

TREX CO INC  
Form 10-K/A  
March 06, 2007  
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## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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### FORM 10-K/A

(Amendment No. 1)

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(Mark One)

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

For the fiscal year ended December 31, 2005

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: 001-14649

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## Trex Company, Inc.

(Exact name of registrant as specified in its charter)

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Delaware  
(State or other jurisdiction of  
incorporation or organization)

160 Exeter Drive, Winchester, Virginia  
(Address of principal executive offices)

(540) 542-6300

54-1910453  
(I.R.S. Employer

Identification No.)

22603-8605  
(Zip Code)

Registrant's telephone number, including area code:

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**Not Applicable**

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

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

|                             |   |
|-----------------------------|---|
| <b>Title of each class:</b> | <b>Name of each exchange on which registered:</b> |
| <b>Common Stock</b>         | <b>New York Stock Exchange</b>                    |

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

**None**

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

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  No

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

Indicate by check mark 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.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The aggregate market value of the registrant's voting stock held by non-affiliates of the registrant at June 30, 2005, based on the closing price of such stock on the New York Stock Exchange on such date, was approximately \$305,000,000.

The number of shares of the registrant's common stock outstanding on February 28, 2006 was 14,909,229.

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**EXPLANATORY STATEMENT**

**Why we are filing this Amendment to our Form 10-K**

We are filing this amendment to our Annual Report on Form 10-K for the fiscal year ended December 31, 2005 ( 2005 10-K ) of Trex Company, Inc. (the Company ) to restate the Company s consolidated financial statements and related disclosures in order to correct errors in the recording of certain expenses in cost of sales, selling, general and administrative expenses, and interest expense. The errors related to the improper recording of the receipt of goods and services, the timing of cost capitalization, the calculation of depreciation and capitalized interest, the timing of recording certain liabilities, the improper recording of cash disbursements, the valuation of raw material inventory, and the calculation of the allowance for doubtful accounts and miscellaneous receivables.

This amendment includes the Company s restated consolidated balance sheets as of December 31, 2004 and 2005 and its restated statements of operations, stockholders equity and cash flows for the fiscal years ended December 31, 2003, 2004, and 2005. The amendment also restates the quarterly financial information previously included in Note 14 to the consolidated financial statements with respect to the fiscal quarters ended March 31, 2004 and 2005, June 30, 2004 and 2005, September 30, 2004 and 2005 and December 31, 2004 and 2005. The Company does not intend to amend its Quarterly Reports on Form 10-Q for these fiscal quarters.

The restatement adjustments had the cumulative effect of increasing the Company s reported net income for the fiscal years ended December 31, 2003 through 2005 by \$0.2 million. For the fiscal years ended December 31, 2003 and 2004, the Company s reported net income increased as a result of the restatement adjustments by \$0.1 million and \$0.3 million, respectively, or \$0.00 and \$0.02 per diluted share, respectively. For the fiscal year ended December 31, 2005, the Company s reported net income decreased as a result of the restatement by \$0.2 million, or \$0.02 per diluted share.

**Amended Items of Form 10-K**

We are amending the following items of our 2005 10-K:

|         |         |   |
|---------|---------|---|
| Part II | Item 6  | Selected Financial Data   |
| Part II | Item 7  | Management s Discussion and Analysis of Financial Condition and Results of Operations |
| Part II | Item 8  | Financial Statements and Supplementary Data   |
| Part II | Item 9A | Controls and Procedures   |
| Part IV | Item 15 | Exhibits and Financial Statement Schedules  |

**All information not affected by the restatement is unchanged**

We have not changed any information included in our 2005 10-K that is not affected by the restatement. Accordingly, the information included in our 2005 10-K and included in this amendment that is not affected by the restatement describes conditions as they existed and were presented in our 2005 10-K at the time we filed that report with the Securities and Exchange Commission on March 16, 2006. We have not taken into account any other events occurring after the original filing of our 2005 10-K that might have affected those disclosures, nor have we modified or updated those disclosures, including the exhibits to our 2005 10-K, to reflect any other subsequent events. We will also be filing amendments to our Quarterly Reports on Form 10-Q for the fiscal quarters ended March 31, 2006, June 30, 2006 and September 30, 2006. Accordingly, in conjunction with reading this amendment to our 2005 10-K, you should also read our amendments to those Quarterly Reports on Form 10-Q/A, and all other filings we have made with the Securities and Exchange Commission since March 16, 2006.

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**Table of Contents****PART II****Item 6. Selected Financial Data**

The selected financial data for the fiscal years ended December 31, 2003, 2004 and 2005 set forth in this Item 6 have been restated to reflect adjustments to our consolidated financial statements and other financial information contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, originally filed with the Securities and Exchange Commission ( SEC ) on March 16, 2006 (the 2005 10-K ). The following selected financial data should be read in conjunction with our restated consolidated financial statements and the related notes to consolidated financial statements.

|   | Year Ended December 31,                         |            |                 |                 |                 |
|---|---|------------|-----------------|-----------------|-----------------|
|   | 2001  | 2002       | 2003            | 2004            | 2005            |
|   |   |            | As Restated (2) | As Restated (2) | As Restated (2) |
|   | (In thousands, except share and per share data) |            |                 |                 |                 |
| <b>Statement of Operations Data:</b>            |   |            |                 |                 |                 |
| Net sales                                       | \$ 116,860                                      | \$ 167,079 | \$ 191,008      | \$ 253,628      | \$ 294,133      |
| Cost of sales                                   | 67,973  | 90,479     | 107,110         | 150,793         | 213,897         |
| Gross profit                                    | 48,887  | 76,600     | 83,898          | 102,835         | 80,236          |
| Selling, general and administrative expenses    | 31,801  | 42,150     | 46,829          | 56,351          | 77,398          |
| Income from operations                          | 17,086  | 34,450     | 37,069          | 46,484          | 2,838           |
| Interest expense, net                           | 3,850   | 7,782      | 3,560           | 3,064           | 2,606           |
| Income before income taxes                      | 13,236  | 26,668     | 33,509          | 43,420          | 232             |
| Provision (benefit) for income taxes            | 4,186   | 9,891      | 12,429          | 15,933          | (2,019)         |
| Net income                                      | \$ 9,050  | \$ 16,777  | \$ 21,080       | \$ 27,487       | \$ 2,251        |
| Basic earnings per share                        | \$ 0.64   | \$ 1.18    | \$ 1.45         | \$ 1.88         | \$ 0.15         |
| Basic weighted average shares outstanding       | 14,145,660                                      | 14,166,307 | 14,522,092      | 14,636,959      | 14,769,799      |
| Diluted earnings per share                      | \$ 0.64   | \$ 1.16    | \$ 1.43         | \$ 1.85         | \$ 0.15         |
| Diluted weighted average shares outstanding     | 14,182,457                                      | 14,481,234 | 14,727,838      | 14,834,718      | 14,879,661      |
| <b>Cash Flow Data:</b>                          |   |            |                 |                 |                 |
| Cash provided by operating activities           | \$ 7,004  | \$ 52,964  | \$ 5,617        | \$ 45,265       | \$ 11,234       |
| Cash used in investing activities               | (31,972)  | (6,192)    | (17,727)        | (56,319)        | (29,374)        |
| Cash provided by (used in) financing activities | 24,968  | (31,879)   | 5,379           | 26,859          | (4,432)         |
| <b>Other Data (unaudited):</b>                  |   |            |                 |                 |                 |
| EBITDA (1)                                      | \$ 25,709                                       | \$ 44,039  | \$ 49,608       | \$ 60,197       | \$ 18,977       |
| <b>Balance Sheet Data:</b>                      |   |            |                 |                 |                 |
| Cash and cash equivalents and restricted cash   | \$  | \$ 14,893  | \$ 8,162        | \$ 44,926       | \$ 1,395        |
| Working capital                                 | 3,216   | 24,134     | 49,728          | 78,910          | 40,061          |
| Total assets                                    | 184,637   | 183,556    | 210,391         | 286,772         | 285,714         |
| Total debt                                      | 86,094  | 55,196     | 54,376          | 78,497          | 73,606          |
| Total stockholder's equity                      | 81,985  | 98,775     | 127,297         | 159,937         | 164,708         |

(1)

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EBITDA represents net income before interest, income taxes, depreciation and amortization. EBITDA is not a measurement of financial performance under accounting principles generally accepted in the United States, or GAAP. The company has included data with respect to EBITDA because management evaluates and projects the performance of the company's business using several measures, including EBITDA. Management considers EBITDA to be an important supplemental indicator of the company's operating performance, particularly as compared to the operating performance of the company's competitors, because this measure eliminates many differences among companies in capitalization and tax structures, capital investment cycles and ages of related assets, as well as some recurring non-cash and non-operating charges to net income or loss. For these

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reasons, management believes that EBITDA provides important supplemental information to investors regarding the operating performance of the company and facilitates comparisons by investors between the operating performance of the company and the operating performance of its competitors. Management believes that consideration of EBITDA should be supplemental, because EBITDA has limitations as an analytical financial measure. These limitations include the following:

EBITDA does not reflect the company's cash expenditures, or future requirements for capital expenditures, or contractual commitments;

EBITDA does not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on the company's indebtedness;

although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and EBITDA does not reflect any cash requirements for such replacements;

EBITDA does not reflect the effect of earnings or charges resulting from matters the company considers not to be indicative of its ongoing operations; and

not all of the companies in the company's industry may calculate EBITDA in the same manner in which the company calculates EBITDA, which limits its usefulness as a comparative measure.

The company compensates for these limitations by relying primarily on its GAAP results to evaluate its operating performance and by considering independently the economic effects of the foregoing items that are not reflected in EBITDA. As a result of these limitations, EBITDA should not be considered as an alternative to net income, as calculated in accordance with GAAP, as a measure of operating performance, nor should it be considered as an alternative to cash flows as a measure of liquidity. The following table sets forth, for the years indicated, a reconciliation of EBITDA and net income. The applicable amounts shown in the table have been restated as described in Note 2 to the company's consolidated financial statements appearing elsewhere in this report.

|                                       | Year Ended December 31, |                  |                        |                        |                        |
|---------------------------------------|-------------------------|------------------|------------------------|------------------------|------------------------|
|                                       | 2003                    | 2004             | 2005                   | 2006                   | 2007                   |
|                                       | <b>2001</b>             | <b>2002</b>      | <b>As Restated (2)</b> | <b>As Restated (2)</b> | <b>As Restated (2)</b> |
|                                       | (In thousands)          |                  |                        |                        |                        |
| Net income                            | \$ 9,050                | \$ 16,777        | \$ 21,080              | \$ 27,487              | \$ 2,251               |
| Plus interest expense, net            | 3,850                   | 7,782            | 3,560                  | 3,064                  | 2,606                  |
| Plus income taxes provision (benefit) | 4,186                   | 9,891            | 12,429                 | 15,933                 | (2,019)                |
| Plus depreciation and amortization    | 8,623                   | 9,589            | 12,539                 | 13,713                 | 16,139                 |
| <b>EBITDA</b>                         | <b>\$ 25,709</b>        | <b>\$ 44,039</b> | <b>\$ 49,608</b>       | <b>\$ 60,197</b>       | <b>\$ 18,977</b>       |

(2) See Note 2 to the Company's consolidated financial statements appearing elsewhere in this report.

**Table of Contents****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 contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. We intend our forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. All statements regarding our expected financial position and operating results, our business strategy, our financing plans, forecasted demographic and economic trends relating to our industry and similar matters are forward-looking statements. These statements can sometimes be identified by our use of forward-looking words such as may, will, anticipate, estimate, expect or intend. We cannot promise you that our expectations in such forward-looking statements will turn out to be correct. Our actual results could be materially different from our expectations because of various factors, including the factors discussed under Item 1A. Risk Factors in this report.*

**Restatement**

On January 26, 2007, the Audit Committee of the company's Board of Directors concluded, based upon the recommendation of the company's management that, to correct certain errors, the company should restate its financial results, including quarterly results, for its fiscal years ended December 31, 2003, 2004 and 2005 and its quarterly results for the first nine months of its fiscal year ended December 31, 2006. Accordingly, we have restated our financial statements to correct these errors, as described more fully in Note 2 of the consolidated financial statements in this Form 10-K/A. The restatement adjustments have the cumulative effect of increasing the company's reported net income for fiscal 2003 through 2005 by \$0.2 million. For the fiscal years ended December 31, 2003 and 2004, the company's reported net income increased as a result of the restatement adjustments by \$0.1 million and \$0.3 million, respectively, or \$0.00 and \$0.02 per diluted share, respectively. For the fiscal year ended December 31, 2005, the company's reported net income decreased as a result of the restatement by \$0.2 million, or \$0.02 per diluted share. This Management's Discussion and Analysis of Financial Condition and Results of Operations has been modified and updated principally to reflect the effect of these restatements.

The amendment also includes restated quarterly financial information in Note 14 to the consolidated financial statements with respect to the fiscal quarters ended March 31, 2004 and 2005, June 30, 2004 and 2005, September 30, 2004 and 2005 and December 31, 2004 and 2005.

**Overview**

*General.* Management considers growth in net sales, gross margin, selling, general and administrative expenses, and net income as key indicators of our operating performance. Growth in net sales reflects consumer acceptance of composite decking, the demand for Trex over competing products, the success of our branding strategy, the effectiveness of our distributors, and the strength of our dealer network and contractor franchise. Management emphasizes gross margin as a key measure of performance because it reflects the company's ability to price its products accurately and to manage effectively its manufacturing unit costs. Managing selling, general and administrative expenses is important to support profitable growth. The company's investment in research and development activities, which is included in selling, general and administrative expenses, enables it to enhance manufacturing operations, develop new products and evaluate new technologies. Management considers net income to be a measure of the company's overall financial performance.

In the last two years, the company has expanded its product offerings by introducing the Trex Accents and Trex Brasilia decking product lines and the new Trex Designer Series Railing product. Sales of the Trex Accents product, which was launched in the fourth quarter of 2003, accounted for approximately 51% of total gross sales in 2005. Sales of the Trex Brasilia product, which was introduced in the fourth quarter of 2004, accounted for approximately 7% of total gross sales in 2005. Because these new products have a higher price per unit, the introduction of the products into the sales mix has a positive effect on total revenue.

The management of raw materials costs, the strengthening of manufacturing performance and the enhancement of product quality constitute some of the company's principal operating objectives. In 2005, manufacturing unit costs increased primarily because of higher costs for reclaimed polyethylene, or PE material, and lower manufacturing plant utilization resulting in part from the temporary suspension of operations of some production lines. The company expects that new PE material sourcing and purchasing initiatives will be necessary for it to manage effectively its costs of PE material in future periods. The company curtailed operation of approximately 35% of its manufacturing capacity in the second half of 2005 in order to balance finished goods inventory levels with product demand. The resulting reduction in production output contributed to higher manufacturing costs by reducing the absorption of fixed manufacturing costs. The company continues to focus on product quality initiatives to enhance the appearance and overall quality of the entire product line. These initiatives emphasize color consistency and other product specifications. In addition, each manufacturing plant has added personnel to its inspection functions and finished goods packaging has been redesigned to minimize damage to the product in transit. These initiatives have contributed to higher manufacturing costs by reducing manufacturing line efficiencies, as well as increasing labor and raw material costs.





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The company continues to support its branding efforts through advertising campaigns in print publications and on television. These expenditures supported a new, more extensive advertising campaign inaugurated by the company in the first quarter of 2005. Branding expenditures in 2005 increased \$7.6 million over 2004.

*Net Sales.* Net sales consists of sales and freight, net of returns and discounts. The level of net sales is principally affected by sales volume and the prices paid for Trex. The company's branding and product differentiation strategy enables it to command premium prices over wood and to maintain price stability for Trex. To ensure adequate availability of product to meet anticipated seasonal consumer demand, the company historically has provided its distributors and dealers incentives to build inventory levels before the start of the prime deck-building season. These incentives include prompt payment discounts or extended payment terms. In addition, the company from time to time may offer price discounts on specified products and other incentives based on increases in distributor sales volumes as part of specific promotional programs.

There are no product return rights granted to the company's distributors except those granted pursuant to the warranty provisions of the company's agreement with its distributors. Under such warranty provisions, the company warrants that its products will be free from defects in workmanship and materials and will conform to the company's standard specifications for its products in effect at the time of the shipment. If there is such a defect in any of its products, the company has an obligation under its warranty to replace the products. On some occasions, the company will voluntarily replace products for distributors as a matter of distributor relations, even though the company does not have a legal obligation to do so. Product returns were not material to net sales in fiscal years 2003, 2004 or 2005.

Under the company's limited warranty with consumers, the company warrants that its products will be free from material defects in workmanship and material and will not check, split, splinter, rot or suffer structural damage from termites or fungal decay. If there is such a defect in any of its products, the company has an obligation either to replace the defective product or refund the purchase price, in either case without any payment for labor to replace the defective product or freight. Warranty costs have not been material during fiscal year 2003, 2004 or 2005. On some occasions, the company will voluntarily replace a product or refund a portion of the purchase price to consumers as a matter of consumer relations, even though the company does not have a legal obligation to do so. The company considers on a case-by-case basis each situation in which it may effect such a discretionary replacement or refund.

*Gross Profit.* Gross profit represents the difference between net sales and cost of sales. Cost of sales consists of raw materials costs, direct labor costs, manufacturing costs and freight. Raw materials costs generally include the costs to purchase and transport waste wood fiber, PE material and pigmentation for coloring Trex products. Direct labor costs include wages and benefits of personnel engaged in the manufacturing process. Manufacturing costs consist of costs of depreciation, utilities, maintenance supplies and repairs, indirect labor, including wages and benefits, and warehouse and equipment rental activities.

*Selling, General and Administrative Expenses.* The largest components of selling, general and administrative expenses are branding and other sales and marketing costs, which have increased significantly as the company has sought to build brand awareness of Trex in the decking and railing market. Sales and marketing costs consist primarily of salaries, commissions and benefits paid to sales and marketing personnel, advertising expenses and other promotional costs. General and administrative expenses include salaries and benefits of personnel engaged in research and development, procurement, accounting and other business functions, office occupancy costs attributable to these functions, and professional fees. As a percentage of net sales, selling, general and administrative expenses have varied from quarter to quarter due, in part, to the seasonality of the company's business.

We have not yet determined the impact the adoption of SFAS No. 123R will have on our results of operations. The adoption of SFAS No. 123R is expected to result in compensation expense that will reduce our net income. The amount of the reduction in net income will depend on a number of factors, including the number of options granted, the vesting periods of options granted, our stock price and volatility, and employee exercise behaviors. For information about SFAS No. 123R, see note 3 to our consolidated financial statements appearing elsewhere in this report.

### **Critical Accounting Policies, Estimates and Risks and Uncertainties**

Our significant accounting policies are described in note 3 to our consolidated financial statements appearing elsewhere in this report. Critical accounting policies include the areas where we have made what we consider to be particularly difficult, subjective or complex judgments in making estimates, and where these estimates can significantly affect our financial results under different assumptions and conditions. We prepare our financial statements in conformity with accounting principles generally accepted in the United States. As a result, we are required to make estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the periods presented. Actual results could be different from these estimates.



