HEADWATERS

November 30, 2015

Mr. Robert W. Errett, Deputy Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

SUBJECT: FILE NO: S7-20-15 Delivered via email
Financial Disclosures about Entities Other Than the Registrant

Dear Mr. Errett:

We support the Commission's Disclosure Effectiveness Initiative and are pleased to respond to the Commission's request for comment regarding certain financial disclosure requirements in Regulation S-X.

Headwaters Incorporated is a large accelerated filer and either currently or in the recent past has been subject to the disclosure requirements of three of the rules related to financial statements of certain entities other than the registrant:

- Rule 3-05, Financial Statements of Businesses Acquired or to be Acquired;
- Rule 3-09, Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons; and
- Rule 3-10, Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered.

<u>Rule 3-05</u>

An important part of Headwaters' strategy has been and continues to be to expand our business through acquisitions. We look for bolt-on niche acquisitions that meet our criteria and enhance product offerings to our core customer base. Many of our acquisitions and potential acquisitions are small to medium-sized companies.

Two requirements of Rule 3-05 have been particularly troublesome for Headwaters as we implement our acquisition strategy: 1) the income test used to determine significance of an acquired business, and 2) the 75-day time requirement to submit audited financial statements of an acquired business.

Income Test. As part of our due diligence process for each potential acquisition, we perform all of the required significance tests to determine whether audited financial statements may be required for the subject business for one or more years. Our business experiences significant income fluctuations during the course of economic cycles. The income test most often has been problematic for us due to the significant variation in our pre-tax income (loss) from continuing operations from year to year. When our income has been close to breakeven for example, many businesses have met the income test threshold, even though in our opinion, and we believe in the opinion of our investors, the business is clearly immaterial by almost any other standard applied, including the other two significance tests.

We note that the SEC Staff Training Manual indicates income averaging can be used in certain applications of the income test. However, income averaging is of limited usefulness to a company such as ours, which operates in a cyclical industry, since assigning loss years a value of zero reduces the numerator in the income test significantly. In addition to difficulties with the outcome of the income test experienced by Headwaters and other registrants, as you note in your request for comment, the current income test is the subject of significant implementation difficulties and requests for guidance from the Commission's staff.

Headwaters has in several instances been precluded from pursuing potential acquisitions because a small business met the income test, but was unaudited and not able or willing to submit to the requirement that they obtain a timely audit of their financial statements. This problem exists not only for many small companies, but for large companies that are selling a small part of their business for which carve-out financial statements must be prepared and audited. We believe such an outcome is not in the best interests of our investors when the small business is not material to Headwaters. In addition, we believe Headwaters has been at a comparative disadvantage in regards to other potential acquirers which at the time might have been larger or more profitable and therefore not required to impose an audit on the target company as a result.

As an alternative to the current income test, we suggest the Commission consider instead a revenue test. Revenue is inherently much less volatile than income, is a better predictor of relative size and materiality, and in most situations a revenue test would be straightforward and uncomplicated to perform. Under the current rules, often the materiality of a potential business acquisition depends on a registrant's income in a given year, or the existence or non-existence of non-routine charges. Using a revenue materiality threshold would in most cases yield more consistent conclusions as to materiality from period to period. In addition, revenue is often a better indicator of the incremental financial results of a business combination than is income, which may change significantly post-acquisition due to non-routine charges, synergies, changes in capital structure, etc. Certainly in Headwaters' experience, use of a revenue test in lieu of an income test would yield more consistent results.

Another potentially better alternative to the current income test would be a test of purchase price compared to a registrant's current or average market capitalization for a period of time. Use of a revenue test or market capitalization test would, we believe, serve the interests of investors because material acquisitions would be disclosed, but unnecessary and costly disclosure of immaterial information would be reduced.

75-Day Time Requirement. We have found the 75-day time period to submit audited financial statements for previously unaudited businesses, along with the required additional pro forma information using that audited financial information, to be impracticable in most situations. Financial audits have become more complex in recent years, requiring more time and effort by companies and by auditors. As a result, a 75-day time limit to plan, prepare for and complete an audit, especially one covering a three-year period, is insufficient.

In recent years, Headwaters has been involved with potential acquisition transactions that were abandoned due to a real or perceived problem in getting an audit completed within the required time period. This issue is especially pertinent in regards to closely-held businesses that have never prepared S-X compliant financial statements before, or when a large company, even one that has audited S-X compliant financial statements, is spinning off a part of their business, necessitating carve-out financial statements be prepared before an audit can even begin.

We suggest the Commission consider an increase in the allowable time to 180 days to file audited financial statements of a material acquired subsidiary, especially when any such subsidiary has not previously been audited as of its most recent fiscal year end.

Rule 3-09

Our comments on Rule 3-09 mirror the comments provided above as pertaining to materiality and the income test for significance. While it is understandable that investors may deem useful some information about certain material subsidiaries which are not consolidated, it serves no useful purpose to require summarized financial information, and especially audited financial statements, for entities that are not clearly significant. Accordingly, our comments provided above for Rule 3-05 related to the income test in determining significance are also relevant in determining the significance of entities for Rule 3-09. In summary, we believe a revenue test would be a better indicator of significance than the current income test.

Rule 3-10

In regards to the subsidiary guarantors and non-guarantors of our long-term debt, for many years Headwaters has been regularly providing the consolidating information commonly known as the "Alternative Disclosures" allowed by Rule 3-10. Such information is time-consuming and costly to prepare and to audit and appears to us to provide little if any value to our investors, including debt holders, based on queries to our investor relations department and others within our company.

In our most recently filed Form 10-K, approximately 15% of the entire financial section was comprised of the Alternative Disclosures mandated by Rule 3-10. In our most recently filed Form 10-Q, the ratio was approximately 28%. While we do not believe the Alternative Disclosures provide meaningful information to our investors, we do believe they contribute to the problem of disclosure overload, and that the costs of preparing and auditing this information exceed any benefit obtained.

We encourage the Commission to seriously consider eliminating altogether the requirement for Alternative Disclosures when debt is jointly and severally, fully and unconditionally guaranteed by a registrant and by substantially all of the registrant's 100%-owned or substantially 100%-owned subsidiaries, particularly when there are no significant restrictions on the ability of a registrant or subsidiary to obtain funds from guarantor subsidiaries nor on the ability of the guarantor subsidiaries to obtain funds from the parent or other guarantor subsidiaries.

If the Commission deems elimination of the Alternative Disclosures to be imprudent, we suggest they be required on an annual basis instead of a quarterly basis, and that the content of the Alternative Disclosures be simplified from the S-X Article 10 presentation rules. We do not believe that the detailed financial statement presentation inherent in the Alternative Disclosures is necessary for an investor to be able to evaluate the likelihood of debt repayment.

In regard to the significance tests used to determine if a subsidiary is minor, we recommend increasing the 3% test thresholds to 10%, or at least 5%, and reducing the number of items tested to two or three instead of five. With five mandated calculations and a threshold level of 3% for even one calculation, virtually no subsidiaries are ever deemed to be minor.

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We appreciate the opportunity to respond to the Commission's request for comment on Rules 3-05, 3-09 and 3-10 and would be please to respond to any questions the Commission may have about the comments provided.

Very truly yours,

Don P. Newman
Chief Financial Officer
Headwaters Incorporated