital expenditure requirements, to meet our pension obligations, and to meet our debt service obligations, including our obligations under our senior notes and our ABL Facility;
- labor relations (i.e., disruptions, strikes or work stoppages), labor costs and availability of labor;
- increases in the costs of raw materials or wages or any shortage in supplies or labor;
- our ability to keep pace with technological developments;
- cyber security threats and attacks;
- the actions taken by, and the continued success of, certain key customers;
- our ability to maintain relationships with certain customers;
- the ability to generate the benefits of our restructuring activities;
- retention of key management personnel;
- environmental and other government regulations; and
- limitations on operating our business as a result of covenant restrictions under our existing and future indebtedness, including our senior notes and our ABL Facility.

We caution you that the foregoing list of important factors is not exclusive. In addition, in light of these risks and uncertainties, the matters referred to in the forward-looking statements contained in this Quarterly Report may not in fact occur. We undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events or otherwise, except as otherwise required by law.

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## PART I – FINANCIAL INFORMATION

### Item 1. Unaudited Financial Statements

**MASONITE INTERNATIONAL CORPORATION**
**Condensed Consolidated Statements of Comprehensive Income (Loss)**
(In thousands of U.S. dollars, except per share amounts)
(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, 2018 | October 1, 2017 | September 30, 2018 | October 1, 2017 |
| Net sales | $557,148 | $517,503 | $1,641,753 | $1,524,425 |
| Cost of goods sold | 446,306 | 413,517 | 1,301,808 | 1,217,556 |
| **Gross profit** | 110,842 | 103,986 | 339,945 | 306,869 |
| Selling, general and administration expenses | 64,530 | 59,063 | 204,592 | 188,043 |
| Restructuring costs, net | — | 1,393 | — | 986 |
| Loss (gain) on disposal of subsidiaries | — | — | — | 212 |
| **Operating income (loss)** | 46,312 | 43,530 | 135,353 | 117,628 |
| Interest expense (income), net | 10,151 | 7,213 | 27,981 | 21,349 |
| Loss on extinguishment of debt | 5,414 | — | 5,414 | — |
| Other expense (income), net | (1,105) | (451) | (2,347) | (1,253) |
| **Income (loss) from continuing operations before income tax expense (benefit)** | 31,852 | 36,768 | 104,305 | 97,532 |
| Income tax expense (benefit) | 6,151 | 5,989 | 20,746 | 13,242 |
| **Income (loss) from continuing operations** | 25,701 | 30,779 | 83,559 | 84,290 |
| Income (loss) from discontinued operations, net of tax | (157) | (139) | (538) | (518) |
| **Net income (loss)** | 25,544 | 30,640 | 83,021 | 83,772 |
| Less: net income (loss) attributable to non-controlling interest | 748 | 1,162 | 2,658 | 3,845 |
| **Net income (loss) attributable to Masonite** | $24,796 | $29,478 | $80,363 | $79,927 |
| | | | | |
| Earnings (loss) per common share attributable to Masonite: | | | | |
| Basic | $0.90 | $1.01 | $2.90 | $2.70 |
| Diluted | $0.89 | $1.00 | $2.85 | $2.65 |
| | | | | |
| Earnings (loss) per common share from continuing operations attributable to Masonite: | | | | |
| Basic | $0.91 | $1.02 | $2.91 | $2.72 |
| Diluted | $0.89 | $1.00 | $2.87 | $2.67 |
| | | | | |
| **Comprehensive income (loss):** | | | | |
| Net income (loss) | $25,544 | $30,640 | $83,021 | $83,772 |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation gain (loss) | 2,484 | 13,652 | (23,187) | 36,133 |
| Amortization of actuarial net losses | 300 | 292 | 899 | 876 |
| Income tax benefit (expense) related to other comprehensive income (loss) | (63) | 427 | (263) | (385) |
| Other comprehensive income (loss), net of tax: | 2,721 | 14,371 | (22,551) | 36,624 |
| Comprehensive income (loss) | 28,265 | 45,011 | 60,470 | 120,396 |
| Less: comprehensive income (loss) attributable to non-controlling interest | 990 | 1,521 | 2,288 | 4,585 |
| Comprehensive income (loss) attributable to Masonite | $27,275 | $43,490 | $58,182 | $115,811 |

See accompanying notes to the condensed consolidated financial statements.

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**MASONITE INTERNATIONAL CORPORATION**
**Condensed Consolidated Balance Sheets**
(In thousands of U.S. dollars, except share amounts)
(Unaudited)

| ASSETS | September 30, 2018 | December 31, 2017 |
|---|---|---|
| **Current assets:** | | |
| Cash and cash equivalents | $ 192,843 | $ 176,669 |
| Restricted cash | 10,485 | 11,895 |
| Accounts receivable, net | 301,599 | 269,235 |
| Inventories, net | 249,742 | 234,042 |
| Prepaid expenses | 30,193 | 27,665 |
| Income taxes receivable | 1,994 | 2,364 |
| **Total current assets** | 786,856 | 721,870 |
| Property, plant and equipment, net | 594,281 | 573,559 |
| Investment in equity investees | 12,782 | 11,310 |
| Goodwill | 178,862 | 138,449 |
| Intangible assets, net | 222,657 | 182,484 |
| Long-term deferred income taxes | 28,079 | 29,899 |
| Other assets, net | 27,974 | 22,687 |
| **Total assets** | $ 1,851,491 | $ 1,680,258 |
| | | |
| **LIABILITIES AND EQUITY** | | |
| **Current liabilities:** | | |
| Accounts payable | $ 103,454 | $ 94,497 |
| Accrued expenses | 133,482 | 126,759 |
| Income taxes payable | 4,248 | 869 |
| **Total current liabilities** | 241,184 | 222,125 |
| Long-term debt | 796,388 | 625,657 |
| Long-term deferred income taxes | 80,006 | 60,820 |
| Other liabilities | 30,227 | 35,754 |
| **Total liabilities** | 1,147,805 | 944,356 |
| Commitments and Contingencies (Note 9) | | |
| **Equity:** | | |
| Share capital: unlimited shares authorized, no par value, 27,135,071 and 28,369,877 shares issued and outstanding as of September 30, 2018, and December 31, 2017, respectively | 603,965 | 624,403 |
| Additional paid-in capital | 220,032 | 226,528 |
| Retained earnings (accumulated deficit) | 139 | (18,150) |
| Accumulated other comprehensive income (loss) | (132,333) | (110,152) |
| **Total equity attributable to Masonite** | 691,803 | 722,629 |
| Equity attributable to non-controlling interests | 11,883 | 13,273 |
| **Total equity** | 703,686 | 735,902 |
| **Total liabilities and equity** | $ 1,851,491 | $ 1,680,258 |

See accompanying notes to the condensed consolidated financial statements.

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**MASONITE INTERNATIONAL CORPORATION**
**Condensed Consolidated Statements of Changes in Equity**
(In thousands of U.S. dollars, except share amounts)
(Unaudited)

| | Common Shares Outstanding | Share Capital | Additional Paid-In Capital | Retained Earnings (Accumulated Deficit) | Accumulated Other Comprehensive Income (Loss) | Total Equity Attributable to Masonite | Equity Attributable to Non-controlling Interests | Total Equity |
|---|---|---|---|---|---|---|---|---|
| Balances as of January 1, 2017 | 29,774,784 | $650,007 | $234,926 | $ (89,063) | $ (148,986) | $ 646,884 | $ 12,892 | $659,776 |
| Net income (loss) | | | | 151,739 | | 151,739 | 5,242 | 156,981 |
| Other comprehensive income (loss), net of tax | | | | | 38,834 | 38,834 | 752 | 39,586 |
| Dividends to non-controlling interests | | | | | | — | (5,613) | (5,613) |
| Share based compensation expense | | | 11,644 | | | 11,644 | | 11,644 |
| Common shares issued for delivery of share based awards | 372,826 | 12,290 | (12,290) | | | — | | — |
| Common shares withheld to cover income taxes payable due to delivery of share based awards | | | (7,466) | | | (7,466) | | (7,466) |
| Common shares issued under employee stock purchase plan | 16,368 | 1,168 | (286) | | | 882 | | 882 |
| Common shares repurchased and retired | (1,794,101) | (39,062) | | (80,826) | | (119,888) | | (119,888) |
| Balances as of December 31, 2017 | 28,369,877 | $624,403 | $226,528 | $ (18,150) | $ (110,152) | $ 722,629 | $ 13,273 | $735,902 |
| Net income (loss) | | | | 80,363 | | 80,363 | 2,658 | 83,021 |
| Other comprehensive income (loss), net of tax | | | | | (22,181) | (22,181) | (370) | (22,551) |
| Dividends to non-controlling interests | | | | | | — | (3,678) | (3,678) |
| Share based compensation expense | | | 8,243 | | | 8,243 | | 8,243 |
| Common shares issued for delivery of share based awards | 215,910 | 11,043 | (11,043) | | | — | | — |
| Common shares withheld to cover income taxes payable due to delivery of share based awards | | | (3,594) | | | (3,594) | | (3,594) |
| Common shares issued under employee stock purchase plan | 13,984 | 949 | (102) | | | 847 | | 847 |
| Common shares repurchased and retired | (1,464,700) | (32,430) | | (62,074) | | (94,504) | | (94,504) |
| Balances as of September 30, 2018 | 27,135,071 | $603,965 | $220,032 | $ 139 | $ (132,333) | $ 691,803 | $ 11,883 | $703,686 |

See accompanying notes to the condensed consolidated financial statements.