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*Inventories.* The company accounts for its inventories at the lower of cost (last-in, first-out, or LIFO) or market value. The company believes that its current inventory of finished goods will be saleable in the ordinary course of business and, accordingly, has not established significant reserves for estimated slow moving products or obsolescence. The company has written down certain finished goods inventory that does not meet the company's new quality standards to its estimated market value. The company has also written down the estimated portion of PE material and other raw materials that are not consumable to its estimated market value. At December 31, 2005, the excess of the replacement cost of inventory over the LIFO value of inventory was approximately \$24.7 million. The company cannot estimate at this time the effect of future reductions, if any, in inventory levels on its future operating results. The company currently anticipates that inventory levels will increase in 2006.

*Property, Plant and Equipment.* At December 31, 2005, the company's construction in process totaled approximately \$24.5 million. The construction in process consisted primarily of funds expended to complete production lines in various stages of construction at the Winchester, Fernley and Olive Branch manufacturing sites and to construct plastic reprocessing equipment. The company currently expects that the production lines in process will be completed and put into service by mid-2007. Pursuant to Statement of Financial Accounting Standards, or SFAS, No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable, the company compares the carrying values of its long-lived assets, including construction in process, against the estimated undiscounted cash flows relating to those assets. Actual results could differ from those estimates. In such event, the carrying value and the estimated useful lives of the company's long-lived assets could be reduced in the future.

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets. The depreciable lives of these assets range from five to 40 years. We make estimates of the useful lives, in part, based upon historical performance of similar assets. We periodically review the remaining estimated useful lives of our property, plant and equipment to determine if any revisions to our estimates are necessary. Changes to our estimate of the useful lives of our property, plant and equipment could have a material effect on our financial position or results of operations.

*Contingencies and Other Liabilities.* In July 2005, in anticipation of relocating its corporate headquarters to Dulles, Virginia, the company entered into a new lease agreement. The lease agreement provides for the initial occupancy of approximately 50,000 square feet of office space, which will increase during the lease term to approximately 75,000 square feet. The company has reconsidered its decision to relocate its corporate headquarters and has decided not to move the headquarters. Minimum payments under the lease over the years ending December 31, 2006, 2007, 2008, 2009, and 2010 are \$0.7 million, \$1.1 million, \$1.5 million, \$1.5 million and \$1.6 million, respectively, and \$19.8 million thereafter. The company is currently attempting to sublet the Dulles, Virginia office space. Based on current market conditions, the company estimates that the present value of the estimated future sublease rentals, net of transaction costs, will be greater than the company's remaining minimum lease obligations under its lease agreement and, accordingly, has not recorded a loss related to the lease as of December 31, 2005.

The company's assumptions in estimating future sublease income included consideration of vacancy rates, rental rates and the timing of future sublease income. Vacancy rates in the area where the property is located were approximately 10% at December 31, 2005. Management believes that the rental rates in the company's lease reflect the current market rates in the area. Anticipated delivery of a limited amount of new office space in the area over the next 12 months may cause vacancy rates and rental rates in the short term to remain at current levels. The inability to sublet the office space or unfavorable changes to key management's assumptions used in the estimate of the future sublease income may result in charges in future periods.

The company is subject, from time to time, to various lawsuits and other claims related to patent infringement, product liability and other matters. The company is required to assess the likelihood of any adverse judgments or outcomes to these matters as well as potential ranges of probable losses. The company makes a determination of the amount of reserves required, if any, for these contingencies after an analysis of each lawsuit and claim. The required reserves may change in the future as a result of new developments in any such matter or changes in approach, such as a change in settlement strategy in dealing with a particular matter. In the opinion of management, adequate provision has been made for any probable losses as of December 31, 2005. The company's provisions for probable losses have not materially affected the company's operating results in any annual period presented in this report.

*Revenue Recognition.* The company recognizes revenue when title is transferred to customers, which is generally upon shipment of the product to the customer from the company's manufacturing facilities. Pursuant to Emerging Issues Task Force Issue 00-10, Accounting for Shipping and Handling Fees and Costs, the company records all shipping and handling fees in net sales and records all of the related costs in cost of sales. The company offers several programs to dealers and distributors, including cash rebates, sales incentives and cooperative advertising. The company accounts for these programs as either reductions to sales or as selling, general and administrative expenses in accordance with EITF Issue 01-09, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products). The company classifies cash rebates as a reduction in revenue. Cash rebates are recorded in the period in which the related revenue is recognized. Sales incentives are accrued based upon estimates of the amounts that will be earned by customers. Cooperative advertising costs are classified in selling, general and administrative expenses and are accrued as the related advertising expenditures are incurred.



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*Valuation of Deferred Tax Assets.* The company provides for valuation allowances against its deferred tax assets in accordance with the requirements of SFAS No. 109, Accounting for Income Taxes. At December 31, 2005, the company had a valuation allowance of \$1.4 million related primarily to uncertainty regarding the recoverability of certain state tax credit carryforwards and incentives. The company has considered all available evidence, including its historical levels of taxable income, the future reversal of existing taxable temporary differences, estimated future taxable income for each applicable state, and the expiration period of tax credit carryforwards, in determining the need for a valuation allowance. Based upon this analysis, management determined that it is more likely than not that certain state tax credit carryforwards will expire unused and, accordingly, recorded a valuation allowance for such credit carryforwards. It is possible that the facts underlying the company's estimates and assumptions may not materialize in future periods, which may require the company to record additional deferred tax valuation allowances, or to reduce previously recorded valuation allowances.

**Results of Operations**

The following table shows, for the last three years, selected statement of operations data as a percentage of net sales:

|  | Year Ended December 31, |                 |                 |
|--|-------------------------|-----------------|-----------------|
|  | 2003                    | 2004            | 2005            |
|  | As Restated (1)         | As Restated (1) | As Restated (1) |
| Net sales                                    | 100.0%                  | 100.0%          | 100.0%          |
| Cost of sales                                | 56.1                    | 59.5            | 72.7            |
| Gross profit                                 | 43.9                    | 40.5            | 27.3            |
| Selling, general and administrative expenses | 24.5                    | 22.2            | 26.3            |
| Income from operations                       | 19.4                    | 18.3            | 1.0             |
| Interest expense, net                        | 1.9                     | 1.2             | 0.9             |
| Income before taxes and extraordinary item   | 17.5                    | 17.1            | 0.1             |
| Provision (benefit) for income taxes         | 6.5                     | 6.3             | (0.7)           |
| Net income                                   | 11.0%                   | 10.8%           | 0.8%            |

(1) See Note 2 to the company's consolidated financial statements appearing elsewhere in this report.  
**2005 Compared to 2004**

*Net Sales.* Net sales increased 16.0% to \$294.1 million in 2005 from \$253.6 million in 2004. The increase in net sales was primarily attributable to an increase in price per unit and, to a lesser extent, a 3% growth in sales volume as a result of an increase in demand from dealers and distributors. The increase in price per unit resulted from a price increase, effective on April 1, 2005, of 8% on decking and railing products and from increased sales of higher unit priced products. The company offered various sales incentives to its distributor customers during both 2004 and 2005. The company has historically utilized an annual early buy sales program to create an incentive for distributors and dealers to commit to purchase Trex products before the start of the decking season. The company's early buy program in 2004 and 2005 included extended payment terms for purchases in the first four months of each year. The payment options provided in the 2004 early buy program included prompt payment discounts from 0.5% to 3.0% or extended payment terms from 30 to 90 days. The payment options provided in the 2005 early buy program included prompt payment discounts from 1.0% to 2.0% or extended payment terms from 45 to 90 days. In addition, in the fourth quarter of 2004, the company granted extended payment terms of up to 120 days on shipments in the fourth quarter to support new product introductions and to encourage distributors to start stocking inventory for the upcoming decking season. These incentives were not offered in the fourth quarter of 2005.

*Gross Profit.* Gross profit decreased 22.0% to \$80.2 million in 2005 from \$102.8 million in 2004. The decrease was primarily attributable to higher unit manufacturing costs, which resulted principally from the increased cost of raw materials, particularly PE material. Gross profit as a percentage of net sales, or gross margin, decreased to 27.3% in 2005 from 40.5% in 2004. The increased cost of PE material resulted in a decrease in gross margin of approximately 9.8% from 2004. Gross margin was also adversely affected by a decrease in production rates due to

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product quality initiatives and lower capacity utilization and the associated decrease in absorption of fixed manufacturing expenses which contributed to an 8.3% decrease in gross margin. At December 31, 2005, as part of its product quality initiatives, the company wrote down certain finished goods inventory by \$0.8 million to the estimated market

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value. These initiatives also resulted in \$0.7 million of incremental labor and packaging costs in 2005. In addition, the company separately wrote down \$0.7 million of PE material and other raw materials to the estimated market value. During 2004, the company wrote down \$0.1 million of finished goods inventory to the estimated market value. The negative effect of the foregoing factors on gross margin in 2005 was offset, in part, by the positive impact on gross margin of 7.6% from increased sales prices and increased sales of higher margin priced products.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses increased 37.3% to \$77.4 million in 2005 from \$56.4 million in 2004. The higher selling, general and administrative expenses resulted principally from increases of \$7.6 million in sales and marketing costs, \$6.6 million in corporate personnel expenses, \$4.8 million in consumer relations expenses, \$2.7 million in professional expenses and \$2.0 million in hiring and relocation expenses. The increased sales and marketing costs consisted primarily of branding costs, which include expenses of promotion, advertising, public relations, sales literature, trade shows and cooperative advertising. Selling, general and administrative expenses in 2005 also included the write-off of \$1.0 million in equipment that the company disposed of during 2005 in connection with the retooling of certain production lines. The increase in the foregoing components of selling, general and administrative expenses was partially offset by a decrease of \$2.9 million in profit sharing and management bonus expenses, as a result of decreased profitability in 2005. Selling, general and administrative expenses as a percentage of net sales increased to 26.3% in 2005 from 22.2% in 2004.

*Interest Expense.* Net interest expense decreased to \$2.6 million in 2005 from \$3.1 million in 2004. The decrease was primarily attributable to an increase in the amount of interest capitalized on construction in process and a reduction in interest expense on the company's senior notes. The reduced senior note interest expense reflected a decrease in outstanding borrowings following the company's payment in June 2005 of the first of five scheduled \$8.0 million principal payments. The company capitalized \$2.2 million of interest in 2005 and \$1.3 million of interest in 2004. These effects were offset in part by additional interest expense related to the \$25.0 million variable rate promissory note that the company issued in December 2004. Total interest under the promissory note totaled \$0.9 million in 2005.

*Provision for Income Taxes.* The provision for income taxes decreased to \$(2.0) million in 2005 (net benefit) from \$15.9 million in 2004 (net expense). The provision reflected a benefit of approximately 870.1% in 2005 compared to tax expense of approximately 36.7% in 2004. The change in the 2005 effective rate was primarily due to the impact of state taxes. For 2005, the tax provision consisted of federal tax expense of approximately \$0.4 million, which was offset by a state tax benefit of \$2.4 million. The state tax benefit resulted from the expansion of the company's operations into Mississippi and the recognition of certain other state tax credits and incentives. At December 31, 2005 and 2004, the company had income tax refunds receivable of \$8.2 million and \$0.3 million, respectively. The increase in the income tax receivable resulted from the amendment of certain prior year tax returns and from the overpayment of taxes during early 2005 that resulted from lower than estimated taxable income.

**2004 Compared to 2003**

*Net Sales.* Net sales increased 32.8% to \$253.6 million in 2004 from \$191.0 million in 2003. The increase in net sales was primarily attributable to an 18% growth in sales volume as a result of an increase in demand from dealers and distributors and, to a lesser extent, to an increase in price per unit. The increase in price per unit resulted from a price increase, effective on May 1, 2004, of 5% on decking products and 9% on railing products and, to a lesser extent, from increased sales of higher unit priced products. The company offered sales incentives to its distributor customers during 2003 and 2004. The company has historically utilized an annual early buy sales program to create an incentive for distributors and dealers to commit to purchase Trex products before the start of the decking season. The company's early buy program in 2004 included extended payment terms for purchases in the first four months of the year. The payment options provided in the 2004 early buy program included prompt payment discounts from 0.5% to 3.0% or extended payment terms from 30 to 90 days. The early buy program in 2003 included prompt payment discounts from 1.0% to 2.0%, but did not include an extended payment term option. In the 2003 and 2004 fourth quarters, the company granted extended payment terms of up to 90 days on shipments in the fourth quarter to distributors to support the introduction of new products. The company offered additional incentives in the 2004 fourth quarter to encourage distributors to start stocking inventory for the upcoming decking season. The incentives included extended payment terms of 120 days for shipments in December 2004.

*Gross Profit.* Gross profit increased 22.6% to \$102.8 million in 2004 from \$83.9 million in 2003. The increase was primarily attributable to the higher net sales volume, increased sale prices and increased sales of higher unit priced products. The effect of these factors was offset in part by higher unit manufacturing costs, which resulted from the increased cost of raw materials, including PE material and additives. Gross margin decreased to 40.5% in 2004 from 43.9% in 2003. The increased cost of raw materials contributed to a decrease in gross margin of approximately 5.9% from 2003. Gross margin was also adversely affected by a decrease in production rates due to product quality initiatives and the associated decrease in absorption of fixed manufacturing expenses, which contributed to a 2.7% decrease in gross margin. The negative effect of the foregoing factors on gross margin in 2004 was offset by the positive impact on gross margin of 6.3% from increased sales prices and increased sales of higher margin priced products.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses increased 20.3% to \$56.4 million in 2004 from \$46.8 million in 2003. The higher selling, general and administrative expenses resulted in part from increases of \$4.2





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million in corporate personnel expenses, \$2.3 million in sales and marketing costs, \$1.8 million in legal and professional expenses and \$1.3 million in research and development expenses. The increased sales and marketing costs consisted primarily of branding costs, which include expenses of promotion, advertising, consumer relations, sales literature, trade shows and cooperative advertising. The increased legal and professional expenses resulted primarily from the settlement of class action litigation. Selling, general and administrative expenses as a percentage of net sales decreased to 22.2% in 2004 from 24.5% in 2003.

*Interest Expense.* Net interest expense decreased to \$3.1 million in 2004 from \$3.6 million in 2003. Increased interest income, resulting from higher cash balances, and an increase in the amount of interest capitalized on construction in process contributed to lower net interest expense in 2004. The company capitalized \$1.3 million of interest in 2004 and \$1.1 million of interest in 2003.

*Provision for Income Taxes.* The provision for income taxes increased to \$15.9 million in 2004 from \$12.4 million in 2003. The increase was primarily attributable to an increase in pretax income. The effective tax rate was approximately 36.7% in 2004 compared to approximately 37.1% in 2003. The decrease in the effective rate in 2004 related primarily to a decrease in non-deductible expenses.

**Liquidity and Capital Resources**

The company finances its operations and growth primarily with cash flow from operations, borrowings under its credit facility and other loans, operating leases and normal trade credit terms.

*Sources and Uses of Cash.* The company's cash provided by operating activities was \$5.6 million in 2003, \$45.3 million in 2004 and \$11.2 million in 2005. In 2003, the effects on cash flows of a higher net sales volume were more than offset by increases in inventory levels and receivables. In 2004, the effects on cash flows of a higher net sales volume and increases in accounts payable and accrued expenses were offset, in part, by increases in receivables. In 2005, the effects on cash flows of a higher net sales volume and lower receivables were more than offset by lower profitability and an increase in inventories and income tax payments. Net income in 2005 decreased 91.8%, or \$25.2 million, from 2004. Accounts receivable decreased \$9.6 million from \$22.0 million at December 31, 2004 to \$12.4 million at December 31, 2005, compared to an increase of \$16.1 million from \$5.9 million at December 31, 2003 to \$22.0 million at December 31, 2004. The reduced use of cash in 2005 to support accounts receivable was attributable to the effect of a higher than historical level of accounts receivable at December 31, 2004. The higher accounts receivable balance at December 31, 2004 resulted from the extended payment terms offered to customers in the fourth quarter of 2004 to facilitate new product introductions and to provide additional incentives to customers to meet early season demand. The company did not offer this type of program in the fourth quarter of 2005. The company's total inventories, including raw materials and finished goods, increased \$12.6 million from \$44.3 million at December 31, 2004 to \$56.9 million at December 31, 2005 compared to a decrease of \$1.6 million from \$45.9 million at December 31, 2003 to \$44.3 million at December 31, 2004. Raw materials inventories increased \$6.3 million from \$11.8 million at December 31, 2004 to \$18.1 million at December 31, 2005 compared to an increase of \$2.1 million from \$9.7 million at December 31, 2003 to \$11.8 million at December 31, 2004. Finished goods inventories increased \$6.2 million from \$32.6 million at December 31, 2004 to \$38.8 million at December 31, 2005 compared to a decrease of \$3.6 million from \$36.2 million at December 31, 2003 to \$32.6 million at December 31, 2004. The company's inventories increased in 2005 primarily as a result of production at the new Olive Branch manufacturing facility and the company's expanded product offerings. Income tax receivables increased to \$8.2 million at December 31, 2005 from \$0.3 million at December 31, 2004 primarily due to the overpayment of income taxes during the first half of 2005. The company expects to receive refunds of such taxes in 2006.

The company's cash used in investing activities totaled \$17.7 million in 2003, \$56.3 million in 2004 and \$29.4 million in 2005 and primarily related to expenditures for the purchase of property, plant and equipment to support extension of the company's manufacturing capacity, including its third manufacturing facility in Olive Branch, Mississippi in 2004 and 2005.

The company's cash provided by (used in) financing activities was \$5.4 million in 2003, \$26.9 million in 2004 and \$(4.4) million in 2005. In 2004, the company received \$25.0 million in proceeds from borrowings, as described below, which were used to fund a portion of the construction and equipment costs associated with its third manufacturing site. In June 2005, the company paid the first of five scheduled \$8.0 million principal payments on its senior notes. At December 31, 2005, there were \$4.1 million of borrowings outstanding under the company's revolving credit facility.

*Indebtedness.* At December 31, 2005, the company's indebtedness totaled \$74.4 million and the annualized overall weighted average interest rate of such indebtedness was approximately 6.2%.

On June 19, 2002, the company refinanced total indebtedness of \$47.6 million outstanding under a senior bank credit facility and various real estate loans. The company refinanced this indebtedness with the proceeds from its sale of \$40.0 million principal amount of senior notes due June 19, 2009 and borrowings under new real estate loans having a principal amount of \$12.6 million. In connection with the refinancing, the

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company replaced its existing revolving credit facility with a \$20.0 million revolving credit facility with a new lender. Borrowings under the revolving credit facility and the senior notes were secured by liens on substantially all of the company's assets. These liens were subsequently released in connection with the 2004 refinancing described below. The senior notes, which were privately placed with institutional investors, accrue interest at an annual rate of 8.32%. Five principal payments of \$8.0 million annually to retire the notes began in June 2005.