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**MASONITE INTERNATIONAL CORPORATION**
**Condensed Consolidated Statements of Cash Flows**
(In thousands of U.S. dollars)
(Unaudited)

| | Nine Months Ended | |
|---|---|---|
| **Cash flows from operating activities:** | **September 30, 2018** | **October 1, 2017** |
| Net income (loss) | $83,021 | $83,772 |
| Adjustments to reconcile net income (loss) to net cash flow provided by (used in) operating activities: | | |
| Loss (income) from discontinued operations, net of tax | 538 | 518 |
| Loss (gain) on disposal of subsidiaries | — | 212 |
| Loss on extinguishment of debt | 5,414 | — |
| Depreciation | 43,340 | 43,475 |
| Amortization | 20,951 | 17,782 |
| Share based compensation expense | 8,243 | 8,694 |
| Deferred income taxes | 9,985 | 8,359 |
| Unrealized foreign exchange loss (gain) | (699) | 1,083 |
| Share of loss (income) from equity investees, net of tax | (1,472) | (1,293) |
| Pension and post-retirement expense (funding), net | (5,976) | (5,743) |
| Non-cash accruals and interest | 605 | 1,161 |
| Loss (gain) on sale of property, plant and equipment | 2,574 | 1,529 |
| Changes in assets and liabilities, net of acquisitions: | | |
| Accounts receivable | (25,780) | (39,532) |
| Inventories | (7,480) | (18,399) |
| Prepaid expenses | (2,411) | (1,745) |
| Accounts payable and accrued expenses | 12,240 | 2,993 |
| Other assets and liabilities | (2,642) | (4,761) |
| **Net cash flow provided by (used in) operating activities** | 140,451 | 98,105 |
| **Cash flows from investing activities:** | | |
| Additions to property, plant and equipment | (51,259) | (52,340) |
| Cash used in acquisitions, net of cash acquired | (135,276) | — |
| Proceeds from sale of property, plant and equipment | 1,404 | 962 |
| Other investing activities | (2,862) | (2,793) |
| **Net cash flow provided by (used in) investing activities** | (187,993) | (54,171) |
| **Cash flows from financing activities:** | | |
| Proceeds from issuance of long-term debt | 300,000 | 155,246 |
| Repayments of long-term debt | (125,279) | (332) |
| Payment of debt extinguishment costs | (5,250) | — |
| Payment of debt issuance costs | (4,344) | — |
| Tax withholding on share based awards | (3,594) | (6,167) |
| Distributions to non-controlling interests | (3,678) | (2,955) |
| Repurchases of common shares | (94,504) | (109,866) |
| **Net cash flow provided by (used in) financing activities** | 63,351 | 35,926 |
| Net foreign currency translation adjustment on cash | (1,045) | (844) |
| **Increase (decrease) in cash, cash equivalents and restricted cash** | 14,764 | 79,016 |
| Cash, cash equivalents and restricted cash, beginning of period | 188,564 | 83,910 |
| **Cash, cash equivalents and restricted cash, at end of period** | $203,328 | $162,926 |

See accompanying notes to the condensed consolidated financial statements.

**MASONITE INTERNATIONAL CORPORATION**
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**(Unaudited)**

**1. Business Overview and Significant Accounting Policies**

Unless we state otherwise or the context otherwise requires, references to "Masonite," "we," "our," "us" and the "Company" in these notes to the condensed consolidated financial statements refer to Masonite International Corporation and its subsidiaries.

*Description of Business*

Masonite International Corporation is one of the largest manufacturers of doors in the world, with significant market share in both interior and exterior door products. Masonite operates 67 manufacturing locations in 8 countries and sells doors to customers throughout the world, including the United States, Canada and the United Kingdom.

*Basis of Presentation*

We prepare these unaudited condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") and applicable rules and regulations of the U.S. Securities and Exchange Commission ("SEC") regarding interim financial reporting. Accordingly, they do not include all of the information and notes required by GAAP for annual financial statements. In the opinion of management, all adjustments consisting of normal and recurring entries considered necessary for a fair presentation of the results for the interim periods presented have been included. All significant intercompany balances and transactions have been eliminated. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect reported amounts in the financial statements and accompanying notes. These estimates are based on information available as of the date of the unaudited condensed consolidated financial statements; therefore, actual results could differ from those estimates. Interim results are not necessarily indicative of the results for a full year.

These unaudited condensed consolidated financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017, as filed with the SEC. Our fiscal year is the 52- or 53-week period ending on the Sunday closest to December 31. In a 52-week year, each fiscal quarter consists of 13 weeks. For ease of disclosure, the 13- and 39-week periods are referred to as three- and nine-month periods, respectively. Certain prior year amounts have been reclassified to conform to the current basis of presentation, related to Accounting Standards Updates ("ASU") 2017-07 and 2016-18, as described below.

***Changes in Accounting Standards and Policies***

There have been no changes in the significant accounting policies from those that were disclosed in the fiscal year 2017 audited consolidated financial statements, other than as noted below.

*Adoption of Recent Accounting Pronouncements*

In March 2017, the Financial Accounting Standards Board ("FASB") issued ASU 2017-07, “Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost,” which amended Accounting Standards Codification ("ASC") 715, “Retirement Benefits”. This ASU required disaggregation of the service cost component from the other components of net benefit cost. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations. This standard was effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years; early adoption was permitted and retrospective application was required. We have utilized the practical expedient allowing the use of the prior years' disclosed service cost and other cost as the basis for our retrospective changes in presentation. The adoption of this standard changed the presentation of the other components of net benefit cost in our condensed consolidated statements of comprehensive income (loss), requiring the reclassification of a $0.3 million and $0.8 million benefit related to other components of net benefit cost out of previously-presented selling, general and administration expense and into previously presented other expense (income), net, for the three and nine months ended October 1, 2017, respectively. The effect of this reclassification

reduced previously-presented operating income by this amount for the same periods. The total benefit which will be reclassified for the years ended December 31, 2017, and January 1, 2017, will be $1.1 million and $0.5 million, respectively.

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
**(Unaudited)**

In November 2016, the FASB issued ASU 2016-18, "Restricted Cash Flows", which amended ASC 230 "Statement of Cash Flows". This ASU clarified how entities should present restricted cash and restricted cash equivalents in the statement of cash flows. The new guidance requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. As a result, entities no longer present transfers between cash and cash equivalents and restricted cash and restricted cash equivalents in the statement of cash flows. This ASU was effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods; early adoption was permitted and retrospective application was required. The adoption of this standard changed the presentation of restricted cash in our condensed consolidated statements of cash flows, which is now being summed with cash and cash equivalents, and had the effect of a $0.3 million increase to previously-presented cash flow used in investing activities for the nine months ended October 1, 2017.
In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers," which created ASC 606, "Revenue from Contracts with Customers," and largely superseded the existing guidance of ASC 605, "Revenue Recognition." This standard outlined a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and superseded most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers - Deferral of the Effective Date," and the guidance would now be effective for annual and interim periods beginning on or after December 15, 2017. We have adopted the guidance of ASC 606 as of January 1, 2018, using the modified retrospective method and have applied the standard to only those contracts which were not completed as of the transition date. The adoption of this standard did not have any material impact on revenues in the three months ended April 1, 2018. Prior period amounts were not adjusted and have continued to be reported in accordance with our historic accounting under Topic 605. While we considered an adjustment to opening retained earnings as prescribed by the modified retrospective method, there was no material adjustment ultimately required. Furthermore, there was no material difference between the prior period amounts as reported under ASC 605 and such amounts as would have been reported under ASC 606. Information about the nature, amount and timing of our revenues from contracts with customers is disclosed in Note 10. Revenues. Our accounting policy for revenue recognition is set forth below.
*Revenue Recognition*
Revenue from the sale of products is recognized when control of the promised goods is transferred to our customers based on the agreed-upon shipping terms, in an amount that reflects the consideration to which we expect to be entitled in exchange for those goods or services. Volume rebates, expected returns, discounts and other incentives to customers are considered variable consideration and we estimate these amounts based on the expected amount to be provided to customers and reduce the revenues we recognize accordingly. Sales taxes and value added taxes assessed by governmental entities are excluded from the measurement of consideration expected to be received. Shipping and handling costs incurred after a customer has taken possession of our goods are treated as a fulfillment cost and are not considered a separate performance obligation. Shipping and other transportation costs charged to customers are recorded in both revenues and cost of goods sold in the condensed consolidated statements of comprehensive income (loss).
*Other Recent Accounting Pronouncements not yet Adopted*
In August 2018, the FASB issued ASU 2018-15, “Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract”. This ASU amends the definition of a hosting arrangement and requires a customer in a cloud computing arrangement that is a service contract to follow the internal-use software guidance in ASC 350-40 “Intangibles–Goodwill and Other–Internal-Use Software” to determine which implementation

costs to capitalize as assets or expense as incurred. Capitalized implementation costs related to a hosting arrangement that is a service contract will be amortized over the term of the hosting arrangement, beginning when the module or component of the hosting arrangement is ready for its intended use. The guidance is effective for annual periods beginning after December 15, 2019, and interim periods within those annual periods; early adoption is permitted and either retrospective or prospective application is required for all implementation costs incurred after the date of adoption. We are in the process of evaluating this guidance to determine the impact it may have on our financial statements.



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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
**(Unaudited)**

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)", which will replace the existing guidance in ASC 840, "Leases." This standard was supplemented by ASUs 2018-10 and 2018-11 in July 2018. The updated standards aim to increase transparency and comparability among organizations by requiring lessees to recognize lease assets and lease liabilities on the balance sheet and requiring disclosure of key information about leasing arrangements. The transition option in ASU 2018-11 allows entities to not apply the new leases standard in the comparative periods they present in their financial statements in the year of adoption. These ASUs are effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods; early adoption is permitted. We are currently implementing a new lease system in connection with the adoption of ASU 2016-02. We are progressing with implementation and continuing to evaluate the impact on our consolidated financial statements and disclosures. We currently anticipate that the primary impact upon adoption will be a material adjustment to our consolidated balance sheets from the recognition, on a discounted basis, of our expected future payments for our operating leases, resulting in the recognition of right to use assets and lease obligations. Our current minimum undiscounted lease commitments under non-cancelable operating leases are disclosed in Note 9. Commitments and Contingencies.

**2. Acquisitions and Disposition**

*2018 Acquisitions*

On June 1, 2018, we completed the acquisition of the operating assets of the wood door companies of AADG, Inc., including the brands Graham Manufacturing Corporation and The Maiman Company (collectively, "Graham & Maiman"). We acquired the operating assets of Graham & Maiman for cash consideration of $39.0 million. Graham & Maiman are based in Mason City, Iowa, and Springfield, Missouri. Graham & Maiman provide the non-residential construction industry with a full range of architectural premium and custom grade flush wood doors, architectural stile and rail wood doors, thermal-fused flush wood doors and wood door frames. The excess purchase price over the fair value of net assets acquired of $11.0 million was allocated to goodwill. The goodwill principally represents anticipated synergies to be gained from the integration into our existing Architectural business and the goodwill is deductible for tax purposes.

On January 29, 2018, we completed the acquisition of DW3 Products Holdings Limited (“DW3”), a leading UK provider of high quality premium door solutions and window systems, supplying products under brand names such as Solidor, Residor, Nicedor and Residence. We acquired 100% of the equity interests in DW3 for cash consideration of $96.3 million, net of cash acquired. DW3 is based in Stoke-on-Trent and Gloucester, England, and their online quick ship capabilities and product portfolio both complement and expand the strategies we are pursuing with our business. The excess purchase price over the fair value of net assets acquired of $33.6 million was allocated to goodwill. The goodwill principally represents anticipated synergies to be gained from the integration into our existing United Kingdom business. This goodwill is not deductible for tax purposes and relates to the Europe segment.

The fair value of assets acquired and liabilities assumed in the Graham & Maiman and DW3 acquisitions are as follows:

| *(In thousands)* | **Graham & Maiman** | **DW3** | **Total 2018 Acquisitions** |
|---|---|---|---|
| Accounts receivable | $— | $8,590 | $ 8,590 |
| Inventory | 6,090 | 5,059 | 11,149 |
| Property, plant and equipment | 19,557 | 8,196 | 27,753 |
| Goodwill | 10,996 | 33,623 | 44,619 |
| Intangible assets | 2,750 | 62,873 | 65,623 |
| Accounts payable and accrued expenses | (426) | (10,418) | (10,844) |

| | | | |
|---|---|---|---|
| Deferred income taxes | — | (11,546 ) | (11,546 ) |
| Other assets and liabilities, net | — | (68 ) | (68 ) |
| Cash consideration, net of cash acquired | $38,967 | $96,309 | $ 135,276 |

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
**(Unaudited)**

The gross contractual value of acquired trade receivables was $9.1 million for the DW3 acquisition. The fair values of intangible assets acquired are based on management's estimates and assumptions including variations of the income approach, the cost approach and the market approach. The intangible assets acquired are not expected to have any residual value. During the three months ended September 30, 2018, we completed the final customary working capital adjustment for the Graham & Maiman acquisition, which resulted in an immaterial difference in the purchase price allocation when compared to the previously-presented preliminary purchase price allocation. Additionally, we finalized the DW3 purchase price allocation during the nine months ended September 30, 2018.
Intangible assets acquired from the 2018 Acquisitions consist of the following:

| *(In thousands)* | **Graham & Maiman** | **Expected Useful Life (Years)** | **DW3** | **Expected Useful Life (Years)** |
|---|---|---|---|---|
| Customer relationships | $ 2,400 | 10.0 | $49,554 | 10.0 |
| Trademarks and trade names | 350 | 1.5 | 11,785 | 10.0 |
| Patents | — | | 1,420 | 10.0 |
| Other | — | | 114 | 3.0 |
| Total intangible assets acquired | $ 2,750 | | $62,873 | |

The following schedule represents the amounts of net sales and net income (loss) attributable to Masonite from the 2018 Acquisitions which have been included in the consolidated statements of comprehensive income (loss) for the periods indicated subsequent to the acquisition date.

| | **Three Months Ended September 30, 2018** | | |
|---|---|---|---|
| *(In thousands)* | **Graham & Maiman** | **DW3** | **Total 2018 Acquisitions** |
| Net sales | $18,336 | $18,470 | $ 36,806 |
| Net income (loss) attributable to Masonite | 845 | 1,433 | 2,278 |

| | **Nine Months Ended September 30, 2018** | | |
|---|---|---|---|
| *(In thousands)* | **Graham & Maiman** | **DW3** | **Total 2018 Acquisitions** |
| Net sales | $24,602 | $48,019 | $ 72,621 |
| Net income (loss) attributable to Masonite | 1,147 | 3,526 | 4,673 |

*2017 Acquisition*
On October 2, 2017, we completed the acquisition of A&F Wood Products, Inc. (“A&F”), through the purchase of 100% of the equity interests in A&F and certain assets of affiliates of A&F for cash consideration of $13.8 million, net of cash acquired. A&F is based in Howell, Michigan, and is a wholesaler and fabricator of architectural and commercial doors in the Midwest United States. The excess purchase price over the fair value of net assets acquired of $5.9 million was allocated to goodwill. The goodwill principally represents anticipated synergies from A&F's integration into our existing Architectural door business. This goodwill is not deductible for tax purposes and relates to the Architectural segment. A&F generated external net sales of $4.4 million and $11.7 million for the three and nine months ended September 30, 2018, respectively. Additional information relating to the A&F acquisition is

described in our Annual Report on Form 10-K for the year ended December 31, 2017.

*Pro Forma Information*

The following unaudited pro forma financial information represents the consolidated financial information as if the acquisitions had been included in our consolidated results beginning on the first day of the fiscal year prior to their respective acquisition dates. The pro forma results have been calculated after adjusting the results of the acquired entities to remove intercompany transactions and transaction costs incurred and to reflect the additional depreciation and amortization that would have been charged assuming the fair value adjustments to property, plant and equipment and

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
**(Unaudited)**

intangible assets had been applied on the first day of the fiscal year prior to the respective acquisitions, together with the consequential tax effects. The pro forma results do not reflect any cost savings, operating synergies or revenue enhancements that the combined company may achieve as a result of the acquisitions; the costs to combine the companies' operations; or the costs necessary to achieve these costs savings, operating synergies and revenue enhancements. The pro forma results do not necessarily reflect the actual results of operations of the combined companies' under our ownership and operation.