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On September 30, 2004, the company amended its \$20.0 million revolving credit facility and certain real estate loans. The amendment extended the maturity date of the revolving credit facility from June 30, 2005 to September 30, 2007 and the maturity date of the real estate loans from June 30, 2005 to September 30, 2009. The revolving credit facility and real estate loans accrue interest at annual rates equal to the specified London Interbank Offered Rate, or LIBOR, plus specified margins. The specified margins are determined based on the company's ratio of total consolidated debt to consolidated earnings before interest, taxes, depreciation and amortization, as computed under the credit facility. The amendment reduced the margins for the credit facility from a range of 1.50% to 3.25% to a range of 1.25% to 1.75% and the real estate loans from a range of 1.75% to 3.50% to a range of 1.50% to 2.50%. Under the amendment, the lender and the holders of the senior notes described above released their liens on the company's assets under the revolving credit facility and the senior notes. The amendment also made less restrictive some of the negative and financial covenants in the revolving credit facility.

The company's ability to borrow under the revolving credit facility is tied to a borrowing base that consists of certain receivables and inventories. At December 31, 2005, the borrowing base was \$43.0 million and \$4.1 million of borrowings were outstanding under the facility.

On December 16, 2004, the company borrowed, under a variable rate promissory note, \$25.0 million of the proceeds from the sale of variable rate demand environmental improvement revenue bonds issued by the Mississippi Business Finance Corporation, a Mississippi public corporation. The bonds restricted the company's use of the proceeds to financing all or a portion of the costs of the acquisition, construction and equipping of solid waste disposal facilities to be used in connection with the company's new manufacturing facility, which is located in Olive Branch, Mississippi. The bonds are special, limited obligations of the issuer and, unless sooner paid pursuant to redemption or other specified principal payment event, will mature on December 1, 2029. Under its loan agreement with the bond issuer, the company is obligated to make payments sufficient to pay the principal of, premium, if any, and interest on the bonds when due. The company's obligation to make these payments will be satisfied to the extent of payments made to the trustee of the bonds under a \$25.3 million letter of credit opened for the company's account. The company is obligated under a reimbursement agreement to reimburse the letter of credit bank for drawings made under the letter of credit and to make other specified payments. Interest on the bonds will initially be paid each month at a variable rate established on a weekly basis. The variable rate on the bonds was 3.63% on December 31, 2005. The note interest rate is based on auction rates and is reset every seven days. The reimbursement agreement contains affirmative covenants and negative covenants which, among other things, restrict the company's ability to incur additional indebtedness and liens, engage in any consolidation, merger or sale of assets outside the ordinary course of business, and make specified investments, loans or advances. The company's obligations under the reimbursement agreement are secured by a first priority security interest in specified assets relating to the third manufacturing site and facility.

Effective for December 31, 2005, the company entered into amendments to its revolving credit facility agreement and bond reimbursement agreement. Among other things, the amendments:

increased the principal amount of the revolving credit commitment under the credit facility for the period from January 1, 2006 to and including June 30, 2006 from \$20.0 million to \$30.0 million;

adjusted the margins that are used to calculate interest on related real estate loans from a range of 1.50% to 2.50% to a range of 1.50% to 3.00% and adjusted the margins that are used to calculate interest for each revolving loan from a range of 1.25% to 1.75% to a range of 1.25% to 2.75%;

provided that the company's fixed charge coverage ratios, as prescribed under each of the agreements, would not be measured for the fiscal quarters ended December 31, 2005 and ending March 31, 2006; and

provided that the ratio of the company's total consolidated debt to consolidated EBITDA, as prescribed under the revolving credit facility, and the ratio of the company's funded net debt to consolidated EBITDA, as prescribed under the reimbursement agreement, would not be measured for the fiscal quarters ended December 31, 2005 and ending March 31, 2006.

*Interest Payment Obligations.* The company uses interest rate swap contracts to manage its exposure to fluctuations in the interest rates of its real estate loans. At December 31, 2005, the company had capped its interest rate exposure at an annual effective rate of approximately 9.0% on all of its \$12.5 million principal amount of real estate loans.

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The company financed its purchase of its Winchester, Virginia site in June 1998 with a ten-year term loan of \$3.8 million. Pursuant to amended terms adopted on September 30, 2004, the loan will be payable in full on September 30, 2009. Under an interest rate swap agreement, the company pays interest on this loan at an annual effective rate of 9.12% at December 31, 2005.

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The company financed its purchase of the Trex Technical Center in November 1998 in part with the proceeds of a ten-year term loan of \$1.0 million. Pursuant to amended terms adopted on September 30, 2004, the loan will be payable in full on September 30, 2009. Under an interest rate swap agreement, the company pays interest on this loan at an annual effective rate of 8.8% at December 31, 2005.

In connection with its acquisition of its Fernley, Nevada site, the company in September 1999 obtained a 15-year term loan in the original principal amount of \$6.7 million. Under an interest rate swap agreement, interest on this loan is payable at an annual effective rate of 7.90% at December 31, 2005.

In connection with its acquisition of a site adjacent to its original Winchester, Virginia site, the company in August 2000 obtained a 15-year term loan in the original principal amount of \$5.9 million. Pursuant to amended terms adopted on September 30, 2004, the loan will be payable in full on September 30, 2009. Under an interest rate swap agreement, the company pays interest on this loan at an annual effective rate of 10.10% at December 31, 2005.

In January 2005, under interest rate swap agreements, the company pays interest on \$10.0 million principal amount of its variable rate promissory note at an annual effective rate of 3.12% for seven years and interest on an additional \$10.0 million principal amount at an annual effective rate of 2.95% for five years.

*Debt Covenants.* To remain in compliance with its credit facility, senior note and bond loan document covenants, the company must maintain specified financial ratios based on its levels of debt, capital, net worth, fixed charges, and earnings (excluding extraordinary gains and extraordinary non-cash losses) before interest, taxes, depreciation and amortization. At December 31, 2005, after giving effect to covenant amendments described above, the company was in compliance with these covenants. The foregoing debt agreements contain cross-default provisions.

The company's ability to make scheduled principal and interest payments on its real estate loans, senior notes and variable rate promissory note, borrow under its revolving credit facility and maintain compliance with the related financial covenants will depend primarily on its ability to generate substantial cash flow from operations. The generation of operating cash flow is subject to the risks of the company's business, some of which are discussed in the 2005 10-K under Risk Factors.

*Contractual Obligations.* The following tables show, as of December 31, 2005, the company's contractual obligations and commercial commitments, which consist primarily of long-term debt, operating leases and letters of credit (in thousands):

**Contractual Obligations****Payments Due by Period**

|   | <b>Total</b>      | <b>Less than<br/>1 year</b> | <b>1-3 years</b> | <b>4-5 years</b> | <b>After<br/>5 years</b> |
|---|-------------------|-----------------------------|------------------|------------------|--------------------------|
| Long-term debt                            | \$ 69,536         | \$ 9,031                    | \$ 18,369        | \$ 14,640        | \$ 27,496                |
| Operating leases                          | 50,319            | 5,436                       | 10,402           | 8,782            | 25,699                   |
| <b>Total contractual cash obligations</b> | <b>\$ 119,855</b> | <b>\$ 14,467</b>            | <b>\$ 28,771</b> | <b>\$ 23,422</b> | <b>\$ 53,195</b>         |

The amount shown for contractual obligations does not include amounts that the company is obligated to purchase under raw material supply contracts. The waste wood and PE material supply contracts generally provide that the company is obligated to purchase all of the waste wood or PE material a supplier provides, if the waste wood or PE material meets certain specifications. The amount of waste wood and PE material the company is required to purchase under these contracts varies with the production of its suppliers and, accordingly, is not fixed or determinable. For information about these contractual cash obligations, see notes 7, 9 and 12 to the company's consolidated financial statements appearing elsewhere in this report.

**Other Commercial Commitments****Payments Due by Period**

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|                              | <b>Total</b> | <b>Less than<br/>1 year</b> | <b>1-3 years</b> | <b>4-5 years</b> | <b>After<br/>5 years</b> |
|------------------------------|--------------|-----------------------------|------------------|------------------|--------------------------|
| Letters of credit            | \$ 766       | \$ 766                      | \$               | \$               |                          |
| Total commercial commitments | \$ 766       | \$ 766                      | \$               | \$               |                          |

The company does not have off-balance sheet financing arrangements other than its operating leases and letters of credit.

*Capital Requirements.* The company made capital expenditures of \$17.0 million in 2003, \$34.1 million in 2004 and \$49.9 million in 2005, primarily to expand its manufacturing capacity. The company currently estimates that its capital requirements in 2006

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will total approximately \$20 to \$30 million. Capital expenditures in 2006 are expected to be used to make process and productivity improvements, and to increase capacity at the company's three existing manufacturing sites. The company expects that it will continue to make significant capital expenditures in 2007 and subsequent years to meet an anticipated increase in the demand for Trex.

As of December 31, 2005, the company had a total of approximately \$1.4 million of cash and cash equivalents. The company believes that cash on hand, cash flow from operations and borrowings expected to be available under the company's existing revolving credit facility will provide sufficient cash to enable the company to fund its planned capital expenditures, make scheduled principal and interest payments, meet its other cash requirements and maintain compliance with the terms of its financing agreements for at least the next 12 months. Thereafter, significant capital expenditures will likely be required to expand the production capabilities of the company's manufacturing sites to provide increased capacity to meet the company's expected growth in demand for its products. The amount and timing of these investments will depend on the anticipated demand for Trex, the production obtained from its existing sites, the availability of funds and other factors. The actual amount and timing of the company's future capital requirements may differ materially from the company's estimate depending on the demand for Trex and new market developments and opportunities.

The company funded its aggregate capital expenditures of \$101.0 million for the three-year period ended December 31, 2005 from a combination of cash flow from operations and proceeds from financing activities, including borrowings under various loan and revolving credit facilities. The company currently expects that it will fund its future capital expenditures primarily with cash from operations and with borrowings under its revolving credit facility and other bank financing arrangements. As of the date of this report, the company had no commitment for any such other financing arrangements. The company also may determine that it is necessary or desirable to obtain financing for such requirements through the issuance of debt or equity securities. Any such debt financing would increase the company's level of indebtedness, while any such equity financing would dilute the ownership of the company's stockholders. There can be no assurance as to whether, or as to the terms on which, the company would be able to obtain such financing.

### **Item 8. Financial Statements and Supplementary Data**

The financial statements listed in Item 15 and appearing on pages 19 through 41 are incorporated by reference in this Item 8 and are filed as part of this report.

### **Item 9A. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer, who is our principal executive officer, and our Senior Vice President and Chief Financial Officer, who is our principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of December 31, 2005. Based upon this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as a result of the material weakness in our internal control over financial reporting as of December 31, 2005 described below under "Management's Report on Internal Control Over Financial Reporting," our disclosure controls and procedures were not effective as of December 31, 2005. We have initiated the implementation of measures to remediate this material weakness as described below under "Remediation of Material Weakness in Internal Control Over Financial Reporting."

#### **Management's Report on Internal Control Over Financial Reporting**

We, as members of management of Trex Company, Inc. (the "Company"), are responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.



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We assessed the Company's internal control over financial reporting as of December 31, 2005, based on criteria for effective internal control over financial reporting established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO Framework). Based on this assessment, management identified a material weakness (as defined by the Public Company Accounting Oversight Board) as of December 31, 2005.

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At December 31, 2005, the Company did not have a sufficient complement of personnel with knowledge of and experience in the Company's financial reporting processes or with adequate technical expertise in the application of U.S. generally accepted accounting principles and in resolving non-routine or complex accounting matters. As a result, the review of the accounting for certain transactions and the reconciliation of certain accounts was not appropriately completed on a timely basis, which resulted in errors in the recording of certain expenses (including cost of sales, selling, general and administrative expenses, and interest expense) and the related accounts payable and accrued expenses, errors in recording cash disbursements, errors in accounts receivable and inventory valuation, errors in cost capitalization and the related depreciation, and errors in income taxes as well as errors in the preparation of financial statement disclosures. As further described in Notes 2 and 14 to the consolidated financial statements, these errors resulted in the restatement of the Company's financial statements for the years ended December 31, 2003, 2004 and 2005, including the interim financial statements for these periods. This control deficiency could also result in other errors that would result in a material misstatement to the annual or interim consolidated financial statements. Management has concluded that this control deficiency constitutes a material weakness. Accordingly, management has determined that, because of this material weakness, the Company did not maintain effective internal control over financial reporting as of December 31, 2005 based on the criteria specified in the COSO Framework.

Ernst & Young LLP, an independent registered public accounting firm, which audited the Company's consolidated financial statements included in this report, has issued a report on management's assessment of the effectiveness and on the Company's internal control over financial reporting, which is included in this report.

TREX COMPANY, INC.

March 6, 2007

By: /s/ ANTHONY J. CAVANNA  
Anthony J. Cavanna

Chairman and Chief Executive Officer

(Principal Executive Officer)

March 6, 2007

By: /s/ PAUL D. FLETCHER  
Paul D. Fletcher

Senior Vice President and Chief Financial Officer

(Principal Financial Officer)

**Remediation Efforts Related to Material Weakness in Internal Control Over Financial Reporting**

In 2005, we experienced a number of challenging business issues, including those related to the opening of a new manufacturing facility, new product introductions, turnover in accounting, finance and information technology personnel, and a contemplated relocation of our corporate headquarters. As a result, for certain periods of time we did not have a sufficient complement of qualified staff to ensure that our financial statement close processes resulted in reported results that were complete and accurate. During the fourth quarter of 2005, we added members to our accounting, finance and information technology staff and implemented additional levels of review in our financial statement close processes to begin to address these challenges.

In 2006 and into 2007, we added additional accounting, finance and information technology staff members at our headquarters and plant locations and implemented a series of new internal control procedures to improve the effectiveness of our transaction processing and our financial statement close processes. In addition to these enhancements, we have provided training regarding effective review and approval procedures to the appropriate personnel. The additional personnel and process enhancements contributed to the discovery in 2006 of additional errors related to prior periods that led to management's determination that restatement of the prior period financial statements was warranted. Accordingly, management's assessment that the Company did not maintain effective internal control over financial reporting as of December 31, 2005 remains unchanged. Management has not yet evaluated the effectiveness of our internal control over financial reporting as of December 31, 2006. Our internal control over financial reporting will also be subject to testing by our independent registered public accounting firm. There can be no assurance at this time that the actions taken to date will effectively remediate the material weakness described above. We are continuing to closely monitor the effectiveness of our processes, procedures and controls, and will make any further changes as management determines appropriate.

**Changes in Internal Control Over Financial Reporting**

Other than the matters described in this Item 9A under Remediation of Material Weakness in Internal Control Over Financial Reporting, during the fourth quarter ended December 31, 2005, there have been no changes in our internal control over financial reporting that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

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**Report of Ernst & Young LLP,  
Independent Registered Public Accounting Firm,  
On Internal Control Over Financial Reporting**

Board of Directors and Shareholders of Trex Company, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Trex Company, Inc. (Trex) did not maintain effective internal control over financial reporting as of December 31, 2005, because of the effect of the material weakness described below, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Trex's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of Trex's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management's assessment. As of December 31, 2005, Trex lacked a sufficient complement of personnel with knowledge of and experience in the Company's financial reporting processes or with adequate technical expertise in the application of U.S. generally accepted accounting principles and in resolving non-routine or complex accounting matters. As a result, management's review of the accounting for certain transactions and of the reconciliation of certain accounts was not appropriately completed on a timely basis, which resulted in errors in the recording of expenses (including cost of sales, selling, general and administrative expenses, and interest expense) and the related accounts payable and accrued expenses, errors in accounts receivable and inventory valuation, errors in cost capitalization and the related depreciation, and errors in income taxes as well as errors in the preparation of financial statement disclosures. These errors resulted in a number of post-closing adjustments to the 2005 consolidated financial statements. During 2006, additional errors in prior period financial statements attributable to the recording of expenses (including cost of sales, selling, general and administrative expenses, and interest expense) and the related accounts payable and accrued expenses, the recording of cash disbursements, and errors in inventory valuation were identified. The combination of these additional errors with the previously identified errors resulted in the restatement of the Company's financial statements for the years ended December 31, 2003, 2004 and 2005, including the interim financial statements for these periods.

Until this deficiency is remediated, there is more than a remote likelihood that a material misstatement to the annual or interim consolidated financial statements could occur and not be prevented or detected by the Company's controls in a timely manner. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2005 consolidated financial statements, and this report does not affect our report dated March 14, 2006 (except with respect to the matters discussed in Note 2, as to which the date is March 6, 2007) on those financial statements.

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In our opinion, management's assessment that Trex did not maintain effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO control criteria. Also, in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, Trex did not maintain effective internal control over financial reporting as of December 31, 2005, based on the COSO control criteria.

/s/ ERNST & YOUNG LLP

McLean, Virginia

March 14, 2006 (except with respect to the expanded description of the effects

of the material weakness in internal control over financial reporting, as to which the date is March 6, 2007)

**Table of Contents****PART IV****Item 15. Exhibits and Financial Statement Schedules**

(a)(1) The following restated consolidated financial statements of the company appear on pages 19 through 40 of this report and are incorporated by reference in Part II, Item 8:

|   |    |
|---|----|
| <u>Report of Independent Registered Public Accounting Firm</u>  | 18 |
| Consolidated Financial Statements   |    |
| <u>Consolidated Balance Sheets as of December 31, 2004 and 2005</u>   | 19 |
| <u>Consolidated Statements of Operations for the three years ended December 31, 2005</u>                                    | 20 |
| <u>Consolidated Statements of Stockholders' Equity and Comprehensive Income for the three years ended December 31, 2005</u> | 21 |
| <u>Consolidated Statements of Cash Flows for the three years ended December 31, 2005</u>                                    | 22 |
| <u>Notes to Consolidated Financial Statements</u>   | 23 |

(a)(2) All schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions, or are inapplicable or not material and therefore have been omitted.

(a)(3) The following exhibits are either filed with this Form 10-K or are incorporated herein by reference. The company's Securities Exchange Act file number is 001-14649.

| <b>Exhibit Number</b> | <b>Exhibit Description</b>   |
|-----------------------|--|
| 3.1                   | Restated Certificate of Incorporation of Trex Company, Inc. (the "Company"). Filed as Exhibit 3.1 to the Company's Registration Statement on Form S-1 (No. 333-63287) and incorporated herein by reference.  |
| 3.2                   | Amended and Restated By-Laws of the Company. Filed as Exhibit 3.1 to the Company's Quarterly Report Form 10-Q for the quarterly period ended September 30, 2004 and incorporated herein by reference.  |
| 4.1                   | Specimen certificate representing the Company's common stock. Filed as Exhibit 4.1 to the Company's Registration Statement on Form S-1 (No. 333-63287) and incorporated herein by reference.   |
| 10.1                  | Description of Non-Employee Director Compensation. Filed as Exhibit 10.1 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.   |
| 10.2                  | Description of Management Compensatory Plans and Arrangements. Filed as Exhibit 10.2 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.                                 |
| 10.3                  | Trex Company, Inc. 2005 Stock Incentive Plan. Filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2005 and incorporated herein by reference.   |
| 10.4                  | Trex Company, Inc. Amended and Restated 1999 Incentive Plan for Outside Directors, as amended. Filed as Exhibit 10.4 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference. |

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- 10.5 Form of Trex Company, Inc. 2005 Stock Incentive Plan Non-Incentive Stock Option Agreement. Filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005 and incorporated herein by reference.
- 10.6 Form of Trex Company, Inc. 2005 Stock Incentive Plan Stock Appreciation Rights Agreement. Filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005 and incorporated herein by reference.
- 10.7 Form of Trex Company, Inc. 2005 Stock Incentive Plan Performance Award Agreement. Filed as Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005 and incorporated herein by reference.
- 10.8 Form of Trex Company, Inc. 2005 Stock Incentive Plan Restricted Stock Agreement. Filed as Exhibit 10.8 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.
- 10.9 Form of Trex Company, Inc. Amended and Restated 1999 Incentive Plan for Outside Directors Non-Incentive Stock Option Agreement. Filed as Exhibit 10.4 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002 and incorporated herein by reference.
- 10.9 Form of Trex Company, Inc. Amended and Restated 1999 Incentive Plan for Outside Directors Non-Incentive Stock Option Agreement. Filed as Exhibit 10.4 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002 and incorporated herein by reference.
- 10.10 Form of Trex Company, Inc. Amended and Restated 1999 Incentive Plan for Outside Directors Stock Appreciation Rights Agreement. Filed as Exhibit 10.10 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.
- 10.11 Form of Lock-Up Agreement, dated as of December 20, 2005. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 21, 2005 and incorporated herein by reference.
- 10.12 Separation Agreement and Mutual General Release, dated as of October 19, 2005, by and between Trex Company, Inc. and Robert G. Matheny. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 21, 2005 and incorporated herein by reference.
- 10.13 Release and Severance Agreement, dated as of March 6, 2006, by and between Trex Company, Inc. and Philip J. Pifer. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 8, 2006 and incorporated herein by reference.
- 10.14 Form of Distributor Agreement of TREX Company, LLC. Filed as Exhibit 10.5 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001 and incorporated herein by reference.
- 10.15 Deed of Lease, dated June 15, 2000, between TREX Company, LLC and Space, LLC. Filed as Exhibit 10.16 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000 and incorporated herein by reference.
- 10.16 Note Purchase Agreement, dated as of June 19, 2002, by and among Trex Company, Inc., TREX Company, LLC and the Purchasers listed therein. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 25, 2002 and incorporated herein by reference.
- 10.17 Credit Agreement, dated as of June 19, 2002, among TREX Company, LLC, Trex Company, Inc. and Branch Banking and Trust Company of Virginia. Filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed on June 25, 2002 (as amended by the Company's Current Report on Form 8-K/A filed on June 28, 2002) and incorporated herein by reference.
- 10.18 Security Agreement, dated as of June 19, 2002, by and among TREX Company, LLC, Trex Company, Inc. and Branch Banking and Trust Company of Virginia, as collateral agent. Filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed on June 25, 2002 and incorporated herein by reference.
- 10.19 Intercreditor and Collateral Agency Agreement, dated as of June 19, 2002, by and among the Note holders named in Schedule I therein, Branch Banking and Trust Company of Virginia, and Branch Banking and Trust Company of Virginia, as collateral agent. Filed as Exhibit 10.4 to the Company's Current Report on Form 8-K filed on June 25, 2002 and incorporated herein by reference.

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- 10.20 Credit Line Deed of Trust, dated June 19, 2002, by and among TREX Company, LLC, as grantor, BB&T-VA Collateral Service Corporation, as trustee, and Branch Banking and Trust Company of Virginia and Branch Banking and Trust Company, as note holder. Filed as Exhibit 10.5 to the Company's Current Report on Form 8-K filed on June 25, 2002 and incorporated herein by reference.
- 10.21 First Amendment to Credit Agreement, dated as of August 29, 2003, by and between the Company and Branch Banking and Trust Company of Virginia. Filed as Exhibit 10.21 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.
- 10.22 Second Amendment to Credit Agreement, dated as of September 30, 2004, among the Company and Branch Banking and Trust Company of Virginia. Filed as Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2004 and incorporated herein by reference.
- 10.23 Third Amendment to Credit Agreement, dated as of March 31, 2005, by and between the Company and Branch Banking and Trust Company of Virginia. Filed as Exhibit 10.6 to the Company's Quarterly Report of Form 10-Q for the quarterly period ended June 30, 2005 and incorporated herein by reference.
- 10.24 Fourth Amendment to Credit Agreement, dated as of July 25, 2005, by and between the Company and Branch Banking and Trust Company of Virginia. Filed as Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005 and incorporated herein by reference.
- 10.25 Fifth Amendment to Credit Agreement, dated as of December 31, 2005, among the Company and Branch Banking and Trust Company of Virginia. Filed as Exhibit 10.25 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.
- 10.26 Loan Agreement, dated as of December 1, 2004, between the Company and Mississippi Business Finance Corporation. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 20, 2004 and incorporated herein by reference.
- 10.27 Promissory Note, dated as of December 16, 2004, in the principal amount of \$25,000,000 from the Company payable to the order of Mississippi Business Finance Corporation. Filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed on December 20, 2004 and incorporated herein by reference.
- 10.28 Reimbursement and Credit Agreement, dated as of December 1, 2004, between the Company and JPMorgan Chase Bank, N.A., as Bank and Administrative Agent. Filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed on December 20, 2004 and incorporated herein by reference.
- 10.29 First Amendment to Reimbursement and Credit Agreement, dated as of July 25, 2005, by and between the Company and JPMorgan Chase Bank, N.A., as Issuing Bank and Administrative Agent. Filed as Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005 and incorporated herein by reference.
- 10.30 Second Amendment to Reimbursement and Credit Agreement, dated as of December 31, 2005, by and between the Company and JPMorgan Chase Bank, N.A., as Issuing Bank and Administrative Agent. Filed as Exhibit 10.30 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.
- 10.31 Reimbursement Note, dated as of December 1, 2004, in the principal amount of \$25,308,220 from the Company payable to JPMorgan Chase Bank, N.A. Filed as Exhibit 10.4 to the Company's Current Report on Form 8-K filed on December 20, 2004 and incorporated herein by reference.
- 10.32 Land Deed of Trust, dated as of December 1, 2004, made by the Company to the trustee named therein for the benefit of JPMorgan Chase Bank, N.A. Filed as Exhibit 10.5 to the Company's Current Report on Form 8-K filed on December 20, 2004 and incorporated herein by reference.
- 10.33 Trust Indenture, dated as of December 1, 2004, between Mississippi Business Finance Corporation and J.P. Morgan Trust Company, National Association, as Trustee, including Form of Variable Rate Series 2004 Bond and Form of Fixed Rate Series 2004 Bond. Filed as Exhibit 10.6 to the Company's Current Report on Form 8-K filed on December 20, 2004 and incorporated herein by reference.
- 10.34 Deed of Lease, dated as of July 27, 2005, between Trex Company, Inc. and 1 Dulles Town Center, L.L.C. Filed as Exhibit 10.34 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.\*
- 21 Subsidiaries of the Company. Filed as Exhibit 21 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.
- 23 Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm. Filed with this Form 10-K/A.
- 31.1 Certification of Chief Executive Officer of the Company pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934. Filed with this Form 10-K/A.



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- 31.2 Certification of Senior Vice President and Chief Financial Officer of the Company pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934. Filed with this Form 10-K/A.
- 32 Certifications pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. § 1350. Filed with this Form 10-K/A.

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\* Portions of this exhibit have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

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**TREX COMPANY, INC.**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Report of Ernst & Young LLP, Independent Registered Public Accounting Firm**

Board of Directors and Shareholders of Trex Company, Inc.

We have audited the accompanying consolidated balance sheets of Trex Company, Inc. as of December 31, 2004 and 2005, and the related consolidated statements of operations, changes in stockholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Trex Company, Inc. at December 31, 2004 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, the accompanying consolidated balance sheets as of December 31, 2004 and 2005 and the related consolidated statements of operations, changes in stockholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2005 have been restated.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Trex Company, Inc.'s internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 14, 2006 (except with respect to the expanded description of the effects of the material weakness in internal control over financial reporting, as to which the date is March 6, 2007) expressed an unqualified opinion on management's assessment and an adverse opinion on the effectiveness of the Company's internal control over financial reporting because of the existence of a material weakness.

/s/ ERNST & YOUNG LLP

McLean, Virginia

March 14, 2006 (except with respect to the matters discussed in Note 2,

as to which the date is March 6, 2007)

**Table of Contents****TREX COMPANY, INC.****CONSOLIDATED BALANCE SHEETS**

|   | December 31,   |              |
|---|----------------|--------------|
|   | 2004           | 2005         |
|   | As Restated    | As Restated  |
|   | (See Note 2)   | (See Note 2) |
|   | (In thousands) |              |
| <b>ASSETS</b>   |                |              |
| Current Assets:   |                |              |
| Cash and cash equivalents   | \$ 23,967      | \$ 1,395     |
| Restricted cash   | 20,959         |              |
| Accounts receivable (net of allowance for doubtful accounts of \$0.3 million and \$0.6 million in 2004 and 2005, respectively)                                    | 21,964         | 12,364       |
| Inventories   | 44,357         | 56,931       |
| Prepaid expenses and other assets   | 4,162          | 3,750        |
| Income taxes receivable   | 252            | 8,200        |
| Deferred income taxes   | 2,975          | 1,711        |
| Total current assets  | 118,636        | 84,351       |
| Property, plant and equipment, net  | 158,313        | 191,083      |
| Goodwill  | 6,837          | 6,837        |
| Debt-related derivatives  |                | 292          |
| Other assets  | 2,986          | 3,151        |
| Total Assets  | \$ 286,772     | \$ 285,714   |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                |              |
| Current Liabilities:  |                |              |
| Accounts payable  | \$ 15,880      | \$ 13,675    |
| Accrued expenses  | 14,914         | 17,514       |
| Line of credit  |                | 4,070        |
| Current portion of long-term debt   | 8,932          | 9,031        |
| Total current liabilities   | 39,726         | 44,290       |
| Deferred income taxes   | 15,808         | 15,158       |
| Debt-related derivatives  | 1,736          | 1,053        |
| Long-term debt  | 69,565         | 60,505       |
| Total Liabilities   | 126,835        | 121,006      |
| Commitments and contingencies   |                |              |
| Stockholders' Equity:   |                |              |
| Preferred stock, \$0.01 par value, 3,000,000 shares authorized; none issued and outstanding   |                |              |
| Common stock, \$0.01 par value, 40,000,000 shares authorized; 14,843,820 and 14,889,674 shares issued and outstanding at December 31, 2004 and 2005, respectively | 148            | 149          |
| Additional paid-in capital  | 60,182         | 61,901       |
| Deferred compensation   | (1,259)        | (1,076)      |
| Accumulated other comprehensive loss  | (1,098)        | (481)        |

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|  |            |            |
|--|------------|------------|
| Retained earnings                          | 101,964    | 104,215    |
| Total Stockholders' Equity                 | 159,937    | 164,708    |
| Total Liabilities and Stockholders' Equity | \$ 286,772 | \$ 285,714 |

See accompanying notes to financial statements.

**Table of Contents****TREX COMPANY, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

|  | Year Ended December 31,                         |              |              |
|--|---|--------------|--------------|
|  | 2003  | 2004         | 2005         |
|  | As Restated                                     | As Restated  | As Restated  |
|  | (See Note 2)                                    | (See Note 2) | (See Note 2) |
|  | (In thousands, except share and per share data) |              |              |
| Net sales  | \$ 191,008                                      | \$ 253,628   | \$ 294,133   |
| Cost of sales                                      | 107,110   | 150,793      | 213,897      |
| Gross profit                                       | 83,898  | 102,835      | 80,236       |
| Selling, general, and administrative expenses      | 46,829  | 56,351       | 77,398       |
| Income from operations                             | 37,069  | 46,484       | 2,838        |
| Interest income                                    | 327   | 581          | 524          |
| Interest expense                                   | (3,887)   | (3,645)      | (3,130)      |
| Income before provision for income taxes           | 33,509  | 43,420       | 232          |
| Provision (benefit) for income taxes               | 12,429  | 15,933       | (2,019)      |
| Net income   | \$ 21,080                                       | \$ 27,487    | \$ 2,251     |
| Basic earnings per common share                    | \$ 1.45   | \$ 1.88      | \$ 0.15      |
| Basic weighted average common shares outstanding   | 14,522,092                                      | 14,636,959   | 14,769,799   |
| Diluted earnings per common share                  | \$ 1.43   | \$ 1.85      | \$ 0.15      |
| Diluted weighted average common shares outstanding | 14,727,838                                      | 14,834,718   | 14,879,661   |

See accompanying notes to financial statements.

**Table of Contents****TREX COMPANY, INC.****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS****EQUITY AND COMPREHENSIVE INCOME**

|  | Common Stock |        |                                  | Accumulated              |            |               |                      | Total |
|--|--------------|--------|----------------------------------|--------------------------|------------|---------------|----------------------|-------|
|  | Shares       | Amount | Additional<br>Paid-in<br>Capital | Other                    |            |               | Retained<br>Earnings |       |
|  |              |        |                                  | Deferred<br>Compensation | Loss       | Comprehensive |                      |       |
|  |              |        |                                  |                          |            |               |                      |       |
| Balance, December 31, 2002                           | 14,297,711   | \$ 143 | \$ 49,354                        | \$ (2,400)               | \$ (1,719) | \$ 53,397     | \$ 98,775            |       |
| Comprehensive income:                                |              |        |                                  |                          |            |               |                      |       |
| Net income, as restated (See Note 2)                 |              |        |                                  |                          |            | 21,080        | 21,080               |       |
| Unrealized losses on interest rate swaps, net of tax |              |        |                                  |                          | (193)      |               | (193)                |       |
| Derivative loss reclassified to earnings, net of tax |              |        |                                  |                          | 525        |               | 525                  |       |
| Total comprehensive income                           |              |        |                                  |                          |            |               | 21,412               |       |
| Employee stock purchase and option plans             | 50,741       |        | 933                              |                          |            |               | 933                  |       |
| Tax benefit of stock options                         |              |        | 338                              |                          |            |               | 338                  |       |
| Exercise of warrant                                  | 353,779      | 4      | 5,264                            |                          |            |               | 5,268                |       |
| Amortization of deferred compensation                |              |        |                                  | 571                      |            |               | 571                  |       |
| Balance, December 31, 2003 as Restated (See Note 2)  | 14,702,231   | 147    | 55,889                           | (1,829)                  | (1,387)    | 74,477        | 127,297              |       |
| Comprehensive income:                                |              |        |                                  |                          |            |               |                      |       |
| Net income, as restated (See Note 2)                 |              |        |                                  |                          |            | 27,487        | 27,487               |       |
| Unrealized losses on interest rate swaps, net of tax |              |        |                                  |                          | (199)      |               | (199)                |       |
| Derivative loss reclassified to earnings, net of tax |              |        |                                  |                          | 488        |               | 488                  |       |
| Total comprehensive income                           |              |        |                                  |                          |            |               | 27,776               |       |
| Employee stock purchase and option plans             | 141,589      | 1      | 3,290                            |                          |            |               | 3,291                |       |
| Tax benefit of stock options                         |              |        | 1,003                            |                          |            |               | 1,003                |       |
| Amortization of deferred compensation                |              |        |                                  | 570                      |            |               | 570                  |       |
| Balance, December 31, 2004 as Restated (See Note 2)  | 14,843,820   | 148    | 60,182                           | (1,259)                  | (1,098)    | 101,964       | 159,937              |       |
| Comprehensive income:                                |              |        |                                  |                          |            |               |                      |       |
| Net income, as restated (See Note 2)                 |              |        |                                  |                          |            | 2,251         | 2,251                |       |
| Unrealized losses on interest rate swaps, net of tax |              |        |                                  |                          | (49)       |               | (49)                 |       |
| Derivative loss reclassified to earnings, net of tax |              |        |                                  |                          | 666        |               | 666                  |       |
| Total comprehensive income                           |              |        |                                  |                          |            |               | 2,868                |       |

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|  |            |        |           |            |          |            |            |       |
|--|------------|--------|-----------|------------|----------|------------|------------|-------|
| Employee stock purchase and option plans             | 47,120     | 1      | 1,201     |            |          |            |            | 1,202 |
| Tax benefit of stock options and restricted stock    |            |        | 419       |            |          |            |            | 419   |
| Restricted stock awards (grants, net of forfeitures) | 17,312     |        | 842       | (842)      |          |            |            |       |
| Repurchases of common stock                          | (18,578)   |        | (743)     |            |          |            |            | (743) |
| Amortization of deferred compensation                |            |        |           | 1,025      |          |            |            | 1,025 |
| Balance, December 31, 2005 as Restated (See Note 2)  | 14,889,674 | \$ 149 | \$ 61,901 | \$ (1,076) | \$ (481) | \$ 104,215 | \$ 164,708 |       |

See accompanying notes to financial statements.



**Table of Contents****TREX COMPANY, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

|   | Year Ended December 31, |              |              |
|---|-------------------------|--------------|--------------|
|   | 2003                    | 2004         | 2005         |
|   | As Restated             | As Restated  | As Restated  |
|   | (See Note 2)            | (See Note 2) | (See Note 2) |
|   | (In thousands)          |              |              |
| <b>Operating Activities</b>   |                         |              |              |
| Net income  | \$ 21,080               | \$ 27,487    | \$ 2,251     |
| Adjustments to reconcile net income to net cash provided by operating activities: |                         |              |              |
| Deferred income taxes and other   | 3,120                   | 1,651        | 256          |
| Tax benefit of stock options and restricted stock                                 | 338                     | 1,003        | 419          |
| Equity method losses  | 125                     | 42           | 7            |
| Amortization of deferred compensation and financing costs                         | 902                     | 945          | 1,310        |
| Depreciation and amortization   | 12,539                  | 13,713       | 16,139       |
| Loss on disposal of property, plant and equipment                                 | 26                      | 80           | 967          |
| Changes in operating assets and liabilities:                                      |                         |              |              |
| Accounts receivable   | (4,989)                 | (16,135)     | 9,600        |
| Inventories   | (23,521)                | 1,593        | (12,574)     |
| Prepaid expenses and other assets   | (172)                   | (2,263)      | 412          |
| Accounts payable  | (749)                   | 10,298       | (2,205)      |
| Accrued expenses  | (3,221)                 | 7,160        | 2,600        |
| Income taxes receivable   | 139                     | (309)        | (7,948)      |
| Net cash provided by operating activities   | 5,617                   | 45,265       | 11,234       |
| <b>Investing Activities</b>   |                         |              |              |
| Investment in Denplax   | (691)                   | (44)         | (35)         |
| Loans to Denplax  |                         | (1,250)      | (422)        |
| Restricted cash   |                         | (20,959)     | 20,959       |
| Expenditures for property, plant and equipment                                    | (17,036)                | (34,066)     | (49,876)     |
| Net cash used in investing activities   | (17,727)                | (56,319)     | (29,374)     |
| <b>Financing Activities</b>   |                         |              |              |
| Financing costs   |                         | (553)        |              |
| Borrowings under mortgages and notes  |                         | 25,000       |              |
| Principal payments under mortgages and notes                                      | (822)                   | (879)        | (8,961)      |
| Borrowings under line of credit   | 420                     | 1,546        | 24,286       |
| Principal payments under line of credit   | (420)                   | (1,546)      | (20,216)     |
| Repurchase of common stock  |                         |              | (743)        |
| Proceeds from employee stock purchase and option plans                            | 933                     | 3,291        | 1,202        |
| Proceeds from exercise of warrant   | 5,268                   |              |              |
| Net cash provided by (used in) financing activities                               | 5,379                   | 26,859       | (4,432)      |
| Net increase (decrease) in cash and cash equivalents                              | (6,731)                 | 15,805       | (22,572)     |
| Cash and cash equivalents at beginning of year                                    | 14,893                  | 8,162        | 23,967       |
| Cash and cash equivalents at end of year  | \$ 8,162                | \$ 23,967    | \$ 1,395     |

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Supplemental disclosures of cash flow information:

|                            |          |           |          |
|----------------------------|----------|-----------|----------|
| Cash paid for interest     | \$ 4,572 | \$ 4,523  | \$ 4,873 |
| Cash paid for income taxes | \$ 9,322 | \$ 13,085 | \$ 7,852 |

See accompanying notes to financial statements.