| | **Three Months Ended October 1, 2017** | | | | | |
|---|---|---|---|---|---|---|
| *(In thousands, except per share amounts)* | **Masonite** | **Graham & Maiman** | **DW3** | **A&F** | **Historical Sales to 2018 and 2017 Acquisitions** | **Pro Forma** |
| Net sales | $517,503 | $16,178 | $15,064 | $4,292 | $(1,105) | $551,932 |
| Net income (loss) attributable to Masonite | 29,478 | 186 | 787 | 735 | (76) | 31,110 |
| | | | | | | |
| Basic earnings (loss) per common share | $1.01 | | | | | $1.07 |
| Diluted earnings (loss) per common share | 1.00 | | | | | 1.05 |

| | **Nine Months Ended September 30, 2018** | | | | |
|---|---|---|---|---|---|
| *(In thousands, except per share amounts)* | **Masonite** | **Graham & Maiman** | **DW3** | **Historical Sales to 2018 Acquisitions** | **Pro Forma** |
| Net sales | $1,641,753 | $26,887 | $4,918 | $(651) | $1,672,907 |
| Net income (loss) attributable to Masonite | 80,363 | 89 | 81 | (60) | 80,473 |
| | | | | | |
| Basic earnings (loss) per common share | $2.90 | | | | $2.90 |
| Diluted earnings (loss) per common share | 2.85 | | | | 2.85 |

| | **Nine Months Ended October 1, 2017** | | | | | |
|---|---|---|---|---|---|---|
| *(In thousands, except per share amounts)* | **Masonite** | **Graham & Maiman** | **DW3** | **A&F** | **Historical Sales to 2018 and 2017 Acquisitions** | **Pro Forma** |
| Net sales | $1,524,425 | $50,617 | $41,494 | $11,104 | $(4,361) | $1,623,279 |
| Net income (loss) attributable to Masonite | 79,927 | 241 | 1,229 | 1,299 | (244) | 82,452 |
| | | | | | | |
| Basic earnings (loss) per common share | $2.70 | | | | | $2.79 |
| Diluted earnings (loss) per common share | 2.65 | | | | | 2.74 |

***Disposition***

On June 28, 2017, we completed the liquidation of our legal entity in Hungary. As a result, we recognized $0.2 million of cumulative translation adjustment in loss (gain) on disposal of subsidiaries from accumulated other comprehensive income during the nine months ended October 1, 2017.

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
**(Unaudited)**

**3. Accounts Receivable**

Our customers consist mainly of wholesale distributors, dealers, homebuilders and retail home centers. Our ten largest customers accounted for 53.3% and 56.2% of total accounts receivable as of September 30, 2018, and December 31, 2017, respectively. Our largest customer, The Home Depot, Inc., accounted for more than 10% of the consolidated gross accounts receivable balance as of September 30, 2018, and December 31, 2017. Our second largest customer, Lowe's Co. Inc., accounted for more than 10% of the consolidated gross accounts receivable balance as of December 31, 2017. The allowance for doubtful accounts balance was $2.1 million and $1.8 million as of September 30, 2018, and December 31, 2017, respectively.

We maintain an accounts receivable sales program with a third party (the "AR Sales Program"). Under the AR Sales Program, we can transfer ownership of eligible trade accounts receivable of certain customers. Receivables are sold outright to a third party that assumes the full risk of collection, without recourse to us in the event of a loss. Transfers of receivables under this program are accounted for as sales. Proceeds from the transfers reflect the face value of the accounts receivable less a discount. Receivables sold under the AR Sales Program are excluded from trade accounts receivable in the condensed consolidated balance sheets and are included in cash flows from operating activities in the condensed consolidated statements of cash flows. The discounts on the sales of trade accounts receivable sold under the AR Sales Program were not material for any of the periods presented and were recorded in selling, general and administration expense within the condensed consolidated statements of comprehensive income (loss).

**4. Inventories**

The amounts of inventory on hand were as follows as of the dates indicated:

| *(In thousands)* | **September 30, 2018** | **December 31, 2017** |
|---|---|---|
| Raw materials | $ 179,625 | $ 172,960 |
| Finished goods | 78,148 | 68,851 |
| Provision for obsolete or aged inventory | (8,031) | (7,769) |
| Inventories, net | $ 249,742 | $ 234,042 |

**5. Property, Plant and Equipment**

The carrying amounts of our property, plant and equipment and accumulated depreciation were as follows as of the dates indicated:

| *(In thousands)* | **September 30, 2018** | **December 31, 2017** |
|---|---|---|
| Land | $ 29,146 | $ 26,790 |
| Buildings | 179,542 | 176,077 |
| Machinery and equipment | 704,177 | 661,026 |
| Property, plant and equipment, gross | 912,865 | 863,893 |
| Accumulated depreciation | (318,584) | (290,334) |
| Property, plant and equipment, net | $ 594,281 | $ 573,559 |

Total depreciation expense was $15.7 million and $43.3 million in the three and nine months ended September 30, 2018, respectively, and $14.2 million and $43.5 million in the three and nine months ended October 1, 2017, respectively. Depreciation expense is included primarily within cost of goods sold in the condensed consolidated statements of comprehensive income (loss).

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
**(Unaudited)**

**6. Goodwill and Intangible Assets**

Changes in the carrying amount of goodwill were as follows as of the dates indicated:

| *(In thousands)* | North American Residential | Europe | Architectural | Total |
|---|---|---|---|---|
| December 31, 2017 | $ 2,867 | $35,431 | $ 100,151 | $138,449 |
| Goodwill from 2018 acquisitions | — | 33,623 | 10,996 | 44,619 |
| Foreign exchange fluctuations | (12) | (4,084) | (110) | (4,206) |
| September 30, 2018 | $ 2,855 | $64,970 | $ 111,037 | $178,862 |

The cost and accumulated amortization values of our intangible assets were as follows as of the dates indicated:

| | September 30, 2018 | | | |
|---|---|---|---|---|
| *(In thousands)* | Cost | Accumulated Amortization | Translation Adjustment | Net Book Value |
| Definite life intangible assets: | | | | |
| Customer relationships | $212,282 | $ (94,852) | $ (16,776) | $100,654 |
| Patents | 34,068 | (23,330) | (908) | 9,830 |
| Software | 35,784 | (32,379) | (197) | 3,208 |
| Trademarks and tradenames | 15,155 | (3,513) | (943) | 10,699 |
| Other | 12,340 | (10,594) | (1,665) | 81 |
| Total definite life intangible assets | 309,629 | (164,668) | (20,489) | 124,472 |
| Indefinite life intangible assets: | | | | |
| Trademarks and tradenames | 108,572 | — | (10,387) | 98,185 |
| Total intangible assets | $418,201 | $ (164,668) | $ (30,876) | $222,657 |

| | December 31, 2017 | | | |
|---|---|---|---|---|
| *(In thousands)* | Cost | Accumulated Amortization | Translation Adjustment | Net Book Value |
| Definite life intangible assets: | | | | |
| Customer relationships | $160,327 | $ (79,628) | $ (11,338) | $69,361 |
| Patents | 31,999 | (21,768) | (686) | 9,545 |
| Software | 33,574 | (31,183) | (190) | 2,201 |
| Other | 15,246 | (11,836) | (1,781) | 1,629 |
| Total definite life intangible assets | 241,146 | (144,415) | (13,995) | 82,736 |
| Indefinite life intangible assets: | | | | |
| Trademarks and tradenames | 108,572 | — | (8,824) | 99,748 |
| Total intangible assets | $349,718 | $ (144,415) | $ (22,819) | $182,484 |

Amortization of intangible assets was $7.0 million and $20.3 million for the three and nine months ended September 30, 2018, respectively, and $6.0 million and $17.9 million for the three and nine months ended October 1, 2017, respectively. Amortization expense is classified within selling, general and administration expenses in the condensed consolidated statements of comprehensive income (loss).

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
**(Unaudited)**

The estimated future amortization of intangible assets with definite lives as of September 30, 2018, is as follows:

| *(In thousands)* | |
|---|---|
| Fiscal year: | |
| 2018 (remaining three months) | $6,487 |
| 2019 | 25,511 |
| 2020 | 20,124 |
| 2021 | 16,902 |
| 2022 | 13,434 |

**7. Accrued Expenses**

The details of our accrued expenses were as follows as of the dates indicated:

| *(In thousands)* | **September 30, 2018** | **December 31, 2017** |
|---|---|---|
| Accrued payroll | $ 43,556 | $ 38,296 |
| Accrued rebates | 39,884 | 34,488 |
| Accrued interest | 3,277 | 10,688 |
| Other accruals | 46,765 | 43,287 |
| Total accrued expenses | $ 133,482 | $ 126,759 |

**8. Long-Term Debt**

| *(In thousands)* | **September 30, 2018** | **December 31, 2017** |
|---|---|---|
| 5.625% senior unsecured notes due 2023 | $ 500,000 | $ 625,000 |
| 5.75% senior unsecured notes due 2026 | 300,000 | — |
| Unamortized premium on 2023 Notes | 3,903 | 5,714 |
| Debt issuance costs | (8,765) | (6,635) |
| Capital lease obligations | 95 | 378 |
| Other long-term debt | 1,155 | 1,200 |
| Total long-term debt | $ 796,388 | $ 625,657 |

Interest expense related to our consolidated indebtedness under senior unsecured notes was $10.0 million and $27.7 million for the three and nine months ended September 30, 2018, respectively, and $7.1 million and $20.9 million for the three and nine months ended October 1, 2017, respectively.