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**TREX COMPANY, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. BUSINESS AND ORGANIZATION**

Trex Company, Inc. (together with its subsidiaries, the Company), a Delaware corporation, was incorporated on September 4, 1998. The Company manufactures and distributes wood/plastic composite products primarily for residential and commercial decking and railing applications. Trex Wood-Polymer® lumber (Trex) is manufactured in a proprietary process that combines waste wood fibers and reclaimed polyethylene (PE material). The Company operates in one business segment.

**2. RESTATEMENT**

On January 26, 2007, the Audit Committee of the Company's Board of Directors concluded, based upon the recommendation of the Company's management that, to correct certain errors, the Company should restate its financial results, including quarterly results, for its fiscal years ended December 31, 2003, 2004 and 2005.

The restatements reflect the correction of errors related to the recording of certain expenses in cost of sales, selling, general and administrative expenses, and interest expense. The errors included the following:

- (a) Errors related to improperly recording the receipt of goods and services, which resulted from the recording of expenses, inventory and fixed assets at the time of receipt of the goods or services and again at the time the related invoice was received. These errors caused an overstatement of accounts payable, accrued expenses, property, plant and equipment, cost of sales and selling, general and administrative expenses.
- (b) Errors related to the timing of recording certain liabilities, which resulted from the failure to accrue accounts payable related to the purchase of raw materials at the time of receipt of the materials from one vendor that caused an understatement of accounts payable, inventory and cost of sales.
- (c) Errors related to improperly recording cash disbursements, which resulted from recording certain wire transfers in the incorrect period and not appropriately recording certain void checks. These errors caused a net overstatement of cash and a net understatement of cost of sales and selling, general and administrative expenses.
- (d) An error in the valuation of raw material inventory, which resulted from the miscalculation of the quantity of raw material inventory on hand that caused an understatement of inventory and an overstatement of cost of sales.

The following tables summarize the effects of these adjustments on the Company's consolidated balance sheets as of December 31, 2004 and 2005 and consolidated statements of operations and consolidated statement of cash flows for the years ended December 31, 2003, 2004 and 2005.

**Table of Contents****CONSOLIDATED BALANCE SHEETS****December 31, 2004****(In thousands)**

|  | <b>As Previously<br/>Reported</b> | <b>Adjustments</b> | <b>As Restated</b> |
|--|-----------------------------------|--------------------|--------------------|
| Cash and cash equivalents                  | \$ 23,925                         | \$ 42              | \$ 23,967          |
| Income taxes receivable                    | 497                               | (245)              | 252                |
| Total current assets                       | 118,839                           | (203)              | 118,636            |
| Property, plant and equipment, net         | 158,389                           | (76)               | 158,313            |
| Total Assets                               | 287,051                           | (279)              | 286,772            |
| Accounts payable                           | 16,392                            | (512)              | 15,880             |
| Accrued expenses                           | 15,104                            | (190)              | 14,914             |
| Total current liabilities                  | 40,428                            | (702)              | 39,726             |
| Total Liabilities                          | 127,537                           | (702)              | 126,835            |
| Retained earnings                          | 101,541                           | 423                | 101,964            |
| Total Stockholders' Equity                 | 159,514                           | 423                | 159,937            |
| Total Liabilities and Stockholders' Equity | \$ 287,051                        | \$ (279)           | \$ 286,772         |

**CONSOLIDATED BALANCE SHEETS****December 31, 2005****(In thousands)**

|  | <b>As Previously<br/>Reported</b> | <b>Adjustments</b> | <b>As Restated</b> |
|--|-----------------------------------|--------------------|--------------------|
| Cash and cash equivalents                  | \$ 1,931                          | \$ (536)           | \$ 1,395           |
| Inventories                                | 56,726                            | 205                | 56,931             |
| Income taxes receivable                    | 8,297                             | (97)               | 8,200              |
| Total current assets                       | 84,779                            | (428)              | 84,351             |
| Property, plant and equipment, net         | 191,210                           | (127)              | 191,083            |
| Total Assets                               | 286,269                           | (555)              | 285,714            |
| Accounts payable                           | 14,405                            | (730)              | 13,675             |
| Total current liabilities                  | 45,020                            | (730)              | 44,290             |
| Total Liabilities                          | 121,736                           | (730)              | 121,006            |
| Retained earnings                          | 104,040                           | 175                | 104,215            |
| Total Stockholders' Equity                 | 164,533                           | 175                | 164,708            |
| Total Liabilities and Stockholders' Equity | \$ 286,269                        | \$ (555)           | \$ 285,714         |

**CONSOLIDATED STATEMENT OF OPERATIONS****For the year ended December 31, 2003****(in thousands, except per share data)**

|               | <b>As Previously<br/>Reported</b> | <b>Adjustments</b> | <b>As Restated</b> |
|---------------|-----------------------------------|--------------------|--------------------|
| Cost of sales | \$ 107,246                        | \$ (136)           | \$ 107,110         |
| Gross profit  | 83,762                            | 136                | 83,898             |

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|  |        |     |        |
|--|--------|-----|--------|
| Selling, general and administrative expenses | 46,837 | (8) | 46,829 |
| Income from operations                       | 36,925 | 144 | 37,069 |
| Income before provision for income taxes     | 33,365 | 144 | 33,509 |
| Provision for income taxes                   | 12,376 | 53  | 12,429 |
| Net income                                   | 20,989 | 91  | 21,080 |

**Table of Contents****CONSOLIDATED STATEMENT OF OPERATIONS**

For the year ended December 31, 2004

(in thousands, except per share data)

|  | As Previously<br>Reported | Adjustments | As Restated |
|--|---------------------------|-------------|-------------|
| Cost of sales                                | \$ 151,286                | \$ (493)    | \$ 150,793  |
| Gross profit                                 | 102,342                   | 493         | 102,835     |
| Selling, general and administrative expenses | 56,382                    | (31)        | 56,351      |
| Income from operations                       | 45,960                    | 524         | 46,484      |
| Income before provision for income taxes     | 42,896                    | 524         | 43,420      |
| Provision for income taxes                   | 15,741                    | 192         | 15,933      |
| Net income                                   | 27,155                    | 332         | 27,487      |
| Basic earnings per share                     | 1.86                      | 0.02        | 1.88        |
| Diluted earnings per share                   | \$ 1.83                   | \$ 0.02     | \$ 1.85     |

**CONSOLIDATED STATEMENT OF OPERATIONS**

For the year ended December 31, 2005

(in thousands, except per share data)

|  | As Previously<br>Reported | Adjustments | As Restated |
|--|---------------------------|-------------|-------------|
| Cost of sales                                | \$ 213,904                | \$ (7)      | \$ 213,897  |
| Gross profit                                 | 80,229                    | 7           | 80,236      |
| Selling, general and administrative expenses | 76,989                    | 409         | 77,398      |
| Income from operations                       | 3,240                     | (402)       | 2,838       |
| Interest expense, net                        | 2,612                     | (6)         | 2,606       |
| Income before provision for income taxes     | 628                       | (396)       | 232         |
| Provision (benefit) for income taxes         | (1,871)                   | (148)       | (2,019)     |
| Net income                                   | 2,499                     | (248)       | 2,251       |
| Basic earnings per share                     | 0.17                      | (0.02)      | 0.15        |
| Diluted earnings per share                   | \$ 0.17                   | \$ (0.02)   | \$ 0.15     |

**CONSOLIDATED STATEMENT OF CASH FLOWS**

For the year ended December 31, 2003

(in thousands, except per share data)

|  | As Previously<br>Reported | Adjustments | As Restated |
|--|---------------------------|-------------|-------------|
| <b>Operating activities</b>                  |                           |             |             |
| Net income                                   | \$ 20,989                 | \$ 91       | \$ 21,080   |
| Changes in operating assets and liabilities: |                           |             |             |
| Accounts payable                             | (597)                     | (152)       | (749)       |
| Accrued expenses                             | (3,218)                   | (3)         | (3,221)     |
| Income taxes receivable                      | 86                        | 53          | 139         |
| Net cash provided by operating activities    | 5,628                     | (11)        | 5,617       |

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**Investing activities**

|  |          |       |          |
|--|----------|-------|----------|
| Expenditures for property, plant and equipment       | (17,058) | 22    | (17,036) |
| Net cash used in investing activities                | (17,749) | 22    | (17,727) |
| Net increase (decrease) in cash and cash equivalents | (6,742)  | 11    | (6,731)  |
| Cash and cash equivalents at end of year             | \$ 8,151 | \$ 11 | \$ 8,162 |

**Table of Contents****CONSOLIDATED STATEMENT OF CASH FLOWS****For the year ended December 31, 2004****(in thousands, except per share data)**

|  | As Previously<br>Reported | Adjustments | As Restated |
|--|---------------------------|-------------|-------------|
| <b>Operating activities</b>                          |                           |             |             |
| Net income   | \$ 27,155                 | \$ 332      | \$ 27,487   |
| Changes in operating assets and liabilities:         |                           |             |             |
| Accounts payable                                     | 10,658                    | (360)       | 10,298      |
| Accrued expenses                                     | 7,347                     | (187)       | 7,160       |
| Income taxes receivable                              | (501)                     | 192         | (309)       |
| Net cash provided by operating activities            | 45,288                    | (23)        | 45,265      |
| <b>Investing activities</b>                          |                           |             |             |
| Expenditures for property, plant and equipment       | (34,120)                  | 54          | (34,066)    |
| Net cash used in investing activities                | (56,373)                  | 54          | (56,319)    |
| Net increase (decrease) in cash and cash equivalents | 15,774                    | 31          | 15,805      |
| Cash and cash equivalents at beginning of year       | 8,151                     | 11          | 8,162       |
| Cash and cash equivalents at end of year             | \$ 23,925                 | \$ 42       | \$ 23,967   |

**CONSOLIDATED STATEMENT OF CASH FLOWS****For the year ended December 31, 2005****(in thousands, except per share data)**

|  | As Previously<br>Reported | Adjustments | As Restated |
|--|---------------------------|-------------|-------------|
| <b>Operating activities</b>                          |                           |             |             |
| Net income   | \$ 2,499                  | \$ (248)    | \$ 2,251    |
| Changes in operating assets and liabilities:         |                           |             |             |
| Inventories  | (12,369)                  | (205)       | (12,574)    |
| Accounts payable                                     | (1,987)                   | (218)       | (2,205)     |
| Accrued expenses                                     | 2,410                     | 190         | 2,600       |
| Income taxes receivable                              | (7,800)                   | (148)       | (7,948)     |
| Net cash provided by operating activities            | 11,863                    | (629)       | 11,234      |
| <b>Investing activities</b>                          |                           |             |             |
| Expenditures for property, plant and equipment       | (49,927)                  | 51          | (49,876)    |
| Net cash used in investing activities                | (29,425)                  | 51          | (29,374)    |
| Net increase (decrease) in cash and cash equivalents | (21,994)                  | (578)       | (22,572)    |
| Cash and cash equivalents at beginning of year       | 23,925                    | 42          | 23,967      |
| Cash and cash equivalents at end of year             | \$ 1,931                  | \$ (536)    | \$ 1,395    |

See Note 14 for the impact of the restatement on quarterly financial information for the years ended December 31, 2004 and 2005.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES****Basis of Accounting**



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The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States and include the accounts of the Company and its wholly-owned subsidiaries, Winchester Capital, Inc., Winchester SP, Inc. and Trex Wood-Polymer Espana, S.L. ( TWPE ). Intercompany accounts and transactions have been eliminated in consolidation.

TWPE was formed to hold the Company's 35% equity interest in Denplax, S.A. ( Denplax ), a joint venture with a Spanish company responsible for public environmental programs in southern Spain and with an Italian equipment manufacturer. The joint venture was formed to recycle polyethylene at a facility in El Ejido, Spain. The Company's investment in Denplax is accounted for using the equity method.

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**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and the accompanying notes. Actual results could differ from those estimates.

**Cash and Cash Equivalents**

Cash equivalents consist of highly liquid investments purchased with original maturities of three months or less.

**Concentrations and Credit Risk**

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents, trade accounts receivable and interest rate swap contracts. The Company from time to time may have bank deposits in excess of insurance limits of the Federal Deposit Insurance Corporation. As of December 31, 2005, substantially all deposits are maintained in one financial institution. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk related to its cash and cash equivalents.

The Company routinely assesses the financial strength of its customers and, as a consequence, believes that its trade receivable credit risk exposure is limited. Trade receivables are carried at the original invoice amount less an estimate made for doubtful accounts based on a review of all outstanding amounts. A valuation allowance is provided for known and anticipated credit losses, as determined by management in the course of regularly evaluating individual customer receivables. This evaluation takes into consideration a customer's financial condition and credit history, as well as current economic conditions. The Company's losses as a result of uncollectible accounts have not been significant.

In the years ended December 31, 2003, 2004 and 2005, sales from certain customers accounted for 10% or more of the Company's total gross sales. For the year ended December 31, 2003, the Company's four significant customers represented 23%, 17%, 16% and 10%, respectively, of the Company's gross sales. For the year ended December 31, 2004, the Company's three significant customers represented 25%, 17% and 15%, respectively, of the Company's gross sales. For the year ended December 31, 2005, the Company's three significant customers represented 22%, 18% and 15%, respectively. As of December 31, 2004, three customers represented 29%, 24% and 18%, respectively, of the Company's accounts receivable balance. As of December 31, 2005, three customers represented 30%, 21% and 12%, respectively, of the Company's accounts receivable balance.

Approximately 34%, 38% and 36% of the Company's raw materials purchases for the years ended December 31, 2003, 2004 and 2005, respectively, were purchased from its four largest suppliers.

The Company is also exposed to credit loss in the event of nonperformance by the counter-parties to its interest rate swap agreements, but the Company does not anticipate nonperformance by the counter-parties. The amount of such exposure is generally the unrealized gains, if any, under such agreements.

**Inventories**

Inventories are stated at the lower of cost (last-in, first-out, or LIFO) or market value.

**Property, Plant and Equipment**

Property, plant and equipment are stated at historical cost. The costs of additions and improvements are capitalized, while maintenance and repairs are expensed as incurred. Depreciation is provided using the straight-line method over the following estimated useful lives:

|                                 |            |
|---------------------------------|------------|
| Buildings                       | 40 years   |
| Machinery and equipment         | 5-11 years |
| Furniture and equipment         | 10 years   |
| Forklifts and tractors          | 5 years    |
| Computer equipment and software | 3-5 years  |

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Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the asset.

### **Goodwill**

Goodwill represents the excess of cost over net assets acquired resulting from the Company's purchase of the Mobil Composite Products Division in 1996. Each year, in accordance with Statement of Financial Accounting Standards ( SFAS )

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No. 142, Goodwill and Other Intangible Assets, the Company conducts an impairment test. For the years ended December 31, 2004 and 2005, the Company completed its annual impairment test of goodwill and noted no impairment. The Company performs the annual impairment testing of its goodwill as of October 31 in each year, which could have an adverse effect on the Company's future results of operations if an impairment occurs.

**Long-Lived Assets**

In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the Company reviews its long-lived assets, including property, plant and equipment, whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. To determine the recoverability of its long-lived assets, the Company evaluates the probability that future estimated undiscounted net cash flows will be less than the carrying amount of the long-lived assets. If such cash flows are more likely than not to be less than the carrying amount of the long-lived assets, such assets are written down to their fair value. The Company's estimates of anticipated cash flows and the remaining estimated useful lives of long-lived assets could be reduced in the future. As a result, the carrying amount of long-lived assets could be reduced in the future.

**Revenue Recognition**

The Company recognizes revenue when title is transferred to customers, which is generally upon shipment of the product to the customer from the Company's manufacturing facilities. The Company does not grant contractual product return rights to its customers other than pursuant to its product warranty. Product returns have not been material and, consequently, the Company does not maintain an allowance for product returns. Pursuant to Emerging Issues Task Force (EITF) Issue 00-10, Accounting for Shipping and Handling Fees and Costs, the Company records all shipping and handling fees in sales and records all of the related costs in cost of sales. The Company offers several programs to dealers and distributors, including cash rebates, sales incentives and cooperative advertising. The Company accounts for these programs in accordance with EITF Issue 01-09, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products). The Company classifies cash rebates and sales incentives as a reduction in revenue. Cash rebates are recorded in the period in which the related revenue is recognized. Sales incentives are accrued based upon estimates of the amounts that will be earned by customers. Cooperative advertising costs are classified in selling, general and administrative expenses and are accrued as the related advertising expenditures are incurred.

The Company warrants certain attributes of its products. The Company has recorded a provision for estimated warranty and related costs, none of which has been material to the consolidated financial statements, in the period in which the sale is recorded.

**Stock-Based Compensation**

In October 1995, the Financial Accounting Standards Board (FASB) issued SFAS No. 123, Accounting for Stock-Based Compensation. SFAS No. 123 allows companies to account for stock-based compensation under the provisions of SFAS No. 123 or under the provisions of Accounting Principles Board Opinion (APB) No. 25, but requires pro forma disclosures in the footnotes to the financial statements as if the measurement provisions of SFAS No. 123 have been adopted. In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure, which prescribes certain disclosures and provides guidance on how to transition from the intrinsic value method of accounting for stock-based employee compensation under APB No. 25 to the fair value method of accounting of SFAS No. 123, if a company so elects. The Company accounts for its stock-based compensation in accordance with APB No. 25 and its related interpretations. No stock-based compensation cost related to stock option grants has been reflected in net income, as all options granted had an exercise price equal to the fair value of the underlying common stock on the date of grant. The Company has recognized stock-based compensation for awards of restricted common stock. Such compensation is based upon the fair value of the common stock on the date of grant.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123.

|  | Year Ended December 31, |              |              |
|--|-------------------------|--------------|--------------|
|  | 2003                    | 2004         | 2005         |
|  | As Restated             | As Restated  | As Restated  |
|  | (See Note 2)            | (See Note 2) | (See Note 2) |

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|  |            |            |            |
|--|------------|------------|------------|
| Net income, as reported  | \$ 21,080  | \$ 27,487  | \$ 2,251   |
| Deduct: Additional stock-based compensation expense determined under fair value based method, net of related tax effects | \$ (1,556) | \$ (1,235) | \$ (4,273) |
| Pro forma net income   | \$ 19,524  | \$ 26,252  | \$ (2,022) |
| Earnings per share:  |            |            |            |
| Basic-as reported  | \$ 1.45    | \$ 1.88    | \$ 0.15    |
| Basic-pro forma  | \$ 1.34    | \$ 1.79    | \$ (0.14)  |
| Diluted-as reported  | \$ 1.43    | \$ 1.85    | \$ 0.15    |
| Diluted-pro forma  | \$ 1.33    | \$ 1.77    | \$ (0.14)  |

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In accordance with SFAS No. 123, the fair value was estimated at the grant date using a Black-Scholes option pricing model with the following weighted-average assumptions for the years ended December 31, 2003, 2004 and 2005: risk-free interest rates ranging from 3% to 5%; no dividends; expected life of the options of approximately five years; and volatility ranging from 35% to 81%.