*5.75% Senior Notes due 2026*

On August 27, 2018, we issued $300.0 million aggregate principal senior unsecured notes (the “2026 Notes”). The 2026 Notes were issued in a private placement for resale to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended (the “Securities Act”), and to buyers outside of the United States pursuant to Regulation S under the Securities Act. The 2026 Notes were issued without registration rights and are not listed on any securities exchange. The 2026 Notes bear interest at 5.75% per annum, payable in cash semiannually in arrears on March 15 and September 15 of each year and are due September 15, 2026. The 2026 notes were issued at par. We received net proceeds of $295.7 million after deducting $4.3 million of debt issuance costs. The debt issuance costs were capitalized as a reduction to the carrying value of debt and are being accreted to interest expense over the term of the 2026 Notes using the effective interest method. The net proceeds from issuance of the 2026 Notes were used to redeem $125.0

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
**(Unaudited)**

million aggregate principal amount of the 2023 Notes (as described below), including the payment of related premiums, fees and expenses, with the balance of the proceeds available for general corporate purposes.
Subsequent to the closing of the 2026 Notes offering, the 2023 Notes were partially redeemed, with that portion of the notes considered extinguished as of September 12, 2018. Under the terms of the indenture governing the 2023 Notes, we paid the applicable premium of $5.3 million. Additionally, the proportionate shares of the unamortized premium of $1.0 million and unamortized debt issuance costs of $1.1 million relating to the 2023 Notes were written off in conjunction with the partial extinguishment of the 2023 Notes. The resulting loss on extinguishment of debt was $5.4 million and is recorded as part of income (loss) from continuing operations before income tax expense (benefit) in the consolidated statements of comprehensive income (loss). Additionally, the cash payment of interest accrued to, but not including, the redemption date was accelerated to the redemption date.
Obligations under the 2026 Notes are fully and unconditionally guaranteed, jointly and severally, on a senior unsecured basis, by certain of our directly or indirectly wholly-owned subsidiaries. We may redeem the 2026 Notes, in whole or in part, at any time on or after September 15, 2021, at the applicable redemption prices specified under the indenture governing the 2026 Notes, plus accrued and unpaid interest, if any, to the date of redemption. If we experience certain changes of control or consummate certain asset sales and do not reinvest the net proceeds, we must offer to repurchase all of the 2026 Notes at a purchase price of 101.00% of their principal amount, plus accrued and unpaid interest, if any, to the repurchase date.
The indenture governing the 2026 Notes contains restrictive covenants that, among other things, limit our ability and the ability of our subsidiaries to: (i) incur additional debt and issue disqualified or preferred stock, (ii) make restricted payments, (iii) sell assets, (iv) create or permit restrictions on the ability of our restricted subsidiaries to pay dividends or make other distributions to the parent company, (v) create or incur certain liens, (vi) enter into sale and leaseback transactions, (vii) merge or consolidate with other entities and (viii) enter into transactions with affiliates. The foregoing limitations are subject to exceptions as set forth in the indenture governing the 2026 Notes. In addition, if in the future the 2026 Notes have an investment grade rating from at least two nationally recognized statistical rating organizations, certain of these covenants will be terminated. The indenture governing the 2026 Notes contains customary events of default (subject in certain cases to customary grace and cure periods). As of September 30, 2018, we were in compliance with all covenants under the indenture governing the 2026 Notes.
*5.625% Senior Notes due 2023*
On September 27, 2017, and March 23, 2015, we issued $150.0 million and $475.0 million aggregate principal senior unsecured notes, respectively (the "2023 Notes"). The 2023 Notes were issued in two private placements for resale to qualified institutional buyers pursuant to Rule 144A under the Securities Act, and to buyers outside the United States pursuant to Regulation S under the Securities Act. The 2023 Notes were issued without registration rights and are not listed on any securities exchange. The 2023 Notes bear interest at 5.625% per annum, payable in cash semiannually in arrears on March 15 and September 15 of each year and are due March 15, 2023. The 2023 Notes were issued at 104.0% and par in 2017 and 2015, respectively, and the resulting premium of $6.0 million is being amortized to interest expense over the term of the 2023 Notes using the effective interest method. We received net proceeds of $153.9 million and $467.9 million, respectively, after deducting $2.1 million and $7.1 million of debt issuance costs in 2017 and 2015, respectively. The debt issuance costs were capitalized as a reduction to the carrying value of debt and are being accreted to interest expense over the term of the 2023 Notes using the effective interest method. The net proceeds from the 2017 issuance of the 2023 Notes are for general corporate purposes. The net proceeds from the 2015 issuance of the 2023 Notes, together with available cash balances, were used to redeem $500.0 million aggregate principal of prior 8.25% senior unsecured notes due 2021 and to pay related premiums, fees and expenses.
Obligations under the 2023 Notes are fully and unconditionally guaranteed, jointly and severally, on a senior unsecured basis, by certain of our directly or indirectly wholly-owned subsidiaries. We may redeem the 2023 Notes,

in whole or in part, at any time on or after March 15, 2018, at the applicable redemption prices specified under the indenture governing the 2023 Notes, plus accrued and unpaid interest, if any, to the date of redemption. If we experience certain changes of control or consummate certain asset sales and do not reinvest the net proceeds, we must offer to repurchase all of the 2023 Notes at a purchase price of 101.00% of their principal amount, plus accrued and unpaid interest, if any, to the repurchase date.

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
**(Unaudited)**

The indenture governing the 2023 Notes contains restrictive covenants that, among other things, limit our ability and the ability of our subsidiaries to: (i) incur additional debt and issue disqualified or preferred stock, (ii) make restricted payments, (iii) sell assets, (iv) create or permit restrictions on the ability of our restricted subsidiaries to pay dividends or make other distributions to the parent company, (v) create or incur certain liens, (vi) enter into sale and leaseback transactions, (vii) merge or consolidate with other entities and (viii) enter into transactions with affiliates. The foregoing limitations are subject to exceptions as set forth in the indenture governing the 2023 Notes. In addition, if in the future the 2023 Notes have an investment grade rating from at least two nationally recognized statistical rating organizations, certain of these covenants will be replaced with a less restrictive covenant. The indenture governing the 2023 Notes contains customary events of default (subject in certain cases to customary grace and cure periods). As of September 30, 2018, and December 31, 2017, we were in compliance with all covenants under the indenture governing the 2023 Notes.

*ABL Facility*

On April 9, 2015, we and certain of our subsidiaries entered into a $150.0 million asset-based revolving credit facility (the "ABL Facility") maturing on April 9, 2020. The borrowing base is calculated based on a percentage of the value of selected U.S. and Canadian accounts receivable and inventory, less certain ineligible amounts.

Obligations under the ABL Facility are secured by a first priority security interest in certain of the current assets of Masonite's United States and Canadian subsidiaries. In addition, obligations under the ABL Facility are fully and unconditionally guaranteed, jointly and severally, on a senior secured basis, by certain of our directly or indirectly wholly-owned subsidiaries. Borrowings under the ABL Facility bear interest at a rate equal to, at our option, (i) the Base Rate, Canadian Prime Rate or Canadian Base Rate (each as defined in the Amended and Restated Credit Agreement) plus a margin ranging from 0.25% to 0.75% per annum, or (ii) the Eurodollar Base Rate or BA Rate (each as defined in the Amended and Restated Credit Agreement), plus a margin ranging from 1.25% to 1.75% per annum. In addition to paying interest on any outstanding principal under the ABL Facility a commitment fee is payable on the undrawn portion of the ABL Facility in an amount equal to 0.25% per annum of the average daily balance of unused commitments during each calendar quarter.

The ABL Facility contains various customary representations, warranties and covenants by us that, among other things, and subject to certain exceptions, restrict Masonite's ability and the ability of our subsidiaries to: (i) pay dividends on our common shares and make other restricted payments, (ii) make investments and acquisitions, (iii) engage in transactions with our affiliates, (iv) sell assets, (v) merge and (vi) create liens. The Amended and Restated Credit Agreement amended the ABL Facility to, among other things, (i) permit us to incur unlimited unsecured debt as long as such debt does not contain covenants or default provisions that are more restrictive than those contained in the ABL Facility, (ii) permit us to incur debt as long as the pro forma secured leverage ratio is less than 4.5 to 1.0, and (iii) add certain additional exceptions and exemptions under the restricted payment, investment and indebtedness covenants (including increasing the amount of certain debt permitted to be incurred under an existing exception). As of September 30, 2018, and December 31, 2017, we were in compliance with all covenants under the credit agreement governing the ABL Facility and there were no amounts outstanding under the ABL Facility.