In December 2005, the Compensation Committee of the Board of Directors approved the immediate and full acceleration of the vesting of each outstanding otherwise unvested stock option that had an exercise price greater than \$25.92. The acceleration was effective as of December 19, 2005. The acceleration applied to 247,898 stock option awards from 2002 through 2005. Because the accelerated options each had an exercise price in excess of the current market value of the common stock based on the closing price of \$25.92 per share reported on the New York Stock Exchange on December 19, 2005, the Company did not record any incremental compensation expense under the intrinsic value method. The acceleration will minimize certain future compensation expense that the Company would otherwise have recognized in its consolidated statement of operations with respect to those options pursuant to SFAS No. 123R, as discussed below in this Note 3. Future expense related to options granted as of December 31, 2005 under SFAS No. 123R of approximately \$2.6 million was eliminated as a result of the accelerated vesting.

### **Income Taxes**

The Company accounts for income taxes and the related accounts under SFAS No. 109, Accounting for Income Taxes. Deferred tax liabilities and assets are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted rates expected to be in effect during the year in which the differences reverses. Management periodically assesses the likelihood that the Company will be able to recover its deferred tax assets and reflects any changes in estimates in the valuation allowance.

### **Research and Development Costs**

Research and development costs are expensed as incurred. For the years ended December 31, 2003, 2004 and 2005, research and development costs were \$1.7 million, \$2.7 million and \$3.6 million, respectively, and have been included in selling, general and administrative expenses in the accompanying financial statements.

### **Advertising Costs**

The Company expenses its branding and advertising communication costs as incurred. Significant advertising production costs are deferred and recognized as expense over the period that the related advertisement is used, beginning with the first publication or airing of the advertisement and ending with the earlier of the last publication or airing of the advertisement within a fiscal year or the end of the fiscal year. As of December 31, 2005, \$0.1 million was included in prepaid expenses and other assets for advertising production costs for advertisements that will be used in the year ending December 31, 2006. As of December 31, 2004, \$1.8 million was included in prepaid expenses for production costs.

For the years ended December 31, 2003, 2004 and 2005, branding expenses, including advertising expenses as described above, were \$15.0 million, \$17.3 million and \$24.9 million, respectively.

### **Fair Value of Financial Instruments**

The Company considers the recorded value of its financial assets and liabilities, consisting primarily of cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and other current liabilities, real estate loans, and promissory note to approximate the fair value of the respective assets and liabilities at December 31, 2004 and 2005. The fair value of the Company's senior notes at December 31, 2005 was estimated at \$33.2 million.

### **Derivative Instruments**

Effective January 1, 2001, the Company adopted SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities. SFAS No. 133, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and hedging activities and requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value.



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In order to manage market risk exposure related to changing interest rates, the Company has entered into interest rate swap agreements that effectively convert its floating-rate debt to a fixed-rate obligation. These interest rate swap agreements are accounted for as cash flow hedges as permitted by SFAS No. 133, as amended.

The effective portion of the gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in current earnings during the period of change. Such amounts recognized in current earnings have not been material. The Company estimates that of the amount included in accumulated other comprehensive loss at December 31, 2005, which is approximately \$0.3 million, net of taxes, will be reclassified to earnings over the next twelve months.

### **Reclassifications**

Certain prior year amounts have been reclassified to conform with the current year presentation.

### **Investment in Denplax**

During 2000, the Company formed a joint venture, Denplax, with a Spanish environmental company and an Italian equipment manufacturer to operate a plant in Spain designed to recycle waste polyethylene. Denplax qualifies as a variable interest entity under FASB Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51 (the Interpretation). The Company adopted the Interpretation during the first quarter of 2004. The adoption of the Interpretation did not have a material impact on the Company's financial position or results of operations. Denplax was financed with initial equity contributions from the Company and the other partners and debt financing. The Company is not contingently liable for any of Denplax's obligations. The Company does not control Denplax and records its proportional 35% share of Denplax's operating results using the equity method. Under a separate supply agreement, the Company has agreed to purchase up to 27,200 metric tons of the Denplax plant's production per year, if the production meets certain material specifications. In the years ended December 31, 2003, 2004 and 2005, the Company purchased 18,393 metric tons for approximately \$3.8 million, 14,424 metric tons for approximately \$3.2 million, and approximately 13,275 metric tons for approximately \$2.8 million, respectively, excluding freight costs. In each such year, the Company's purchases accounted for substantially all of the Denplax plant's production. During the years ended December 31, 2004 and 2005, the Company made additional investments in Denplax of approximately \$44,000 and \$35,000, respectively. The carrying value of the Company's investment in Denplax was approximately \$0.8 million at December 31, 2004 and 2005. In addition, under a revolving line of credit financing arrangement that matures on December 31, 2006 and bears interest at an annual rate of 4%, the Company had loaned Denplax approximately \$1.2 million and \$1.7 million at December 31, 2004 and 2005, respectively. At December 31, 2005, the Company had also prepaid \$0.3 million for purchases in route from Denplax.

### **New Accounting Standards**

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, and Amendment of ARB No. 43, Chapter 4. SFAS No. 151 amends Accounting Research Bulletin 43, Chapter 4, to clarify that abnormal amounts of idle facility expense, freight, handling costs and wasted materials (spoilage) should be recognized as current period charges. It also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company is currently evaluating the effect that the adoption of SFAS No. 151 will have on its results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123R, Share-Based Payment, which becomes effective for the Company for reporting periods beginning after December 31, 2005. SFAS No. 123R addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for equity instruments of the company or liabilities that are based on the fair value of the company's equity instruments or that may be settled by the issuance of such equity instruments. This statement requires that share-based transactions be accounted for using a fair-value-based method to recognize compensation expense. SFAS No. 123R allows for the use of the Black-Scholes or lattice option-pricing model to value options. The Company has not yet determined the option-pricing model it will use to calculate the fair value of its options.

As allowed by SFAS No. 123R, the Company may elect to adopt the standard using either the modified prospective method, which applies the statement to new awards and modified awards after the effective date, and to any unvested awards as service is rendered on or after the effective date, or the modified retrospective method, which can apply the statement either to all prior years for which SFAS No. 123 was effective or only to prior interim periods in the year of adoption. The Company is currently evaluating which method of adoption it will use. Note 3 under Stock-Based Compensation above illustrates the effects on net income and earnings per share if the Company had adopted SFAS No. 123, using



the Black-Scholes option-

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pricing model. The impact of the adoption of SFAS No. 123R cannot be predicted at this time, because such impact will depend on levels of share-based payments granted in the future. However, if the Company had adopted SFAS No. 123R in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma income and earnings per share.

SFAS No. 123R requires that compensation cost be recognized for unvested awards over the period through the date that the employee is no longer required to provide future services to earn the award, rather than over the explicit service period. Accordingly, the Company will adjust its existing policy for recognizing compensation cost to coincide with the date that the employee is eligible to retire, rather than the actual retirement date, for all options granted subsequent to January 1, 2006. SFAS No. 123R also requires the benefits of tax deductions in excess of compensation amounts recognized for book purposes to be reported as a financing cash flow rather than as an operating cash flow as required under current rules. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. The Company cannot estimate what those amounts will be in the future because they depend on, among other things, when employees exercise stock options.

**4. INVENTORIES**

Inventories (at LIFO value) consist of the following as of December 31 (in thousands):

|                | 2004         | 2005         |
|----------------|--------------|--------------|
|                | As Restated  | As Restated  |
|                | (See Note 2) | (See Note 2) |
| Finished goods | \$ 32,564    | \$ 38,779    |
| Raw materials  | 11,793       | 18,152       |
|                | \$ 44,357    | \$ 56,931    |

At December 31, 2004 and 2005, the excess of the replacement cost of inventory over the LIFO value of inventory was approximately \$10.7 million and \$24.7 million, respectively.

**5. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment consist of the following as of December 31 (in thousands):

|                           | 2004         | 2005         |
|---------------------------|--------------|--------------|
|                           | As Restated  | As Restated  |
|                           | (See Note 2) | (See Note 2) |
| Building and improvements | \$ 36,466    | \$ 49,104    |
| Machinery and equipment   | 121,901      | 164,523      |
| Furniture and equipment   | 2,247        | 2,254        |
| Forklifts and tractors    | 3,846        | 3,874        |
| Computer equipment        | 5,913        | 7,859        |
| Construction in process   | 36,844       | 24,473       |
| Land                      | 8,857        | 8,857        |
|                           | 216,074      | 260,944      |
| Accumulated depreciation  | (57,761)     | (69,861)     |
|                           | \$ 158,313   | \$ 191,083   |

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The Company had construction in process as of December 31, 2005 of approximately \$24.5 million. The Company expects that the construction in process will be completed and put into service by mid-2007.

Depreciation expense for the years ended December 31, 2003, 2004 and 2005 totaled \$12.5 million, \$13.7 million and \$16.1 million, respectively.

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In connection with the retooling of certain production lines at the Company's Winchester and Fernley plants, the Company disposed of certain equipment, which resulted in a \$1.0 million charge in 2005 included in selling, general, and administrative expenses.

**6. ACCRUED EXPENSES**

Accrued expenses consist of the following (in thousands):

|                                      | <b>2004</b>         |                  |
|--------------------------------------|---------------------|------------------|
|                                      | <b>As Restated</b>  |                  |
|                                      | <b>(See Note 2)</b> | <b>2005</b>      |
| Accrued sales and marketing costs    | \$ 3,442            | \$ 4,181         |
| Accrued compensation and benefits    | 5,404               | 4,552            |
| Accrued manufacturing expenses       | 1,047               | 1,854            |
| Accrued professional and legal costs | 1,954               | 686              |
| Accrued freight                      | 785                 | 661              |
| Deferred rent                        | 439                 | 488              |
| Accrued interest                     | 191                 | 349              |
| Other                                | 1,652               | 4,743            |
| <b>Total</b>                         | <b>\$ 14,914</b>    | <b>\$ 17,514</b> |

**7. DEBT****2002 Refinancing**

On June 19, 2002, the Company refinanced total indebtedness of \$47.6 million outstanding under a senior bank credit facility and various real estate loans. The Company refinanced this indebtedness with the proceeds from its sale of senior notes in the aggregate principal amount of \$40.0 million and borrowings under new real estate loans having an aggregate principal amount of \$12.6 million. In connection with the refinancing, the Company replaced its existing revolving credit facility with a \$20.0 million revolving credit facility with a new lender. Borrowings under the revolving credit facility and the senior notes were secured by liens on substantially all of the Company's assets. These liens were subsequently released in connection with the September 30, 2004 refinancing described below.

The senior notes accrue interest at an annual rate of 8.32%. Five principal payments of \$8.0 million annually to retire the notes began in June 2005.

Amounts drawn under the revolving credit facility are subject to a borrowing base consisting of accounts receivable and finished goods inventories. At December 31, 2005, \$4.1 million was outstanding under the revolving credit facility and the borrowing base totaled approximately \$43.0 million. As of December 31, 2005, the Company had issued letters of credit under the revolving credit facility that totaled \$0.8 million and expire in the year ended December 31, 2006.

The Company capitalized \$1.3 million of financing costs relating to the foregoing refinancing. The deferred financing costs are amortized over the terms of the various debt instruments.

**Real Estate Loans**

The Company's real estate loans accrue interest at annual rates equal to LIBOR plus specified margins. The real estate loans are secured by the Company's various real estate holdings and are held by financial institutions.

In May 2000, the Company financed its purchase of a manufacturing facility through borrowings under its revolving credit facility. In August 2000, the Company refinanced the borrowings with a 15-year term loan in the original principal amount of \$5.9 million. Pursuant to terms of the September 30, 2004 refinancing described below, the loan provides for monthly payments of principal and interest and will be payable in full on

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September 30, 2009. Under an interest rate swap agreement, interest on this loan is payable at an annual effective rate of 10.10% at December 31, 2005.

In September 1999, the Company refinanced two loans incurred in connection with the site acquisition and construction of a manufacturing facility with a 15-year term loan in the original principal amount of approximately \$6.7 million. The loan provides for monthly payments of principal and interest over the 15-year amortization schedule. Under an interest rate swap agreement, interest on this loan is payable at an annual effective rate of 7.90% at December 31, 2005.

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In 1998, the Company borrowed \$4.8 million under two loans to fund, in part, the acquisition of the site for a manufacturing facility and the site of its research and development facility. The loans provided for monthly payments of principal and interest over a 15-year amortization schedule, with all remaining principal due on the tenth anniversary of the loan dates. Pursuant to terms of the September 30, 2004 refinancing described below, the loans will be payable in full on September 30, 2009. Under interest rate swap agreements, interest on these loans is payable at annual effective rates of 9.12% and 8.80%, respectively, at December 31, 2005.

### **2004 Refinancing**

On September 30, 2004, the Company amended its \$20.0 million revolving credit facility and certain real estate loans. The amendment extended the maturity date of the revolving credit facility from June 30, 2005 to September 30, 2007 and the maturity date of the real estate loans from June 30, 2005 to September 30, 2009. The revolving credit facility and real estate loans accrue interest at annual rates equal to the specified London Interbank Offered Rate ( LIBOR ) plus specified margins. The specified margins are determined based on the Company's ratio of total consolidated debt to consolidated earnings before interest, taxes, depreciation and amortization, as computed under the credit facility. The amendment reduced the margins for the credit facility from a range of 1.50% to 3.25% to a range of 1.25% to 1.75% and the real estate loans from a range of 1.75% to 3.50% to a range of 1.50% to 2.50%. Under the amendment, the lender and the holders of the senior notes described above released their liens on the Company's assets under the revolving credit facility and the senior notes. The amendment also made less restrictive some of the negative and financial covenants in the revolving credit facility.

The Company capitalized \$0.1 million of financing costs relating to the foregoing refinancing. The deferred financing costs are amortized over the term of the various debt instruments.

### **Promissory Note**

On December 16, 2004, the Company borrowed, under a variable rate promissory note, \$25.0 million of the proceeds from the sale of variable rate demand environmental improvement revenue bonds issued by the Mississippi Business Finance Corporation, a Mississippi public corporation. The bonds restrict the Company's use of the proceeds to financing all or a portion of the costs of the acquisition, construction and equipping of solid waste disposal facilities to be used in connection with the Company's new manufacturing facility, which is located in Olive Branch, Mississippi. As a result, the unused proceeds as of December 31, 2004 were included in restricted cash on the accompanying balance sheet. The bonds are special, limited obligations of the issuer and, unless sooner paid pursuant to redemption or other specified principal payment event, will mature on December 1, 2029. Under its loan agreement with the bond issuer, the Company is obligated to make payments sufficient to pay the principal of, premium, if any, and interest on the bonds when due. The Company's obligation to make these payments will be satisfied to the extent of payments made to the trustee of the bonds under a \$25.3 million letter of credit opened for the Company's account. The Company is obligated under a reimbursement agreement to reimburse the letter of credit bank for drawings made under the letter of credit and to make other specified payments. Interest on the bonds will initially be paid each month at a variable rate established on a weekly basis. The variable rate on the bonds was 3.63% on December 31, 2005. The interest rate is based on auction rates and is reset every seven days. The reimbursement agreement contains certain financial and non-financial covenants. The Company's obligations under the reimbursement agreement are secured by a first priority security interest in specified assets relating to the third manufacturing site and facility.

The Company capitalized \$0.5 million of financing costs relating to the foregoing financing. The deferred financing costs are amortized over the term of the debt instrument.

### **2005 Amendments**

On January 19, 2006, the Company entered into amendments to the Company's bond reimbursement agreement and credit facility agreement. Among other things, the amendments, which were effective as of December 31, 2005, increased the principal amount of the revolving credit commitment under the credit facility agreement for the period from January 1, 2006 through June 30, 2006 from \$20.0 million to \$30.0 million and increased by 1.0% the maximum interest rate margins potentially applicable to revolving loans and real estate loans under the agreement. The amendments also added a new financial covenant under both agreements for the year ended December 31, 2005 and provided that certain financial covenants would not be measured for the three-month periods ended December 31, 2005 and ending March 31, 2006.

To remain in compliance with its credit facility, senior notes and bond loan document covenants, the Company must maintain specified financial ratios based on its levels of debt, capital, net worth, fixed charges and earnings (excluding extraordinary gains and extraordinary non-cash losses) before interest, taxes, depreciation and amortization. At December 31, 2005, after giving effect to the foregoing amendments, the Company was in compliance with these covenants. The foregoing debt agreements contain cross-default provisions.



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Long-term debt consists of the following as of December 31 (in thousands):

|  | 2004             | 2005             |
|--|------------------|------------------|
| Real estate loan, due September 30, 2009 | \$ 2,643         | \$ 2,416         |
| Real estate loan, due September 30, 2009 | 742              | 681              |
| Real estate loan, due September 30, 2009 | 4,893            | 4,593            |
| Real estate loan, due September 30, 2014 | 5,219            | 4,846            |
| Senior notes                             | 40,000           | 32,000           |
| Promissory note                          | 25,000           | 25,000           |
|  | 78,497           | 69,536           |
| Less current portion                     | (8,932)          | (9,031)          |
| <b>Long-term debt</b>                    | <b>\$ 69,565</b> | <b>\$ 60,505</b> |

Future maturities of long-term debt are as follows (in thousands):

| Years ending December 31, |                  |
|---------------------------|------------------|
| 2006                      | \$ 9,031         |
| 2007                      | 9,115            |
| 2008                      | 9,254            |
| 2009                      | 14,091           |
| 2010                      | 549              |
| Thereafter                | 27,496           |
|                           | <b>\$ 69,536</b> |

During the years ended December 31, 2003, 2004 and 2005, the Company capitalized approximately \$1.1 million, \$1.3 million and \$2.2 million of interest, respectively.

**Interest Rate Swaps**

The Company uses interest rate swap contracts to manage its exposure to fluctuations in the interest rates under its real estate loans and variable rate promissory note. At December 31, 2005, the Company had capped its interest rate exposure at an annual effective rate of approximately 9.0% on the principal amount of real estate loans, which totaled approximately \$12.5 million. The agreements effectively entitle the Company to receive from (pay to) the bank the amount, if any, by which the Company's interest payments on its \$2.4 million, \$0.7 million, \$4.8 million and \$4.6 million LIBOR-based floating-rate real estate loans exceed (fall below) 9.1%, 8.8%, 7.9% and 10.1%, respectively, based on the credit spread in effect at December 31, 2005. In January 2005, the Company entered into interest rate swap agreements that capped its interest rate exposure at an annual effective rate of 3.1% for seven years on \$10.0 million principal amount of its \$25.0 million variable rate promissory note and at an annual effective rate of 3.0% for five years on an additional \$10.0 million principal amount of such note. Payments received (made) as a result of the agreements are recognized as a reduction of (increase to) interest expense on the variable rate debt. The Company has evaluated and documented these interest rate swap agreements as cash flow hedges of variable rate debt, in which any changes in fair values of the derivatives are recorded in other comprehensive income, net of taxes. Any hedge ineffectiveness is reported in current earnings. Such amounts have not been material. The Company did not incur a premium or other fee for its interest rate swap agreements.