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
**(Unaudited)**

## 9. Commitments and Contingencies

*Leases*

For lease agreements that provide for escalating rent payments or rent-free occupancy periods, we recognize rent expense on a straight line basis over the non-cancelable lease term and any option renewal period where failure to exercise such option would result in an economic penalty in such amount that renewal appears, at the inception of the lease, to be reasonably assured. The lease term commences on the date when all conditions precedent to our obligation to pay rent are satisfied. The leases contain provisions for renewal ranging from zero to three options of generally five years each. Minimum payments, for the following future periods, under non-cancelable operating leases and service agreements with initial or remaining terms of one year or more consist of the following:

| *(In thousands)* | |
|---|---|
| Fiscal year: | |
| 2018 (remaining three months) | $6,003 |
| 2019 | 23,771 |
| 2020 | 21,793 |
| 2021 | 16,863 |
| 2022 | 12,606 |
| Thereafter | 56,364 |
| Total future minimum lease payments | $137,400 |

Total rent expense, including non-cancelable operating leases and month-to-month leases, was $7.9 million and $23.4 million for the three and nine months ended September 30, 2018, respectively, and $7.2 million and $21.5 million for the three and nine months ended October 1, 2017, respectively.

We have provided customary indemnifications to our landlords under certain property lease agreements for claims by third parties in connection with their use of the premises. We also have provided routine indemnifications against adverse effects related to changes in tax laws and patent infringements by third parties. The maximum amount of these indemnifications cannot be reasonably estimated due to their nature. In some cases, we have recourse against other parties to mitigate the risk of loss from these indemnifications. Historically, we have not made any significant payments relating to such indemnifications.

***Legal Proceedings***

The following discussion describes certain new legal proceedings and material developments in previously disclosed legal proceedings that occurred since December 31, 2017. Refer to Note 9. Commitments and Contingencies in the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2017, for a full description of the previously disclosed legal proceedings.

*Grubb Lumber Company*

On October 19, 2018, Grubb Lumber Company, Inc. filed a purported class action lawsuit against us and JELD-WEN, Inc. (“Jeld-Wen”) in the United States District Court for the Eastern District of Virginia, Richmond Division, alleging, among other things, that defendants conspired to fix prices on, and to eliminate competition with respect to, interior molded doors. The complaint asserts violations of Section 1 of the Sherman Act, and Jeld-Wen’s violation of Section 7 of the Clayton Act, and seeks treble damages and costs of suit, including reasonable attorneys’ fees, and prejudgment and post-judgment interest. While we intend to defend the lawsuit vigorously, there can be no assurance that the ultimate resolution of this lawsuit will not have a material, adverse effect on our consolidated financial condition or results of operations.

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
**(Unaudited)**

*Mathis*
In the Mathis matter, on March 29, 2018, and before any responsive pleadings were filed, the parties entered into a Settlement Agreement and General Release pursuant to which we made a nominal settlement payment in exchange for a general release and the lawsuit was dismissed with prejudice on April 23, 2018. In entering into the settlement, we denied all claims made in the lawsuit and denied any wrongdoing.
*Byrd*
In the Byrd matter, on March 22, 2018 the settlement previously agreed to by the parties received final court approval and the court dismissed the case. Payment of the settlement occurred on April 27, 2018. Payouts to class members were initiated on May 16, 2018 and all required payments were completed on October 4, 2018. The amount we paid as part of the settlement did not have a material impact on our financial condition or operating results.
In addition, from time to time, we are involved in various claims, legal actions and government audits. In the opinion of management, the ultimate disposition of these matters, individually and in the aggregate, will not have a material effect on our financial condition, results of operations or cash flows.
**10. Revenues**
We derive our revenues primarily from the manufacture and delivery of doors and door components as performance obligations that arise from our contracts with customers are satisfied. Materially all of our revenues are generated from contracts with customers and the nature, timing and any uncertainty in the recognition of revenues are not affected by the type of good, customer or geographical region to which the performance obligation relates. Our contracts with our customers are generally in the form of purchase orders and the performance obligation arises upon receipt of the purchase order and agreement upon the transaction price. The performance obligations are satisfied at a point in time when control of the promised goods is transferred to the customer and payment terms vary from customer to customer. Payment terms are short-term, are customary for our industry and in some cases, early payment incentives are offered.
The transaction price recognized as revenue and accounts receivable is determined based upon a number of estimates, including:

- Incentive-based volume rebates, which are based on individual rebate agreements with our customers, as well as historical and expected performance of each individual customer,
- Estimated sales returns, which are based on historical returns as a percentage of revenues, and
- Adjustments for early payment discounts offered by us.

Contract assets are represented by our trade accounts receivable balances on the condensed consolidated balance sheets, and are described in Note 3. Accounts Receivable. There were no other material contract assets or liabilities as of either September 30, 2018, or December 31, 2017. Our warranties are assurance-type warranties and do not represent separate performance obligations to our customers. There were no material impairment losses related to contract assets during the three or nine months ended September 30, 2018, or October 1, 2017.
**11. Share Based Compensation Plans**
Share based compensation expense was $1.6 million and $8.2 million for the three and nine months ended September 30, 2018, respectively, and $2.7 million and $8.7 million for the three and nine months ended October 1, 2017, respectively. As of September 30, 2018, the total remaining unrecognized compensation expense related to share based compensation amounted to $16.5 million, which will be amortized over the weighted average remaining requisite service period of 1.6 years. Share based compensation expense is recognized using a graded-method approach, or to a lesser extent a cliff-vesting approach, depending on the terms of the individual award and is classified within selling, general and administration expenses in the condensed consolidated statements of comprehensive income (loss). All share based awards are settled through issuance of new shares of our common stock. The share based award agreements contain restrictions on sale or transfer other than in limited circumstances. All other transfers would cause the share based awards to become null and void.

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
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*Equity Incentive Plans*
Prior to July 9, 2012, we had a management equity incentive plan (the "2009 Plan"). The 2009 Plan required granting by June 9, 2012, equity instruments which upon exercise would result in management (excluding directors) owning 9.55% of our common equity (3,554,811 shares) on a fully diluted basis, after giving consideration to the potential exercise of warrants and the equity instruments granted to directors. Under the 2009 Plan, we were required to issue equity instruments to directors that represented 0.90% (335,004 shares) of the common equity on a fully diluted basis. The requirement for issuance to employees was satisfied in June 2012, and the requirement for issuance to directors was satisfied in July 2009. No awards have been granted under the 2009 Plan since May 30, 2012, and no future awards will be granted under the 2009 Plan; however, all outstanding awards under the 2009 Plan will continue to be governed by their existing terms. Aside from shares issuable for outstanding awards, there are no further shares of common stock available for future issuance under the 2009 Plan.
On July 12, 2012, the Board of Directors adopted the Masonite International Corporation 2012 Equity Incentive Plan, which was amended on June 21, 2013, by our Board of Directors, further amended and restated by our Board of Directors on February 23, 2015, and approved by our shareholders on May 12, 2015 (as amended and restated, the "2012 Plan"). The 2012 Plan was adopted because the Board believes awards granted will help to attract, motivate and retain employees and non-employee directors, align employee and stockholder interests and encourage a performance-based culture built on employee stock ownership. The 2012 Plan permits us to offer eligible directors, employees and consultants cash and share-based incentives, including stock options, stock appreciation rights, restricted stock, other share-based awards (including restricted stock units) and cash-based awards. The 2012 Plan is effective for ten years from the date of its adoption. Awards granted under the 2012 Plan are at the discretion of the Human Resources and Compensation Committee of the Board of Directors. The Human Resources and Compensation Committee may grant any award under the 2012 Plan in the form of a performance award. The 2012 Plan may be amended, suspended or terminated by the Board at any time; provided, that any amendment, suspension or termination which impairs the rights of a participant is subject to such participant's consent and; provided further, that certain material amendments are subject to shareholder approval. The aggregate number of common shares that can be issued with respect to equity awards under the 2012 Plan cannot exceed 2,000,000 shares plus the number of shares subject to existing grants under the 2009 Plan that may expire or be forfeited or cancelled. As of September 30, 2018, there were 770,619 shares of common stock available for future issuance under the 2012 Plan.
*Deferred Compensation Plan*
We offer to certain of our employees and directors a Deferred Compensation Plan ("DCP"). The DCP is an unfunded non-qualified deferred compensation plan that permits those certain employees and directors to defer a portion of their compensation to a future time. Eligible employees may elect to defer a portion of their base salary, bonus and/or restricted stock units and eligible directors may defer a portion of their director fees or restricted stock units. All contributions to the DCP on behalf of the participant are fully vested (other than restricted stock unit deferrals which remain subject to the vesting terms of the applicable equity incentive plan) and placed into a grantor trust, commonly referred to as a "rabbi trust." Although we are permitted to make matching contributions under the terms of the DCP, we have not elected to do so. The DCP invests the contributions in diversified securities from a selection of investments and the participants choose their investments and may periodically reallocate the assets in their respective accounts. Participants are entitled to receive the benefits in their accounts upon separation of service or upon a specified date, with benefits payable as a single lump sum or in annual installments. All plan investments are categorized as having Level 1 valuation inputs as established by the FASB’s Fair Value Framework.
Assets of the rabbi trust, other than Company stock, are recorded at fair value and included in other assets in the condensed consolidated balance sheets. These assets in the rabbi trust are classified as trading securities and changes in their fair values are recorded in other income (loss) in the condensed consolidated statements of comprehensive

income (loss). The liability relating to deferred compensation represents our obligation to distribute funds to the participants in the future and is included in other liabilities in the condensed consolidated balance sheets. As of September 30, 2018, the liability and asset relating to deferred compensation had a fair value of $6.4 million and $6.5 million, respectively. Any unfunded gain or loss relating to changes in the fair value of the deferred compensation liability is recognized in selling, general and administration expense in the condensed consolidated statements of comprehensive income (loss). As of

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
**(Unaudited)**

September 30, 2018, participation in the deferred compensation plan is limited and no restricted stock awards have been deferred into the deferred compensation plan.