**Warrants**

In connection with revisions to its senior bank credit facility in November 2001, the Company issued the lender a warrant to purchase shares of common stock at \$14.89 per share. In March 2003, the lender exercised the warrant to purchase 353,779 shares of common stock issuable thereunder for a total purchase price of \$5.3 million.





**Table of Contents****8. STOCKHOLDERS EQUITY**

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except share and per share data):

|  | Year Ended December 31, |                   |                   |
|--|-------------------------|-------------------|-------------------|
|  | 2003                    | 2004              | 2005              |
|  | As Restated             | As Restated       | As Restated       |
|  | (See Note 2)            | (See Note 2)      | (See Note 2)      |
| <b>Numerator:</b>                                  |                         |                   |                   |
| Net income   | \$ 21,080               | \$ 27,487         | \$ 2,251          |
| <b>Denominator:</b>                                |                         |                   |                   |
| Basic weighted average shares outstanding          | 14,522,092              | 14,636,959        | 14,769,799        |
| <b>Effect of dilutive securities:</b>              |                         |                   |                   |
| Stock options                                      | 117,127                 | 108,828           | 50,532            |
| Warrants   | 18,904                  |                   |                   |
| Restricted stock                                   | 69,715                  | 88,931            | 59,330            |
| <b>Diluted weighted average shares outstanding</b> | <b>14,727,838</b>       | <b>14,834,718</b> | <b>14,879,661</b> |
| Basic earnings per share                           | \$ 1.45                 | \$ 1.88           | \$ 0.15           |
| <b>Diluted earnings per share</b>                  | <b>\$ 1.43</b>          | <b>\$ 1.85</b>    | <b>\$ 0.15</b>    |

On March 12, 1999, the Company adopted the 1999 Stock Option and Incentive Plan (the 1999 Plan). The 1999 Plan authorized, among other things, the granting of options, restricted stock and other equity-based awards to purchase up to 1,400,000 shares of common stock. The exercise price per share under each option granted under the 1999 Plan could not be less than 100% of the fair market value of the common stock on the option grant date. The Compensation Committee of the Board of Directors determined the vesting terms of the options.

On March 19, 2002, the Company issued 120,000 shares of restricted stock to certain employees under the 1999 Plan. The shares vest in equal installments on the third, fourth and fifth anniversaries of the date of grant. The Company recorded \$2.9 million of deferred compensation relating to the issuance of the restricted stock. The deferred compensation is being amortized on a straight-line basis over the five-year vesting period.

On March 9, 2005, the Company issued 18,944 shares of restricted stock to certain employees under the 1999 Plan. The shares vest in equal installments of the first, second and third anniversaries of the date of grant. The Company recorded \$0.9 million of deferred compensation relating to the issuance of the restricted stock. The deferred compensation is being amortized on a straight-line basis over the three-year vesting period.

In October 2005, the Company entered into a separation agreement with the Company's former Chairman and Chief Executive Officer. The separation agreement provides for cash payments to be paid through March 2006, all of which have been accrued in the accompanying balance sheet at December 31, 2005. The separation agreement also provided for the acceleration of vesting of 6,089 restricted shares of the Company's common stock, which resulted in the acceleration of the recognition of \$0.3 million of stock-based compensation. As a result of the foregoing, the Company recorded a charge of \$1.1 million in the three months ended December 31, 2005.

On March 9, 2005, the Company granted 53,987 performance share awards to certain employees under the Company's 1999 Plan. Payment of the performance share awards will be made in the form of unrestricted common stock on the third anniversary of the date of grant if certain performance targets are met. The Company will record compensation expense relating to the performance share awards when and if the achievement of performance targets becomes probable. For the year ended December 31, 2005, the Company recorded no compensation expense.

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On April 21, 2005, the Company adopted the 2005 Stock Incentive Plan (the 2005 Plan ). The 2005 Plan amended and restated the 1999 Plan and authorizes, among other awards, the granting of options, restricted stock, restricted stock units, stock appreciation rights and unrestricted stock. The aggregate number of shares of stock available for issuance under the 2005 Plan is 2,150,000 shares. The exercise price per share under each option, and the grant price of each stock appreciation right, granted under the 2005 Plan may not be less than 100% of the fair market value of the common stock on the grant date. The Compensation Committee of the Board of Directors determines the vesting terms of the options and stock appreciation rights. At December 31, 2005, 1,017,635 shares of common stock were reserved for issuance under the 2005 Plan in connection with future awards.

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Stock option activity under the 1999 Plan and the 2005 Plan is as follows:

|                                  | <b>Options</b> | <b>Weighted Average<br/>Exercise Price</b> |
|----------------------------------|----------------|--|
|                                  | <b>Options</b> | <b>Per Share</b>                           |
| Outstanding at December 31, 2002 | 452,389        | \$ 22.30                                   |
| Granted                          | 159,269        | \$ 36.08                                   |
| Exercised                        | (41,947)       | \$ 16.73                                   |
| Canceled                         | (15,904)       | \$ 20.38                                   |
| Outstanding at December 31, 2003 | 553,807        | \$ 26.74                                   |
| Granted                          | 193,789        | \$ 38.13                                   |
| Exercised                        | (130,314)      | \$ 22.58                                   |
| Canceled                         | (1,699)        | \$ 33.09                                   |
| Outstanding at December 31, 2004 | 615,583        | \$ 31.19                                   |
| Granted                          | 225,280        | \$ 46.13                                   |
| Exercised                        | (33,242)       | \$ 26.45                                   |
| Canceled                         | (88,859)       | \$ 40.18                                   |
| Outstanding at December 31, 2005 | 718,762        | \$ 34.98                                   |
| Exercisable at December 31, 2005 | 681,620        | \$ 35.68                                   |

At December 31, 2005, the price range of options outstanding was as follows:

|                | <b>Options<br/>Outstanding</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Life (Years)</b> | <b>Options<br/>Exercisable</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> |
|----------------|--------------------------------|--|--|--------------------------------|--|
| \$ 0.00 19.99  | 33,093                         | \$ 17.22   | 5.4  | 33,093                         | \$ 17.22   |
| 20.00 29.99    | 225,377                        | \$ 24.44   | 5.5  | 188,235                        | \$ 24.90   |
| 30.00 39.99    | 257,167                        | \$ 36.68   | 7.7  | 257,167                        | \$ 36.68   |
| 40.00 and over | 203,125                        | \$ 47.43   | 9.1  | 203,125                        | \$ 47.43   |
|                | 718,762                        | \$ 34.98   | 7.3  | 681,620                        | \$ 35.68   |

The grant date weighted average fair value of options granted in the years ended December 31, 2003, 2004 and 2005 was \$15.38, \$15.37 and \$16.96, respectively. Options granted prior to the year ended December 31, 2005 generally vest with respect to 25% of the shares subject to the option on each of the first, second, third and fourth anniversaries of the grant date. Certain options granted in the year ended December 31, 2005 vest with respect to one-third of the shares subject to the option on each of the first, second and third anniversaries of the grant date, and certain options granted in the year ended December 31, 2005 vested immediately. The options are generally forfeitable upon termination of an option holder's service as an employee or director.

**9. LEASES**

The Company leases office space, storage warehouses and certain office and plant equipment under various operating leases. Minimum annual payments under these non-cancelable leases as of December 31, 2005 were as follows (in thousands):

|  |                 |
|--|-----------------|
| <b>Year ending December 31,<br/>2006</b> | <b>\$ 5,436</b> |
|--|-----------------|

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|            |           |
|------------|-----------|
| 2007       | 5,396     |
| 2008       | 5,006     |
| 2009       | 4,337     |
| 2010       | 4,445     |
| Thereafter | 25,699    |
|            | \$ 50,319 |

For the years ended December 31, 2003, 2004 and 2005, the Company recognized rental expenses of approximately \$5.9 million, \$5.8 million and \$8.3 million, respectively.

In July 2005, in anticipation of relocating its corporate headquarters to Dulles, Virginia, the Company entered into a new lease agreement. The lease agreement provides for the initial occupancy of approximately 50,000 square feet of office space, which will increase during the lease term to approximately 75,000 square feet. The company has reconsidered its decision to relocate its corporate headquarters and has decided not to move the headquarters. Minimum payments under the lease over the

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years ending December 31, 2006, 2007, 2008, 2009, and 2010 are \$0.7 million, \$1.1 million, \$1.5 million, \$1.5 million and \$1.6 million, respectively, and \$19.8 million thereafter. The Company is currently attempting to sublet the Dulles, Virginia office space. Based on current market conditions, the Company estimates that the present value of the estimated future sublease rentals, net of transaction costs, will be greater than the Company's remaining minimum lease obligations under the lease agreement and, accordingly, has not recorded a loss related to the lease as of December 31, 2005.

The Company's assumptions in estimating future sublease income included consideration of vacancy rates, rental rates and the timing of future sublease income. Vacancy rates in the area where the property is located were approximately 10% at December 31, 2005. Management believes that the rental rates in the Company's lease reflect the current market rates in the area. Anticipated delivery of a limited amount of new office space in the area over the next 12 months may cause vacancy rates and rental rates in the short term to remain at current levels. The inability to sublet the office space or unfavorable changes to key management's assumptions used in the estimate of the future sublease income may result in charges in future periods.

**10. EMPLOYEE BENEFIT PLANS**

The Company has a 401(k) Profit Sharing Plan and a Money Purchase Pension Plan for the benefit of all employees who meet certain eligibility requirements. These plans cover substantially all of the Company's full-time employees. The plan documents provide for the Company to make defined contributions as well as matching and other discretionary contributions, as determined by the Board of Directors. The Company's contributions totaled \$0.2 million, \$0.3 million and \$0.3 million for the years ended December 31, 2003, 2004 and 2005, respectively, for the 401(k) Profit Sharing Plan and \$0.7 million, \$0.8 million and \$1.0 million for the years ended December 31, 2003, 2004 and 2005, respectively, for the Money Purchase Pension Plan.

The Company has an employee stock purchase plan that permits eligible employees to purchase shares of common stock of the Company at a purchase price which is the lesser of 85% of the market price on the first day of the calendar quarter or 85% of the market price on the last day of the calendar quarter. Eligible employees may elect to participate in the plan by authorizing payroll deductions from 1% to 15% of gross compensation for each payroll period. On the last day of each quarter, each participant's contribution account is used to purchase the maximum number of whole shares of common stock determined by dividing the contribution account's balance by the purchase price. The aggregate number of shares of common stock that may be purchased under the plan is 300,000. Through December 31, 2005, employees had purchased approximately 63,739 shares under the plan.

**11. INCOME TAXES**

The Company's provision (benefit) for income taxes consists of the following (in thousands):

|                                  | Year Ended December 31,     |                             |                             |
|----------------------------------|-----------------------------|-----------------------------|-----------------------------|
|                                  | 2003                        | 2004                        | 2005                        |
|                                  | As Restated<br>(See Note 2) | As Restated<br>(See Note 2) | As Restated<br>(See Note 2) |
| Federal income taxes (benefit)   |                             |                             |                             |
| Current                          | \$ 8,804                    | \$ 13,411                   | \$ 634                      |
| Deferred                         | 2,832                       | 1,493                       | (263)                       |
| State income taxes (benefit)     |                             |                             |                             |
| Current                          | 505                         | 871                         | (1,070)                     |
| Deferred                         | 288                         | 158                         | (1,320)                     |
| <b>Total provision (benefit)</b> | <b>\$ 12,429</b>            | <b>\$ 15,933</b>            | <b>\$ (2,019)</b>           |

The provision (benefit) for income taxes differs from the amount of income tax determined by applying the U.S. federal statutory rate of 35% to income before taxes as a result of the following (in thousands):

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|  | Year Ended December 31,     |                             |                             |
|--|-----------------------------|-----------------------------|-----------------------------|
|  | 2003                        | 2004                        | 2005                        |
|  | As Restated<br>(See Note 2) | As Restated<br>(See Note 2) | As Restated<br>(See Note 2) |
| U.S. federal statutory taxes                       | \$ 11,728                   | \$ 15,197                   | \$ 81                       |
| State and local taxes, net of U.S. federal benefit | 581                         | 659                         | (709)                       |
| State tax credits                                  |                             |                             | (2,571)                     |
| Research and development credit                    |                             |                             | (204)                       |
| Permanent differences                              | 69                          | 77                          | 108                         |
| Increase in valuation allowance                    |                             |                             | 1,354                       |
| Other  | 51                          |                             | (78)                        |
|  | \$ 12,429                   | \$ 15,933                   | \$ (2,019)                  |

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Deferred tax assets and liabilities as of December 31, 2004 and 2005 consist of the following (in thousands):

|   | As of December 31, |             |
|---|--------------------|-------------|
|   | 2004               | 2005        |
| Deferred tax assets:                        |                    |             |
| Accruals not currently deductible and other | \$ 4,038           | \$ 4,111    |
| State tax credit carryforwards              |                    | 2,571       |
| Valuation allowance                         |                    | (1,354)     |
|   | \$ 4,038           | \$ 5,328    |
| Deferred tax liabilities:                   |                    |             |
| Depreciation and other                      | \$ (16,871)        | \$ (18,775) |
| Net deferred tax liability                  | \$ (12,833)        | \$ (13,447) |

The net current deferred tax asset was \$3.0 million and \$1.7 million as of December 31, 2004 and 2005, respectively. The net long-term deferred tax liability was \$15.8 million and \$15.2 million as of December 31, 2004 and 2005, respectively.

The valuation allowance as of December 31, 2005 of \$1.4 million is attributable to the uncertainty related to the realizability of certain state tax credit carryforwards. Such state tax credits totaled \$2.6 million at December 31, 2005 and begin expiring in the year ending December 31, 2008. The Company has considered all available evidence, including its historical levels of taxable income, the future reversal of existing taxable temporary differences, estimated future taxable income for each applicable state, and the expiration period of tax credit carryforwards, in determining the need for a valuation allowance. Based upon this analysis, management determined that it is more likely than not that certain state tax credit carryforwards will expire unused and, accordingly, recorded a valuation allowance for such credit carryforwards.

The Company operates in multiple tax jurisdictions and its tax returns are subject to audit by various taxing authorities. The Company believes that adequate provisions have been made for all tax returns subject to audit.

**12. COMMITMENTS AND CONTINGENCIES****Legal Matters**

On July 28, 2000, a purported class action case was commenced against the Company in the Superior Court of New Jersey Essex County, by Michael Kanefsky generally alleging that the Company has violated state and common law by negligently misrepresenting the characteristics of its products, by breaching contracts, by breaching implied or express warranties and/or by defrauding consumers in the sale and promotion of these products. The plaintiffs sought reformation of the Company's warranty, as well as compensatory damages in an unspecified amount. On May 28, 2004, the superior court certified the following three class action cases against the Company: (1) a nationwide class for reformation of warranty; (2) a New Jersey class for alleged violation of the New Jersey Consumer Fraud Act; and (3) a New Jersey class for alleged breach of express and implied warranties. On August 24, 2004, the court preliminarily approved a proposed settlement of the action. Notice of the proposed settlement was given by the Company to the class members. On December 17, 2004, the court granted final approval of the settlement. Although the Company denies the allegations in the complaint, and believes that the court erred in certifying the classes, pursuant to the terms of the settlement, the Company has agreed that upon proper proof of claim, it will replace, at the Company's sole expense (including labor), any class member's product that exhibits certain specified characteristics. The Company has also agreed to modify its warranty in certain respects, and to discontinue certain advertising claims. The settlement does not include the payment of any monetary damages by the Company (other than \$10,000 to each of the four named plaintiffs), although the Company agreed to pay \$1,750,000 in legal fees to plaintiffs' counsel. The Company does not believe that the implementation of the settlement will have a material adverse effect on the Company's results of operations or financial condition.

Commencing on July 8, 2005, two lawsuits, both of which seek certification as a class action, were filed in the United States District Court for the Western District of Virginia naming as defendants the Company, Robert G. Matheny, a director and the former Chairman and Chief Executive Officer of the Company, and Paul D. Fletcher, Senior Vice President and Chief Financial Officer of the Company. The plaintiffs and the defendants have agreed that the two lawsuits should be consolidated,





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and on December 27, 2005, the plaintiffs filed a consolidated class action complaint. The complaints principally allege that the Company, Mr. Matheny and Mr. Fletcher violated Sections 10(b) and 20(a) of and Rule 10b-5 under the Securities Exchange Act of 1934 by, among other things, making false and misleading public statements concerning the Company's operating and financial results and expectations. The complaints also allege that certain directors of the Company sold shares of the Company's common stock at artificially inflated prices. The plaintiffs seek unspecified compensatory damages. The Company believes that the lawsuits are without merit and intends to vigorously defend against them and any other similar lawsuits that may be served on the Company or any individual director or officer. Two separate derivative lawsuits have been filed in the United States District Court for the Western District of Virginia naming as defendants Mr. Matheny, Mr. Fletcher, and each of the directors of the Company. The filed complaints in the derivative lawsuits are based upon the same factual allegations as the complaints in the class action lawsuits, and allege that the directors and Mr. Fletcher breached their fiduciary duties by permitting the Company to issue false and misleading public statements concerning the Company's operating and financial results, and also allege that certain directors of the Company sold shares of the Company's common stock at artificially inflated prices.

On December 5, 2001, Ron Nystrom commenced an action against the Company in the United States District Court, Eastern District of Virginia, Norfolk Division, alleging that the Company's decking products infringed his patent. The Company denied any liability and filed a counterclaim against the plaintiff for declaratory judgment and antitrust violations based upon patent misuse. The Company sought a ruling that the plaintiff's patent is invalid, that the Company does not infringe the patent, and that the Company is entitled to monetary damages against the plaintiff. On October 17, 2002, the district court issued a final judgment finding that the Company does not infringe any of the plaintiff's patent claims and holding that certain of the plaintiff's patent claims are invalid. The plaintiff appealed this decision to the United States Court of Appeals for the Federal Circuit. On June 28, 2004, the court of appeals reversed the district court's grant of summary judgment to the Company, and remanded the case to the district court for further proceedings. The Company sought a rehearing of the decision by the court of appeals, which, on September 14, 2005, withdrew its prior decision and affirmed the district court's grant of summary judgment to the Company with respect to non-infringement. On January 25, 2006, the district court issued judgment dismissing the plaintiff's case against the Company. The plaintiff filed a petition for writ of certiorari in the United States Supreme Court on January 30, 2006 and a notice of appeal of the district court's judgment to the United States Court of Appeals for the Federal Circuit on February 22, 2006.