*Stock Appreciation Rights*

We have granted Stock Appreciation Rights ("SARs") to certain employees under both the 2009 Plan and the 2012 Plan, which entitle the recipient to the appreciation in value of a number of common shares over the exercise price over a period of time, each as specified in the applicable award agreement. The exercise price of any SAR granted may not be less than the fair market value of our common shares on the date of grant. The compensation expense for the SARs is measured based on the fair value of the SARs at the date of grant and is recognized over the requisite service period. The SARs vest over a maximum of three years, have a life of ten years and settle in common shares. We recognize forfeitures of SARs in the period in which they occur.

The total fair value of SARs vested was $0.7 million and $0.4 million during the nine months ended September 30, 2018, and October 1, 2017, respectively.

| *Nine Months Ended September 30, 2018* | **Stock Appreciation Rights** | **Aggregate Intrinsic Value (in thousands)** | **Weighted Average Exercise Price** | **Average Remaining Contractual Life (Years)** |
|---|---|---|---|---|
| Outstanding, beginning of period | 537,930 | $ 23,263 | $ 32.00 | 4.5 |
| Granted | 69,752 | | 65.00 | |
| Exercised | (85,913) | 4,624 | 15.84 | |
| Outstanding, end of period | 521,769 | $ 13,781 | $ 39.07 | 4.9 |
| Exercisable, end of period | 398,884 | $ 13,663 | $ 30.44 | 3.7 |

| *Nine Months Ended October 1, 2017* | **Stock Appreciation Rights** | **Aggregate Intrinsic Value (in thousands)** | **Weighted Average Exercise Price** | **Average Remaining Contractual Life (Years)** |
|---|---|---|---|---|
| Outstanding, beginning of period | 790,290 | $ 32,659 | $ 24.47 | 4.6 |
| Granted | 59,265 | | 77.00 | |
| Exercised | (226,468) | 13,122 | 18.98 | |
| Forfeited | (29,082) | | 53.43 | |
| Outstanding, end of period | 594,005 | $ 23,851 | $ 30.39 | 4.6 |
| Exercisable, end of period | 509,674 | $ 23,387 | $ 23.31 | 3.8 |

The value of SARs granted is determined using the Black-Scholes Merton valuation model, and the corresponding expense is recognized over the average requisite service period of 2.0 years for all periods presented. Expected volatility is based upon the historical volatility of our public industry peers' common shares amongst other considerations. The expected term is calculated using the simplified method, due to insufficient exercise activity during recent years as a basis from which to estimate future exercise patterns. The weighted average grant date assumptions used for the SARs granted were as follows for the periods indicated:

| | **2018 Grants** | **2017 Grants** |
|---|---|---|
| SAR value (model conclusion) | $18.63 | $22.65 |
| Risk-free rate | 2.7 % | 2.0 % |

| | | | | |
|---|---|---|---|---|
| Expected dividend yield | 0.0 | % | 0.0 | % |
| Expected volatility | 22.8 | % | 25.8 | % |
| Expected term (years) | 6.0 | | 6.0 | |

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
**(Unaudited)**

*Restricted Stock Units*
We have granted Restricted Stock Units ("RSUs") to directors and certain employees under both the 2009 Plan and the 2012 Plan. The RSUs confer the right to receive shares of our common stock at a specified future date or when certain conditions are met. The compensation expense for the RSUs awarded is based on the fair value of the RSUs at the date of grant and is recognized over the requisite service period. The RSUs vest over a maximum of three years and call for the underlying shares to be delivered no later than 30 days following the vesting date unless the participant is subject to a blackout period. In such case, the shares are to be delivered once the blackout restriction has been lifted. We recognize forfeitures of RSUs in the period in which they occur.

| | Nine Months Ended | | | |
|---|---|---|---|---|
| | September 30, 2018 | | October 1, 2017 | |
| | Total Restricted Stock Units Outstanding | Weighted Average Grant Date Fair Value | Total Restricted Stock Units Outstanding | Weighted Average Grant Date Fair Value |
| Outstanding, beginning of period | 417,598 | $ 66.14 | 501,926 | $ 58.51 |
| Granted | 281,728 | 63.13 | 240,771 | 70.67 |
| Delivered | (164,579 ) | | (187,333 ) | |
| Withheld to cover [1] | (42,449 ) | | (54,638 ) | |
| Forfeited | (18,902 ) | | (60,763 ) | |
| Outstanding, end of period | 473,396 | $ 65.57 | 439,963 | $ 66.03 |

(1) A portion of the vested RSUs delivered were net share settled to cover statutory requirements for income and other employment taxes. We remit the equivalent cash to the appropriate taxing authorities. These net share settlements had the effect of share repurchases by us as we reduced and retired the number of shares that would have otherwise been issued as a result of the vesting.

Approximately one-half of the RSUs granted during the nine months ended September 30, 2018, vest at specified future dates with only service requirements, while the remaining portion of the RSUs vest based on both performance and service requirements. The expense for RSUs granted in the nine months ended September 30, 2018, and October 1, 2017, is being recognized over the weighted average requisite service period of 2.6 and 2.7 years, respectively. 207,028 RSUs vested during the nine months ended September 30, 2018, at a fair value of $13.3 million.

**12. Restructuring Costs**
Restructuring costs were not material in the three or nine months ended September 30, 2018. The following table summarizes the restructuring charges recorded for the periods indicated:

| | Three Months Ended October 1, 2017 | | | |
|---|---|---|---|---|
| *(In thousands)* | Europe | Architectural | Corporate & Other | Total |
| 2016 Plan | $— | $ 1,378 | $ — | $1,378 |
| 2015 Plan | 69 | — | (53 ) | 16 |
| 2014 Plan | — | — | (1 ) | (1 ) |
| Total Restructuring Costs | $69 | $ 1,378 | $ (54 ) | $1,393 |

| | Nine Months Ended October 1, 2017 | | | |
|---|---|---|---|---|
| *(In thousands)* | Europe | Architectural | Corporate & Other | Total |
| 2016 Plan | $— | $ 2,152 | $— | $2,152 |

| | | | | |
|---|---|---|---|---|
| 2015 Plan | (27 ) | — | (7 ) | (34 ) |
| 2014 Plan | — | — | (1,132 ) | (1,132 ) |
| Total Restructuring Costs | $(27 ) | $ 2,152 | $ (1,139 ) | $986 |

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
**(Unaudited)**

| | Cumulative Amount Incurred Through September 30, 2018 | | | | |
|---|---|---|---|---|---|
| *(In thousands)* | **North American Residential** | **Europe** | **Architectural** | **Corporate & Other** | **Total** |
| 2016 Plan | $— | $— | $ 3,707 | $ — | $3,707 |
| 2015 Plan | — | 2,335 | — | 3,274 | 5,609 |
| 2014 Plan | — | — | — | 7,993 | 7,993 |
| 2013 Plan | 3,025 | 2,733 | — | 2,157 | 7,915 |
| 2012 and Prior Plans | 2,378 | 12,668 | — | 3,609 | 18,655 |
| Total Restructuring Costs | $5,403 | $17,736 | $ 3,707 | $ 17,033 | $43,879 |

Our restructuring plans initiated in 2016 and prior years are described in detail in our Annual Report on Form 10-K for the year ended December 31, 2017. Costs associated with our existing restructuring plans include severance and closure charges and are substantially completed. The 2013 Plan also included impairment of certain property, plant and equipment. Actions associated with all of our existing restructuring plans are substantially completed, although cash payments are expected to continue through 2019, primarily related to lease payments at closed facilities under our restructuring plans initiated in 2012 and prior years. As of September 30, 2018, we do not expect to incur any material future charges relating to any of our existing restructuring plans.
The changes in the accrual for restructuring by activity were as follows for the periods indicated:

| *(In thousands)* | **December 31, 2017** | **Cash Payments** | **September 30, 2018** |
|---|---|---|---|
| 2016 Plan | $ 90 | $ 90 | $ — |
| 2012 and Prior Plans | 194 | 113 | 81 |
| Total | $ 284 | $ 203 | $ 81 |

| *(In thousands)* | **January 1, 2017** | **Severance** | **Closure Costs** | **Cash Payments** | **October 1, 2017** |
|---|---|---|---|---|---|
| 2016 Plan | $ 1,300 | $ 116 | $2,036 | $ 3,242 | $ 210 |
| 2015 Plan | 282 | (7 ) | (27 ) | 248 | — |
| 2014 Plan | 426 | — | (1,132 ) | (1,120 ) | 414 |
| 2012 and Prior Plans | 465 | — | — | 244 | 221 |
| Total | $ 2,473 | $ 109 | $877 | $ 2,614 | $ 845 |

**13. Income Taxes**
The effective tax rate differs from the Canadian statutory rate of 26.5% primarily due to changes in our valuation allowances, tax exempt income and mix of earnings in foreign jurisdictions which are subject to tax rates that differ from the Canadian statutory rate. In addition, we recognized $0.8 million and $1.1 million of income tax benefit due to the exercise and delivery of share-based awards during the three and nine months ended September 30, 2018, and $0.6 million and $5.7 million during the three and nine months ended October 1, 2017.
In accordance with SAB 118, we have reflected the income tax effects of the aspects of the Tax Cuts and Jobs Act of 2017 ("Tax Reform") for which the accounting under ASC 740 is complete. Our provision for income taxes does include estimates of certain deductions. The final impact of Tax Reform may differ from our estimates due to additional regulations that may be issued or changes in interpretations as we gain a more thorough understanding of

the tax law. These changes could be material to income tax expense.



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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
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## 14. Earnings Per Share

Basic earnings per share ("EPS") is calculated by dividing earnings attributable to Masonite by the weighted-average number of our common shares outstanding during the period. Diluted EPS is calculated by dividing earnings attributable to Masonite by the weighted-average number of common shares plus the incremental number of shares issuable from non-vested and vested RSUs and SARs outstanding during the period.

| *(In thousands, except share and per share information)* | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, 2018 | October 1, 2017 | September 30, 2018 | October 1, 2017 |
| Net income (loss) attributable to Masonite | $ 24,796 | $ 29,478 | $ 80,363 | $ 79,927 |
| Less: income (loss) from discontinued operations, net of tax | (157) | (139) | (538) | (518) |
| Income (loss) from continuing operations attributable to Masonite | $ 24,953 | $ 29,617 | $ 80,901 | $ 80,445 |
| | | | | |
| Shares used in computing basic earnings per share | 27,477,430 | 29,086,174 | 27,758,784 | 29,579,076 |
| Effect of dilutive securities: | | | | |
| Incremental shares issuable under share compensation plans and warrants | 434,510 | 488,619 | 475,279 | 557,227 |
| Shares used in computing diluted earnings per share | 27,911,940 | 29,574,793 | 28,234,063 | 30,136,303 |
| | | | | |
| Basic earnings (loss) per common share attributable to Masonite: | | | | |
| Continuing operations attributable to Masonite | $ 0.91 | $ 1.02 | $ 2.91 | $ 2.72 |
| Discontinued operations attributable to Masonite, net of tax | (0.01) | (0.01) | (0.01) | (0.02) |
| Total Basic earnings per common share attributable to Masonite | $ 0.90 | $ 1.01 | $ 2.90 | $ 2.70 |
| | | | | |
| Diluted earnings (loss) per common share attributable to Masonite: | | | | |
| Continuing operations attributable to Masonite | $ 0.89 | $ 1.00 | $ 2.87 | $ 2.67 |
| Discontinued operations attributable to Masonite, net of tax | — | — | (0.02) | (0.02) |
| Total Diluted earnings per common share attributable to Masonite | $ 0.89 | $ 1.00 | $ 2.85 | $ 2.65 |
| | | | | |
| Anti-dilutive instruments excluded from diluted earnings per common share: | | | | |
| Stock appreciation rights | 51,129 | 52,228 | 51,129 | 52,228 |

The weighted average number of shares outstanding utilized for the diluted EPS calculation contemplates the exercise of all currently outstanding SARs and the conversion of all RSUs. The dilutive effect of such equity awards is calculated based on the weighted average share price for each fiscal period using the treasury stock method. For all periods presented, common shares issuable for stock appreciation rights which have a higher strike price than our weighted average market price have been excluded from the computation of diluted earnings per share, as their effect would have been anti-dilutive.

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
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**15. Segment Information**

Our reportable segments are organized and managed principally by end market: North American Residential, Europe and Architectural. The North American Residential reportable segment is the aggregation of the Wholesale and Retail operating segments. The Europe reportable segment is the aggregation of the United Kingdom and Central Eastern Europe operating segments. The Architectural reportable segment consists solely of the Architectural operating segment. The Corporate & Other category includes unallocated corporate costs and the results of immaterial operating segments which were not aggregated into any reportable segment. Operating segments are aggregated into reportable segments only if they exhibit similar economic characteristics. In addition to similar economic characteristics we also consider the following factors in determining the reportable segments: the nature of business activities, the management structure directly accountable to our chief operating decision maker for operating and administrative activities, availability of discrete financial information and information presented to the Board of Directors and investors.

Our management reviews net sales and Adjusted EBITDA (as defined below) to evaluate segment performance and allocate resources. Net assets are not allocated to the reportable segments. Adjusted EBITDA is a non-GAAP financial measure which does not have a standardized meaning under GAAP and is unlikely to be comparable to similar measures used by other companies. Adjusted EBITDA should not be considered as an alternative to either net income or operating cash flows determined in accordance with GAAP. Adjusted EBITDA is defined as net income (loss) attributable to Masonite adjusted to exclude the following items:

• depreciation;
• amortization;
• share based compensation expense;
• loss (gain) on disposal of property, plant and equipment;
• registration and listing fees;
• restructuring costs;
• asset impairment;
• loss (gain) on disposal of subsidiaries;
• interest expense (income), net;
• loss on extinguishment of debt;
• other expense (income), net;
• income tax expense (benefit);
• loss (income) from discontinued operations, net of tax; and
• net income (loss) attributable to non-controlling interest.

This definition of Adjusted EBITDA differs from the definitions of EBITDA contained in the indentures governing the 2026 Notes and 2023 Notes and the credit agreement governing the ABL Facility. Adjusted EBITDA is used to evaluate and compare the performance of the segments and it is one of the primary measures used to determine employee incentive compensation. Intersegment transfers are negotiated on an arm’s length basis, using market prices.

Certain information with respect to segments is as follows for the periods indicated:

| | **Three Months Ended September 30, 2018** | | | | |
|---|---|---|---|---|---|
| *(In thousands)* | **North American Residential** | **Europe** | **Architectural** | **Corporate & Other** | **Total** |
| Net sales | $369,491 | $91,588 | $ 96,116 | $ 5,609 | $562,804 |
| Intersegment sales | (1,229 ) | (362 ) | (4,065 ) | — | (5,656 ) |
| Net sales to external customers | $368,262 | $91,226 | $ 92,051 | $ 5,609 | $557,148 |

| | | | | | |
|---|---|---|---|---|---|
| Adjusted EBITDA | $53,414 | $10,678 | $ 11,228 | $ (4,559 ) | $70,761 |

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**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
**(Unaudited)**

| | Three Months Ended October 1, 2017 | | | | |
|---|---|---|---|---|---|
| *(In thousands)* | North American Residential | Europe | Architectural | Corporate & Other | Total |
| Net sales | $365,406 | $75,463 | $ 78,468 | $ 4,947 | $524,284 |
| Intersegment sales | (1,222 ) | (644 ) | (4,915 ) | — | (6,781 ) |
| Net sales to external customers | $364,184 | $74,819 | $ 73,553 | $ 4,947 | $517,503 |
| | | | | | |
| Adjusted EBITDA | $50,126 | $8,283 | $ 8,692 | $ 2,340 | $69,441 |

| | Nine Months Ended September 30, 2018 | | | | |
|---|---|---|---|---|---|
| *(In thousands)* | North American Residential | Europe | Architectural | Corporate & Other | Total |
| Net sales | $1,108,969 | $280,729 | $ 254,232 | $16,350 | $1,660,280 |
| Intersegment sales | (3,161 ) | (1,653 ) | (13,713 ) | — | (18,527 ) |
| Net sales to external customers | $1,105,808 | $279,076 | $ 240,519 | $16,350 | $1,641,753 |
| | | | | | |
| Adjusted EBITDA | $162,775 | $34,250 | $ 30,886 | $(17,450 ) | $210,461 |

| | Nine Months Ended October 1, 2017 | |
|---|---|---|
| *(In thousands)* | North American Residential | Europe |