The Company currently has other lawsuits, as well as other claims, pending against it. Management believes that the ultimate resolution of these other lawsuits and claims will not have a material effect on the Company's consolidated financial condition, results of operations, liquidity or competitive position.

**Purchase Commitments**

The Company fulfills requirements for raw materials under both purchase orders and supply contracts. In the year ended December 31, 2005, the Company purchased approximately 30% of its waste wood fiber requirements and approximately 68% of its PE material requirements under purchase orders, which do not involve long-term supply commitments. The Company is also party to supply contracts that require it to purchase waste wood fiber and PE material for terms that range from one to eight years. The prices under these contracts are generally reset annually. The waste wood fiber and PE material supply contracts have not had a material adverse effect on the Company's business.

The waste wood and PE material supply contracts generally provide that the Company is obligated to purchase all of the waste wood or PE material a supplier provides, if the waste wood or PE material meets certain specifications. The amount of waste wood and PE material the Company is required to purchase under these contracts varies with the production of its suppliers and, accordingly, is not fixed or determinable.

During the years ended December 31, 2003 and 2004 and 2005, the amounts that the Company has been obligated to purchase under waste wood and PE material supply contracts generally have been less than the amounts of these materials needed for production. During the year ended December 31, 2005, the Company's total commitments for waste wood for one of its facilities exceeded the Company's requirements, which it addressed by selling the excess material to third parties. To meet all of its production requirements, the Company obtained additional PE material and waste wood fiber materials under purchase orders.

**13. RELATED PARTY TRANSACTIONS**

During the years ended December 31, 2003 and 2004, the Company retained Ferrari Consulting, LLC pursuant to a consulting agreement originally signed on March 17, 2003, and extended on July 16, 2003, October 16, 2003 and February 16, 2004. Pursuant to this agreement, Andrew U. Ferrari performed consulting services relating to the development of new business opportunities for the Company. The agreement terminated on June 16, 2004. Approximately \$58,000 and \$6,900 was paid under the agreement in the years ended December 31, 2003 and 2004, respectively. During the period in which the



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agreement was in effect, Mr. Ferrari served as a director of the Company and, during part of this period, as the Company's Executive Vice President of Marketing and Business Development. Effective on August 11, 2005, Mr. Ferrari was appointed the Company's President and Chief Operating Officer.

**14. INTERIM FINANCIAL DATA (Unaudited)**

In addition to the errors described in Note 2 that affected the annual and interim financial statements for 2004 and 2005, the restatements also reflect the correction of certain errors that affected only interim financial statements in 2005. These errors included the following:

- (a) Errors related to the timing of cost capitalization as a result of which costs associated with the Company's new manufacturing facility and the implementation of a new software system were erroneously expensed as incurred rather than capitalized. These errors caused an understatement of property, plant and equipment and an overstatement of selling, general and administrative expenses in the period the costs were incurred.
- (b) Errors related to the calculation of depreciation and capitalized interest resulting primarily from the delay in transferring assets that had been placed in service from construction in process which caused a delay in the commencement of depreciation and cessation of capitalization of interest. These errors caused an overstatement of net property, plant and equipment and an understatement of cost of sales, selling, general and administrative expenses, and interest expense beginning in the period the assets were placed in service.
- (c) An error in the calculation of the allowance for doubtful accounts, which resulted from the exclusion of certain customer balances and the inclusion of customer credit balances in the accounts receivable balances used in the calculation that caused an overstatement of net accounts receivable and an understatement of selling, general and administrative expenses in the period the costs were incurred.
- (d) An error in the calculation of a miscellaneous amount receivable from a service provider that caused an understatement of accrued expenses and an understatement of selling, general and administrative expenses in the period in which the receivable was recorded.

The following tables illustrate selected quarterly financial data for the years ended December 31, 2004 and 2005. The Company's quarterly financial data have been restated. See Note 2 for additional information about the restatements.

(In thousands, except share and per share data)

|  | First Quarter       |           | Second Quarter      |           | Third Quarter       |           | Fourth Quarter      |           |
|--|---------------------|-----------|---------------------|-----------|---------------------|-----------|---------------------|-----------|
|  | As                  |           | As                  |           | As                  |           | As                  |           |
|  | Previously Reported | Restated  | Previously Reported | Restated  | Previously Reported | Restated  | Previously Reported | Restated  |
| <b>2004</b>                                  |                     |           |                     |           |                     |           |                     |           |
| Net sales                                    | \$ 76,257           | \$ 76,257 | \$ 83,407           | \$ 83,407 | \$ 64,350           | \$ 64,350 | \$ 29,614           | \$ 29,614 |
| Cost of sales                                | 46,274              | 46,140    | 46,425              | 46,344    | 39,667              | 39,511    | 18,920              | 18,798    |
| Gross profit                                 | 29,983              | 30,117    | 36,982              | 37,063    | 24,683              | 24,839    | 10,694              | 10,816    |
| Selling, general and administrative expenses | 14,139              | 14,136    | 18,528              | 18,528    | 12,947              | 12,938    | 10,768              | 10,749    |
| Income (loss) from operations                | 15,844              | 15,981    | 18,454              | 18,535    | 11,736              | 11,901    | (74)                | 67        |
| Interest expense, net                        | 974                 | 974       | 935                 | 935       | 640                 | 640       | 515                 | 515       |

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|  |            |            |            |            |            |            |            |            |
|--|------------|------------|------------|------------|------------|------------|------------|------------|
| Income (loss) before provision for income taxes    | 14,870     | 15,007     | 17,519     | 17,600     | 11,096     | 11,261     | (589)      | (448)      |
| Provision (benefit) for income taxes               | 5,533      | 5,583      | 6,451      | 6,481      | 3,995      | 4,056      | (238)      | (187)      |
| Net income (loss)                                  | \$ 9,337   | \$ 9,424   | \$ 11,068  | \$ 11,119  | \$ 7,101   | \$ 7,205   | \$ (351)   | \$ (261)   |
| Basic earnings (loss) per common share             | \$ 0.64    | \$ 0.65    | \$ 0.76    | \$ 0.76    | \$ 0.48    | \$ 0.49    | \$ (0.02)  | \$ (0.02)  |
| Basic weighted average common shares outstanding   | 14,587,853 | 14,587,853 | 14,598,435 | 14,598,435 | 14,654,891 | 14,654,891 | 14,705,706 | 14,705,706 |
| Diluted earnings (loss) per common share           | \$ 0.63    | \$ 0.64    | \$ 0.75    | \$ 0.75    | \$ 0.48    | \$ 0.48    | \$ (0.02)  | \$ (0.02)  |
| Diluted weighted average common shares outstanding | 14,751,621 | 14,751,621 | 14,771,024 | 14,771,024 | 14,856,343 | 14,856,343 | 14,705,706 | 14,705,706 |

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(In thousands, except share and per share data)

| 2005   | First Quarter       |             | Second Quarter      |             | Third Quarter       |             | Fourth Quarter      |             |
|--|---------------------|-------------|---------------------|-------------|---------------------|-------------|---------------------|-------------|
|  | As                  |             | As                  |             | As                  |             | As                  |             |
|  | Previously Reported | As Restated | Previously Reported | As Restated | Previously Reported | As Restated | Previously Reported | As Restated |
| Net sales  | \$ 89,904           | \$ 89,904   | \$ 82,865           | \$ 82,865   | \$ 77,371           | \$ 77,371   | \$ 43,993           | \$ 43,993   |
| Cost of sales                                      | 56,568              | 56,383      | 59,992              | 59,452      | 53,035              | 52,933      | 44,309              | 45,129      |
| Gross profit (loss)                                | 33,336              | 33,521      | 22,873              | 23,413      | 24,336              | 24,438      | (316)               | (1,136)     |
| Selling, general and administrative expenses       | 19,416              | 19,260      | 25,025              | 24,876      | 16,967              | 17,037      | 15,474              | 16,118      |
| Income (loss) from operations                      | 13,920              | 14,261      | (2,152)             | (1,463)     | 7,369               | 7,401       | (15,790)            | (17,254)    |
| Interest expense, net                              | 756                 | 756         | 720                 | 720         | 313                 | 476         | 930                 | 761         |
| Income (loss) before provision for income taxes    | 13,164              | 13,505      | (2,872)             | (2,183)     | 7,056               | 6,925       | (16,720)            | (18,015)    |
| Provision (benefit) for income taxes               | 4,760               | 4,887       | (1,858)             | (1,602)     | 1,891               | 1,842       | (6,664)             | (7,146)     |
| Net income (loss)                                  | \$ 8,404            | \$ 8,618    | \$ (1,014)          | \$ (581)    | \$ 5,165            | \$ 5,083    | \$ (10,056)         | \$ (10,869) |
| Basic earnings (loss) per common share             | \$ 0.57             | \$ 0.58     | \$ (0.07)           | \$ (0.04)   | \$ 0.35             | \$ 0.34     | \$ (0.68)           | \$ (0.73)   |
| Basic weighted average common shares outstanding   | 14,731,889          | 14,731,889  | 14,772,498          | 14,772,498  | 14,782,888          | 14,782,888  | 14,791,975          | 14,791,975  |
| Diluted earnings (loss) per common share           | \$ 0.56             | \$ 0.58     | \$ (0.07)           | \$ (0.04)   | \$ 0.35             | \$ 0.34     | \$ (0.68)           | \$ (0.73)   |
| Diluted weighted average common shares outstanding | 14,921,705          | 14,921,705  | 14,772,498          | 14,772,498  | 14,847,519          | 14,847,519  | 14,791,975          | 14,791,975  |

The Company's net sales, gross profit and income from operations have historically varied from quarter to quarter. Such variations are principally attributable to seasonal trends in the demand for Trex. The Company has historically experienced lower net sales during the fourth quarter because holidays and adverse weather conditions in certain regions reduce the level of home improvement and new construction activity.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this amendment to report to be signed on its behalf by the undersigned, thereunto duly authorized.

**Trex Company, Inc.**

By:                    /s/ PAUL D. FLETCHER  
   **Paul D. Fletcher**  
   **Senior Vice President and Chief Financial Officer**

**(Duly Authorized Officer)**

Date: March 6, 2007

**Table of Contents****EXHIBIT INDEX**

| <b>Exhibit Number</b> | <b>Exhibit Description</b>  |
|-----------------------|---|
| 3.1                   | Restated Certificate of Incorporation of Trex Company, Inc. (the Company). Filed as Exhibit 3.1 to the Company's Registration Statement on Form S-1 (No. 333-63287) and incorporated herein by reference.   |
| 3.2                   | Amended and Restated By-Laws of the Company. Filed as Exhibit 3.1 to the Company's Quarterly Report Form 10-Q for the quarterly period ended September 30, 2004 and incorporated herein by reference.   |
| 4.1                   | Specimen certificate representing the Company's common stock. Filed as Exhibit 4.1 to the Company's Registration Statement on Form S-1 (No. 333-63287) and incorporated herein by reference.  |
| 10.1                  | Description of Non-Employee Director Compensation. Filed as Exhibit 10.1 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.  |
| 10.2                  | Description of Management Compensatory Plans and Arrangements. Filed as Exhibit 10.2 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.  |
| 10.3                  | Trex Company, Inc. 2005 Stock Incentive Plan. Filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2005 and incorporated herein by reference.  |
| 10.4                  | Trex Company, Inc. Amended and Restated 1999 Incentive Plan for Outside Directors, as amended. Filed as Exhibit 10.4 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.                                  |
| 10.5                  | Form of Trex Company, Inc. 2005 Stock Incentive Plan Non-Incentive Stock Option Agreement. Filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005 and incorporated herein by reference.                                  |
| 10.6                  | Form of Trex Company, Inc. 2005 Stock Incentive Plan Stock Appreciation Rights Agreement. Filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005 and incorporated herein by reference.                                   |
| 10.7                  | Form of Trex Company, Inc. 2005 Stock Incentive Plan Performance Award Agreement. Filed as Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005 and incorporated herein by reference.   |
| 10.8                  | Form of Trex Company, Inc. 2005 Stock Incentive Plan Restricted Stock Agreement. Filed as Exhibit 10.8 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.  |
| 10.9                  | Form of Trex Company, Inc. Amended and Restated 1999 Incentive Plan for Outside Directors Non-Incentive Stock Option Agreement. Filed as Exhibit 10.4 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002 and incorporated herein by reference. |
| 10.9                  | Form of Trex Company, Inc. Amended and Restated 1999 Incentive Plan for Outside Directors Non-Incentive Stock Option Agreement. Filed as Exhibit 10.4 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002 and incorporated herein by reference. |
| 10.10                 | Form of Trex Company, Inc. Amended and Restated 1999 Incentive Plan for Outside Directors Stock Appreciation Rights Agreement. Filed as Exhibit 10.10 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference. |
| 10.11                 | Form of Lock-Up Agreement, dated as of December 20, 2005. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 21, 2005 and incorporated herein by reference.  |
| 10.12                 | Separation Agreement and Mutual General Release, dated as of October 19, 2005, by and between Trex Company, Inc. and Robert G. Matheny. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 21, 2005 and incorporated herein by reference.           |
| 10.13                 | Release and Severance Agreement, dated as of March 6, 2006, by and between Trex Company, Inc. and Philip J. Pifer. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 8, 2006 and incorporated herein by reference.                                   |



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| <b>Exhibit Number</b> | <b>Exhibit Description</b>   |
|-----------------------|--|
| 10.14                 | Form of Distributor Agreement of TREX Company, LLC. Filed as Exhibit 10.5 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001 and incorporated herein by reference.  |
| 10.15                 | Deed of Lease, dated June 15, 2000, between TREX Company, LLC and Space, LLC. Filed as Exhibit 10.16 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000 and incorporated herein by reference.   |
| 10.16                 | Note Purchase Agreement, dated as of June 19, 2002, by and among Trex Company, Inc., TREX Company, LLC and the Purchasers listed therein. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 25, 2002 and incorporated herein by reference.   |
| 10.17                 | Credit Agreement, dated as of June 19, 2002, among TREX Company, LLC, Trex Company, Inc. and Branch Banking and Trust Company of Virginia. Filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed on June 25, 2002 (as amended by the Company's Current Report on Form 8-K/A filed on June 28, 2002) and incorporated herein by reference.                              |
| 10.18                 | Security Agreement, dated as of June 19, 2002, by and among TREX Company, LLC, Trex Company, Inc. and Branch Banking and Trust Company of Virginia, as collateral agent. Filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed on June 25, 2002 and incorporated herein by reference.  |
| 10.19                 | Intercreditor and Collateral Agency Agreement, dated as of June 19, 2002, by and among the Note holders named in Schedule I therein, Branch Banking and Trust Company of Virginia, and Branch Banking and Trust Company of Virginia, as collateral agent. Filed as Exhibit 10.4 to the Company's Current Report on Form 8-K filed on June 25, 2002 and incorporated herein by reference. |
| 10.20                 | Credit Line Deed of Trust, dated June 19, 2002, by and among TREX Company, LLC, as grantor, BB&T-VA Collateral Service Corporation, as trustee, and Branch Banking and Trust Company of Virginia and Branch Banking and Trust Company, as note holder. Filed as Exhibit 10.5 to the Company's Current Report on Form 8-K filed on June 25, 2002 and incorporated herein by reference.    |
| 10.21                 | First Amendment to Credit Agreement, dated as of August 29, 2003, by and between the Company and Branch Banking and Trust Company of Virginia. Filed as Exhibit 10.21 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.  |
| 10.22                 | Second Amendment to Credit Agreement, dated as of September 30, 2004, among the Company and Branch Banking and Trust Company of Virginia. Filed as Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2004 and incorporated herein by reference.   |
| 10.23                 | Third Amendment to Credit Agreement, dated as of March 31, 2005, by and between the Company and Branch Banking and Trust Company of Virginia. Filed as Exhibit 10.6 to the Company's Quarterly Report of Form 10-Q for the quarterly period ended June 30, 2005 and incorporated herein by reference.  |
| 10.24                 | Fourth Amendment to Credit Agreement, dated as of July 25, 2005, by and between the Company and Branch Banking and Trust Company of Virginia. Filed as Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005 and incorporated herein by reference.  |
| 10.25                 | Fifth Amendment to Credit Agreement, dated as of December 31, 2005, among the Company and Branch Banking and Trust Company of Virginia. Filed as Exhibit 10.25 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.   |
| 10.26                 | Loan Agreement, dated as of December 1, 2004, between the Company and Mississippi Business Finance Corporation. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 20, 2004 and incorporated herein by reference.   |

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| <b>Exhibit Number</b> | <b>Exhibit Description</b>  |
|-----------------------|---|
| 10.27                 | Promissory Note, dated as of December 16, 2004, in the principal amount of \$25,000,000 from the Company payable to the order of Mississippi Business Finance Corporation. Filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed on December 20, 2004 and incorporated herein by reference.   |
| 10.28                 | Reimbursement and Credit Agreement, dated as of December 1, 2004, between the Company and JPMorgan Chase Bank, N.A., as Bank and Administrative Agent. Filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed on December 20, 2004 and incorporated herein by reference.   |
| 10.29                 | First Amendment to Reimbursement and Credit Agreement, dated as of July 25, 2005, by and between the Company and JPMorgan Chase Bank, N.A., as Issuing Bank and Administrative Agent. Filed as Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005 and incorporated herein by reference.   |
| 10.30                 | Second Amendment to Reimbursement and Credit Agreement, dated as of December 31, 2005, by and between the Company and JPMorgan Chase Bank, N.A., as Issuing Bank and Administrative Agent. Filed as Exhibit 10.30 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.   |
| 10.31                 | Reimbursement Note, dated as of December 1, 2004, in the principal amount of \$25,308,220 from the Company payable to JPMorgan Chase Bank, N.A. Filed as Exhibit 10.4 to the Company's Current Report on Form 8-K filed on December 20, 2004 and incorporated herein by reference.  |
| 10.32                 | Land Deed of Trust, dated as of December 1, 2004, made by the Company to the trustee named therein for the benefit of JPMorgan Chase Bank, N.A. Filed as Exhibit 10.5 to the Company's Current Report on Form 8-K filed on December 20, 2004 and incorporated herein by reference.  |
| 10.33                 | Trust Indenture, dated as of December 1, 2004, between Mississippi Business Finance Corporation and J.P. Morgan Trust Company, National Association, as Trustee, including Form of Variable Rate Series 2004 Bond and Form of Fixed Rate Series 2004 Bond. Filed as Exhibit 10.6 to the Company's Current Report on Form 8-K filed on December 20, 2004 and incorporated herein by reference. |
| 10.34                 | Deed of Lease, dated as of July 27, 2005, between Trex Company, Inc. and 1 Dulles Town Center, L.L.C. Filed as Exhibit 10.34 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.*   |
| 21                    | Subsidiaries of the Company. Filed as Exhibit 21 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.  |
| 23                    | Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm. Filed with this Form 10-K/A.   |
| 31.1                  | Certification of Chief Executive Officer of the Company pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934. Filed with this Form 10-K/A.  |
| 31.2                  | Certification of Senior Vice President and Chief Financial Officer of the Company pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934. Filed with this Form 10-K/A.  |
| 32                    | Certifications pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. § 1350. Filed with this Form 10-K/A.  |

\* Portions of this exhibit have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.